Has managerial enterprise contributed to the success of leading economies

Profession, Manager

The business literature is overflowing with concepts. Some of these, usually only a few, manage to stay ‘ in the spotlight’ for longer; Chandler’s (1962; 1990) ‘ managerial enterprise’ is among them. His theory links strategic decisions, internal structures and corporate performance and despite its criticism, it is still used to explain corporate success (and failure) of the late19th, 20th and even the 21st century (Gospel, 1988: 105). In contrast to the contingency approach, Chandler (1990) advocates the American way of organisation as the ‘ one best way’ for all countries[1]. Yet, can one size fit all? We shall refer to different country examples, industries and time periods to find out.

Chandler argued that large managerial enterprises have managed to prosper through the years due to a basic economic logic, which he named ‘ three-pronged strategy’[2](Chandler, 1995). According to this concept, firms should invest heavily in both their production and distribution functions in order to fully exploit economies of scale and scope at a national and international level (Chandler, 1990; 1995). This can only happen when the firm relies on the accurate judgment of skilful professional management. The aim was to create organisational capabilities and benefit from first-mover advantages via ‘ related diversification’ (Chandler, 1995; Whittington et al., 1999). The implemented structure can best be described, using the author’s own words, as ‘ centralised and functionally-departmentalised’ (Lash and Urry, 1987: 43). Countries that ignored the logic[3]were doomed to moderate performance and low competitiveness (Chandler, 1995).

Hence, Chandler’s thesis was twofold: first, he stressed the relative economic consequences of the multi-divisional structure and second, he argued that the strategies and thus structures of advanced economies are converging towards those adopted in the US of the early 19th century (Whittington et al., 1999).

COUNTRY

% M-Form

TIME

US

86%

1979

JAPAN

50%

1980

EUROPE

70-90%

Early 1990’s

(Data obtained from Whittington and Mayer, 2004: 1057)

Chandler (March/April 1990) claims that the success stories of the pre-WWI core industries (chemicals, electrical and machinery/ i. e. Standard Oil, Bayer &Co and Siemens) were repeated in the core industries of the inter-war (cars: i. e. GM and Chrysler) and post-WWII years (computers and consumer electronics: i. e. IBM[4]). This is one of Chandler's main criticisms: he is trying to fit his examples within a single ' American by-product' (Whittington and Mayer, 2000: 45).

Moreover, at the time he was writing, conglomerate strategies were just beginning to emerge in the US. Fifty years later however, unrelated diversification is a distinctive characteristic of the American economy, challenging his assumption of global convergence towards related diversification strategies (Whittington et al., 1999: 520). The validity of his assumptions was further questioned due his comparisons between uneven things: for instance, one cannot compare the US (with its huge market and strong anti-trust tradition) with the much smaller UK or even Germany (Hannah, 199: 298). Organisational structure is not a result of strategy alone; different industries require different structures. So for instance, steep hierarchies will dominate capital-intensive industries (to which Chandler refers), while flatter hierarchies prevail in labour-intensive ones (Rajan and Zingales, 2001). Finally, his theory explains economic success with single reference to the corporate level, ignoring the significance of other, more nation-specific characteristics (institutionalists' perspective; see Whitley, 1994), which we will discuss subsequently.

United States:

Modern management emerged in the US around the 1850's, as a response to the requirements of the railroads and the consequent growing size of factories[5]. Chandler reports that Du Pond was the first company to master the M-form, as soon as 1919 (Chandler et al., 1996: 220; 381)[6]. The advantage of this structure lies in the separation of top and middle managers' responsibilities, which not only facilitates decentralisation of decision making, but also allows top management to focus on strategic decisions- the ' managerial revolution' (Chandler et al., 1996: 397; Ingham, 1991: 427; Suzuki, 1991: 5)[7]. Entrepreneurs who downplayed this advantage later bared the consequences: Ford's dramatic defeat from GM in the 1920's remains a classic example (Chandler, 1988).

Hence, it appears that the modern enterprise in the US was built upon the need to coordinate the internalised flow of goods. However, this was not necessarily the case for other countries: Suzuki (1991) argues that European corporate structures were driven by the internalisation of the allocation of financial resources. Similarly, in Japan the focus was the allocation of human capital (Suzuki, 1991: 6). The author maintains that while a managerial hierarchy might be efficient for US needs (at least at that time), it is not appropriate to coordinate the flow of other resources. According to him, this can justify the dominant role of holding companies in Europe and the ' hybrid U-form'[8]in Japan (Suzuki, 1991).

Germany:

The development of big firms in Europe was mostly the result of M&As, followed by loose, H-form structures (Suzuki, 1991: 70). On the contrary, holding firms became extinct in the US by the 1960's (Whittington et al., 1999: 530). Still, Chandler (1995) finds a close association between Germany and the US (Chandler, 1995: 11). He does recognise however the differences between what he terms ' co-operative capitalism' and the more individualistic Anglo-Saxon model (Hannah, 1991: 303). Germany invests heavily in training and education, while it is famous for exploiting economies of scope rather than scale (Hannah, 1991: 303). Despite early ' divisionalisers' (i. e. Siemens[9]), personal control persisted into the 1990's (Whittington and Mayer, 2000: 168). So, it looks as if Germany has more in common with the UK than Chandler gives credit for (Hannah, 1991: 305).

' Managerial capitalism' focuses solely on organisational development, undermining the role of other institutions such as banks and the state[10]In Germany for instance banks played a significant role as intermediaries, in contrast to the US, where firms expanded through internal finance (i. e. insurance firms) (Lash and Urry, 1987: 20; 48). Cartels were a dominant feature of the German economy, actually being the equivalent of holding companies in Britain (Lash and Urry, 1987: 18). Despite Chandler's idea that cartels hinder corporate expansion, capital-intensive industries in Germany grew as a result of cartelisation since the1890's -still evident in the 1930's (Lash and Urry, 1987: 20; Sidney, Feb1943). Finally, Hannah (1991) questions Chandler's statistical and corporate evidence, (i. e. Gerbruder Stollwerc superior to Cadbury's) arguing he is trying too hard to prove his point. His analysis of the German economy goes so far as the 1930’s (Hannah, 1991: 304); what happened after its glorious defeat in WWII?

United Kingdom:

In comparison to both Germany and the US, UK was ‘ the laggard’. Chandler (1988) acknowledges that small size doesn’t require divisionalisation, but he accuses the country’s ‘ personal capitalism’ for this. In line with Mackie (2001) though, ‘ personal capitalism’ might describe the 19th century firm but not exactly its successor (Mackie, 2001: 26). The term itself is rather vague too and can have different interpretations (Hannah, 1991: 302). Plus, can a single factor (i. e. managerial tradition) really explain the economic situation of a whole nation? Public policy for instance, and particularly the monetary policy of the 1950’s and 1960’s and the ineffective intervention of the state in the 1930’s ‘ cotton crisis’, have already been examined as potential obstacles to British success (Carnevali, 2002; Greaves, 2002, in Popp, 2004: 158)[11].

Different authors refer to different periods of the legendary ‘ UK failure’: 1893-1914 and 1930’s-1940’s (Lash and Urry, 1987; Hannah, 1991), which in my opinion is largely exaggerated: UK is among the top four nations in GDP terms from 1870 up till 2004[12]! In 1929, Unilever encompassed the largest M-form structure in the country (Church and Clark, 2003). Yet, most large firms in the UK (pre-WWI) were in industries with limited scale advantages, like textiles (Hannah, 1991: 300). More specifically, in 1905, 27/52 top British firms were in textiles and brewing. Even when the M-form was popular in the country, in 1948, 25% of top 200 firms were still in the food and drink industry (Lash and Urry, 1987: 45; 47). Not even successful companies, like Boots, had a multidivisional structure in the 1920’s (Lash and Urry, 1987: 44). Chandler examines only British ‘ failure stories’ as evidence to support his arguments (Hannah, 1991: 301). The chemical industry is a case in point (Chandler, 1990)[13]. Furthermore, Lash and Urry (1987) claim that British cartelisation (especially within holding companies) is undermined, as opposed to the German one for instance (Lash and Urry, 1987: 45).

British firms were deficient in market information, due to the lack of trust towards banks-as intermediaries. Inevitably, family and friends became the key investors (Lash and Urry, 1987: 50). Hence, family firms (and the bias surrounding them) should be included in this discussion. Chandler (1990) assumes that the latter cannot evolve into successful enterprises, since profits roll back to the managers-owners. Similarly, Lazonick (1992) holds that ownership transition to the next generation neglects career credentials (Chandler, 1990; Lazonick, 1992, in Mackie, 2001: 1). For these critics, the longevity of family firms is problematic in itself, because it stifles corporate growth. Nonetheless, different studies suggest that few family firms survive one generation, let alone more (Rose, 1993; Dupree, 1998, in Mackie, 2001: 2). Again, Government regulations were crucial: ‘ limited liability’ increased the chance for their ‘ survival’ (Mackie, 2001: 16).

Proponents of family-controlled businesses argue they “ are the prevailing form of enterprise throughout the world, making significant contributions to their respective economies” (Upton and Petty, 2000: 27)[14]. According to this table, this type of firm is certainly not a unique characteristic of the British economy; the US in particular scores 90% in family-ownership during the 1990's.

% Of Family Firms in the 1990's

European Union

85%

United Kingdom

75%

Germany

80%

United States

90%

(Data obtained from Upton and Petty, 2000: 27-28)

Still, it is true that family-owners tend to rely on internal financing (instead of venture capital), limiting the potential capital decisions (Upton and Petty, 2000: 29; 37). We should note however that this type of firm is usually characteristic of the services industry (Nenadic, 1993, in Mackie, 2001: 2). Finally, one should not neglect the particularity of the British economy, in terms of its premature industrialisation (Lash and Urry, 1987: 42). Gospel (1988) makes an interesting observation: since British markets were already efficient and developed, building further organisational capabilities was not a necessity (Gospel, 1988: 105).

Japan:

The Japanese enterprise system was historically the result of late industrialisation[15](Fruin, 1994: 40). It comprises of three interlinked elements: the factory, the firm and the inter-firm network[16](Fruin, 1994). These business groups are highly influential and include banks and trading companies (Boyce, 1999: 73). In 1935, 40 of the 118 largest firms belonged to one of the major zaibatsu: Mitsui, Mitsubishi, Sumitomo and Yasuda (Suzuki, 1991: 46). Nevertheless, their control over individual businesses is trivial (Suzuki, 1991: 75). Interestingly, removing the ‘ umbrella’ of the zaibatsu uncovers a hierarchical structure at various managerial levels (Suzuki, 1991: 14). As soon as 1908, Mitsubishi had developed an organisation chart resembling US practice (Chandler, 1988: 156).

Japan was the first among the ‘ Asian tigers’ to espouse and adapt the Western organisation following WWII: “ the old zaibatsu holding-companies were dismantled” (Gospel, 1988: 106). Gradually big firms replaced kinship with professional managers (Fruin, 1994: 36). It is interesting to note that the latter were largely promoted from ‘ within’ the firm, to retain the advantages of already established relationships with employees and other firms (Morikawa, 1995: 42). Diversification during the 1950’s and 1960’s was widespread in the ‘ new industries’: i. e. Hitachi (1952), Mitsubishi Electric (1958) and Fuji Electric (1960’s) are some examples. Firms in these industries retained their divisional structure (Suzuki, 1991: 176). Despite divisionalisation, production units obscured the importance of other functions (such as sales and financing), which were held within the business groups (Suzuki, 1991: 11).

Business groups post WWII, are different from the zaibatsu: kigyo shudan groups are either formed around giant companies, or by these companies (i. e. Toyota Motor and Hitachi). They further enjoy preferential finance by banks and engage in mutual shareholding (Suzuki, 1991: 77; 87). Other sources claim that the keiretsu groups are far from dead: they are simply merging with each other to become stronger[17](Economist, 11/25/2000). Therefore, Japan's post-war growth owes much to Chandler's ' managerial enterprise', within which human and physical skills well developed. Still, neither conglomerates nor multi-divisional firms are the norm, compared to Europe and the US (Fruin, 1994: 23). Entrepreneurial firms have been equally important (Morikawa, 1995: 32; 37-38). Finally, enhanced cooperation between divisions and heavy R&D investment are also characteristic of Japan (Fruin, 1994: 25).

China:

China has emerged as one of the most promising developing countries. In 2004 it was first in GDP terms, with a growth rate twice that of the period 1950-1992[18]. Could this be related to the ' managerial enterprise'? The typical Chinese business remains small and unstructured, with centralised decision-making (Redding, 1990: 155). The enterprise system is characterised by such themes as paternalism, hierarchy, responsibility and mutual obligation (Redding, 1990: 155). Despite the fact that the country expanded merely via conglomeration and mergers (opposing Chandler's thesis), Child (2000) suggests that hierarchical structures fit closely to the scale and state-owned history of China's large companies (Child, 2000, in Li and Tsui, 2000: 41).

The particularities of the indigenous context should not be ignored: the role of the state in former communist China is still ' visible' and its Asian identity quite distinct (Child, 2000, in Li and Tsui, 2000: 35; 38). Chinese firms are highly dependent upon state policies and seek long-term relationships with the government. These are known as ' quanxi networks'; the Confucian culture allegedly strengthens this relational approach to business (Gao and Tian, 2006: 70). Yet, we should note that Chinese industry is characterised by strong subcultures (Child, 2000, in Li and Tsui, 2000: 40), largely as a result of its historical background.

" The way people work has changed dramatically, but the way their companies are organised lags far behind" (Hindle, Economist 1/21/06: 3)

In a global economy where joint ventures and strategic alliances are typical, innovativeness, flexibility, responsiveness and cross learning and sharing offer a competitive edge. " Unless structure follows strategy, inefficiency results" (Chandler, in Whittington and Mayer, 2004: 1070). In fact, Chandler's words cannot be more true, only that recent internalisation strategies require an alternative structure. Inevitably, focus has shifted from the traditional hierarchy to business networks (Wilson and Popp, 2003: 355). The ‘ information age’ calls for flatter, more flexible network structures[19]. Whittington and Mayer (2000) argue these are a development of the old M-form (Whittington and Mayer, 2000: 179). Hence, the two aren’t necessarily mutually exclusive (Wilson and Popp, 2003: 359). During the 1990’s the Western world experienced a fierce wave of deregulation and divestments (i. e. Motorola)[20], due to inadequate performance of M-form investment in the previous era[21](Hannah, 1991: 299; Ingham, 1991: 427). Additionally, the theory of core competencies condemns the power of individual divisions (Hamel and Prahalad, 1990, in Whittington and Mayer, 2000: 157). The flexible ‘ matrix’ structure[22]provides a possible ‘ solution’, since it advocates effective cooperation between departments (Johnson, 1990: 225).

In a nutshell, excessive focus on management distracts attention from alternative forces other than structure[23](Baldwin, 1964: 239). Cartels, business groups (characteristic of both Europe -especially Germany and Italy- and Japan)[24], government policies (i. e. anti-trust regulation, protectionism), finance providers (i. e. banks and insurance firms), university-industry relations, cultural ties (i. e. US and Canada), power relationships, competition, barriers to entry and exit, market size and factors like access to technology, industrial apprenticeship (Hannah, 1991) and clustering are ignored. To use Hannah’s (1991) colourful expression, Chandler sees the European ‘ visible hand’ through America’s distorting mirror (Hannah, 1991: 299; 302; Baldwin, 1964: 251). Furthermore, managers’ motives and interests (such as vanity and maximisation of personal remuneration) are at times in conflict with organisational objectives (Baldwin, 1964: 240; 248). So, according to which criteria should managers make their decisions? Despite all the criticisms, Chandler's analysis remains a triumph of systematic comparative analysis of the capital-intensive industries in the US and Europe (Hannah, 1991: 297), acknowledged even by his major critics.

APPENDIX:

Testing the ' managerial enterprise' through time:

Early empirical studies (i. e. Steer and Cable, 1978) support the superior performance of the multi-divisional form. By 1983, nearly 90% of British firms were multi-divisionalised. Yet, critics often accuse these efforts as being ' defensive', ' state-led' and ' mimetic' in nature (Guillen, 1994, in Whittington and Mayer, 2000: 174). In the 1990's, family firms were the minority[25], and as likely to adopt the M-form as any other firm. Similarly, holding companies are no longer the dominant players in neither Germany nor the UK (Whittington and Mayer, 2000: 177; 212). Still, H-form accounted for more than a quarter of German firms during the 1990's (Whittington and Mayer, 2000: 169). Hence, holding firms appear to be more robust in Europe than Chandler (1990) initially proposed, given that they proved to perform equally well to the M-form (Whittington et al., 1999: 530). The problem with the M-form is that due to the large proportion of firms with this structure in a given industry, financial performance is pulled towards the average (Whittington and Mayer, 2000: 186).

Just a decade later (Pickering, 1986) studies suggest pure ‘ M-form firms’ are rare, mainly due to ineffective control systems (Ingham, 1991: 427-128). Nonetheless, data seem to favour Chandler’s view of convergence towards the multi-divisional form. Yet, some resistance is still present by large firms in both Germany and the UK. Ingham’s survey on the insurance market (1989) showed that even though the majority of the sample companies had adopted the M-form following diversification into related services, the dominant trend was away from divisionalisation (i. e. recentralisation), as a result of poor performance (Ingham, 1991: 436). Whittington and Mayer (2004), present three different perspectives to explain why this is the case.

First, the ‘ economics’ perspective stresses economic efficiency and argues that M-form is the result of diversification and not size. Hence, firms pursuing a different strategy will adopt an alternative structure (Chandler, 1962; Rumelt, 1974, in Whittington and Mayer, 2004: 1058). Second, the ‘ political’ point of view argues that firms’ behaviour is often driven by non-economic factors, such as organisational politics. Hence organisational structure is determined by the relevant power of different stakeholders -according to their interests (Pfeffer, 1981, in Whittington and Mayer, 2004: 1058). Finally, the ‘ national institutions’ perspective challenges the international applicability of a single model, arguing that the national context is crucial (Boissot and Child, 1996, in Whittington and Mayer, 2004: 1058).

Their comparative work in Germany and the UK for 1983 and 1993 includes the 100 largest firms by sales (Whittington and Mayer, 2004: 1066). Whittington et al. (1999) observe a trend towards Chandler’s proposed diversification in Germany, France and the UK. Related diversification in particular, appeared more common than conglomeration, even though this was mostly the case in the UK rather than Germany (Whittington et al., 1999: 538; 546).

Variable

GERMANY

UK

1983

1993

1983

1993

Non M-Form

43. 3

30. 2

10. 6

10. 5

Related diversified

43. 3

52. 4

54. 7

56. 7

Unrelated diversified

20. 0

25. 4

16. 0

25. 4

Personal ownership

53. 3

46. 0

8. 0

4. 5

(Data obtained from Whittington and Mayer, 2004: 1070)

Their findings offer strong support for the ‘ economics’ perspective. More specifically, in the 1980’s, resistance to divisionalisation was associated with low diversification, while in the 1990’s, with conglomeration (Whittington and Mayer, 2004: 1076). Moving on, they tested the political influence on structure and how different ownership interests might distort economic logic.

Their results suggest that neither banks, nor family-owners resisted the M-form to protect their interests and treasure their traditional roles (i. e. bankers traditional role of allocating capital). Only in Germany in the 1990’s government was found hostile to divisionalisation (Whittington and Mayer, 2004: 1077). Last but not least, their findings imply that despite signs of convergence, the M-form has not been readily accepted in any nation, not even Germany. In fact, the UK appears to be closer to the US than Chandler (1990) proposed (Whittington and Mayer, 2004: 1064; 1077). In conclusion however, the managerial enterprise seems to be the “ final resting place of corporate development unlikely to be reversed” (Whittington et al., 1999: 546).