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"Summary of article by John Scott: Structures of Corporate Control"

Large corporations clearly dominate modern industrial economies. But since ownership of the stock of these firms is often widely dispersed, it is not so clear who dominates the corporations. This book explores the patterns of ownership, control, and the exercise of power within the corporate economy. The sections summarized here analyze and contrast several possible systems of control, and review the evidence on the ownership of the largest U.S. corporations. Other sections, reviewing comparable data for other countries, find somewhat different patterns of ownership in Japan and in most of Western Europe.

Shareholders, Financiers, and Managers

In analyzing power within the corporation, it is useful to distinguish between the power to set long-run strategic goals and the power to direct day-to-day operations; these can be called control and rule, respectively. The distinction was less important in the classic entrepreneurial firm, where the owner/manager exercised both control and rule. The corporate form separates these two forms of power, giving owners an attenuated form of control – particularly the right to vote on the selection of the top managers, who direct the daily operations of the firm.

There are some cases in which a unified group of shareholders effectively maintains complete control over a corporation. In other cases, however, the power of shareholders may be challenged either by managers, using their position in the organizational hierarchy to rule the corporation for themselves, or by external financiers, who can exercise indirect control by dictating the terms on which credit will be available to the firm.

The patterns of ownership of a corporation range from the case in which one individual or group holds a majority of the stock and hence controls the corporation, to completely dispersed stockholdings that allow management to gain control. An important question of judgment arises between these two extremes: what fraction of the company's stock is required for a large minority stockholder to exercise effective control? The answer depends on the dispersal of the remaining shares; estimates of the threshold for minority control have drifted downward over time. Many analysts now suggest that minority control is possible with 10 percent of a company's stock, and a few claim that only 5 percent is needed, if the other 95 percent is scattered widely among numerous small holdings.

A classic picture of the evolution of ownership, due to Berle and Means[1], assumed that as the original owners sold their shares, stockholdings would become steadily more dispersed. As a

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result, corporations would tend to progress from majority control to minority control, and finally to management control. However, the process of dispersal is not inexorable. The growth of ownership by pension funds, insurance companies, and other financial institutions has led to a renewed concentration of shareholdings. Even when there is no single dominant investor, the institutional and financial investors as a group may be too large for management to ignore.

This raises the possibility of control through a constellation of interests, a concept suggested by Max Weber in his discussion of power. Institutional investors do not generally act like a cohesive controlling group, yet management knows that it cannot disregard their interests. The corporation may depend on its institutional investors for future capital needs, and their shareholdings are large enough that they could, if provoked, demand changes in policies or personnel.

This pattern, implying corporate control through a constellation of interlocking financial interests, characterizes Anglo-American economies. It can be distinguished both from the Berle and Means model of management control, and from the tighter groupings of interlocked firms, clustered around banks, leading companies, or wealthy families, that can be seen in many European countries and in Japan.

Corporate Power and Control in the United States

Throughout the twentieth century the average number of shareholders in the largest corporations has risen, and the average size of personal shareholdings has fallen. The number of companies with majority or minority control by a leading stockholder has fallen as well. The largest owner held 20% or more of the stock in 18 of the 40 largest corporations in 1900, and 84 of the largest 200 in 1929. Yet by 1975, the largest owner held 10% or more, a lower standard, in only 25 of the largest 200 corporations. There are methodological problems with many empirical studies of stock ownership, which may result in a tendency to underestimate family control of corporations. Even when attempts are made to correct for these problems, however, the trend is still toward decreasing family control over major corporations.

A more serious problem concerns the treatment of intercorporate shareholdings. Berle and Means, and many later analysts, have assumed that the decline of family control must imply the rise of management control of corporations. This ignores the role of financial investors, whose stockholdings have risen rapidly; by the 1970s, financial institutions owned one-third of all corporate stock. Could such institutional stockholdings give rise to control through a constellation of interests?

An example of a particular corporation illustrates the growing importance of financial institutions. Union Pacific, a railroad company, was classified by Berle and Means as management controlled in 1929, when the top 20 shareholders owned 10 percent of the company. By 1937 the top 20 held 14 percent; in 1980 the top 20 held 22 percent of the stock. Most of the top 20 shareholders were banks, insurance companies, and pension funds; in 1980, only 5 were families. No single institution or family approached the level of a controlling interest in Union Pacific; the Harriman family was the largest stockholder in 1937 with 3 percent of the stock, and

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second largest (just behind Prudential Insurance) with 2 percent in 1980. Nonetheless, there was a growing concentration of ownership in the hands of a constellation of investors.

A study by the author examined the ownership of the 252 largest American corporations in 1980. In 61 cases the top investors held sufficient stock for majority or minority control; in 154 others, well over half, there was a controlling constellation of interests (i.e., the top 20 owners held between 10 percent and 50 percent of the stock). None of the enterprises for which information was available had a sufficient dispersion of ownership to qualify as management controlled. Family investors have not disappeared; two-thirds of the controlling constellations included some family interests. Yet institutional investors played a larger part than individuals in these constellations.

Institutional investors have usually preferred to remain passive and uninvolved in corporate management. Unfortunately for them, this is not always possible. Institutions may be unable to sell their stock when they are displeased with management, either because other investors are unwilling to buy because they are displeased for the same reasons, or because the institutional stockholdings are so large that a sudden sale would depress the price. Thus institutions may find themselves locked into a stock, and forced to take a more active role in corporate affairs. This can involve seeking representation on the board of directors, or ensuring that the board includes independent, outside influences; in more extreme cases it might include voting against management or attempting to alter the composition of the board. There are scattered signs of growing activism among institutional investors; in 1995 the pension fund TIAA-CREF mobilized other institutions to remove the chairman of W.R. Grace, and to reduce the size of its board and the average age of its directors.

If financial institutions increasingly control non-financial corporations, who owns and controls the financials? A 1970 study found intricate patterns of interlocking ownership among banks in the 1960s; for example, in each of the top six New York banks, between 12 and 20 percent of the shares were held by the same six New York banks. Almost half of the top 275 banks nationwide had at least 5 percent of their stock held by other financial institutions. The limited available information suggests that financial institutions are governed by constellations of interests similar to those found in other corporations, connected by extremely dense networks of interlocking and overlapping ownership.

The twentieth-century history of the ownership and control of U.S. corporations begins with a long decline, but not disappearance, of family ownership, and a corresponding rise of management control until the 1950s. "Since the 1950s, however, managerial enterprises and surviving family enterprises have declined in number as enterprises in which intercorporate 'institutional' shareholdings are the dominant form of ownership have grown in number... Control through a constellation of interests has become the dominant form of strategic control in the largest American enterprises." (78)

Notes

1. A. A. Berle and G. C. Means, *The Modern Corporation and Private Property* (1932).

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