

The End of Managerial Ideology: From Corporate Social Responsibility to Corporate Social Indifference

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During the 1990s, U.S. managerial capitalism underwent a profound transformation from a technocratic to a “proprietary” form. In the technocratic era, managers had functioned as teams to sustain the firm and to promote social welfare by satisfying the demands of competing stakeholders. In the new proprietary era, corporate bureaucratic teams broke up into tournaments in which managers competed for advancement toward the CEO prize. The reward system of the new era depended heavily on stock options that were accompanied by downside risk protection. The tournaments turned managers into a special class of shareholders who sought to maximize their individual utility functions even if deviating from the firm’s best interest. Once this new regime became established, managers discarded their technocratic, stakeholder creed and adopted a property rights ideology, originally elaborated in academia by financial agency theorists. Managers hardly noticed (or cared) they were capturing a disproportionate share of the new wealth being generated in the U.S. economy. When critics brought this fact to light, managers replied like well-schooled economists: markets worked efficiently. Whether they worked fairly was a question they did not address.

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Origins of the Technocratic Creed, 1920–1950

A technocratic creed of the managerial corporation formed out of debates that accompanied the rise of the modern, large-scale corporation at the end of the nineteenth century.¹ Although escaping the grip of strong state regulation in America, corporations developed industry and business associations to defend their interests.² Where industry associations promoted programs to secure strategic advantages for their members, business associations protected owners and later managers' collective interest in controlling the modern corporation. These latter associations found it necessary to articulate a professional creed that reconciled management's enormous powers with democratic rule.

Louis Brandeis was among the first to consider the consequences of large firms for the democratic order. As firms concentrated wealth, they undid the simple market relationship that had inscribed liberty and equality into the nation's economic activities. Under the new circumstances, Brandeis warned that corporations replaced independence with dependency, making the American society potentially ungovernable. Consequently, Brandeis reasoned, businessmen who had substantial market clout should assume a professional responsibility to use their influence in ways that sustained free markets and free government.³ Others embraced similar notions. President Theodore Roosevelt, following ideas that Herbert Croly would systematize in

1. Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass., 1977); Olivier Zunz, *Making America Corporate, 1870–1920* (Chicago, 1990); Louis Galambos and Joseph Pratt, *The Rise of the Corporate Commonwealth: U.S. Business and Public Policy in the Twentieth Century* (New York, 1988); Thomas K. McCraw, *Prophets of Regulation: Charles Francis Adams, Louis D. Brandeis, James M. Landis, Alfred E. Kahn* (Cambridge, Mass., 1984); Gregory S. Alexander, *Commodity and Propriety: Competing Visions of Property in American Legal Thought, 1776–1970* (Chicago, 1997), 277–310; Rudolph J. R. Peritz, *Competition Policy in America, 1888–1992* (New York, 1996), 9–58; Martin J. Sklar, *The Corporate Restructuring of American Capitalism, 1890–1916: The Market, the Law and Politics* (Cambridge, Mass., 1988); Naomi R. Lamoreaux, *The Great Merger Movement in American Business, 1895–1904* (Cambridge, Mass., 1985); Morton J. Horowitz, *The Transformation of American Law 1870–1960: The Crisis of Legal Orthodoxy* (New York, 1992), 67–107; James W. Ely, Jr., *The Guardian of Every Other Right: A Constitutional History of Property Rights* (New York, 1992), 1–118; William E. Nelson, *The Roots of American Bureaucracy, 1830–1900* (Cambridge, Mass., 1982).

2. James Weinstein, *The Corporate Ideal in the Liberal State, 1900–1918* (Boston, 1968); William H. Becker, *The Dynamics of Business-Government Relations: Industry and Exports, 1893–1921* (Chicago, 1982); Joseph Pratt, William H. Becker, and William M. McClenahan, Jr., *Voice of the Market Place: A History of the National Petroleum Council* (College Station, Texas, 2002); Robert Collins, *The Business Response to Keynes, 1929–1964* (New York, 1981).

3. Louis Dembitz Brandeis, *Business—A Profession* (Boston, 1914).

his 1909 work, *The Promise of American Life*, wanted managers to function as semipublic administrators motivated by an ethic of public service rather than one of individual gain.⁴ The idea that those who ran large firms should be held to a public interest standard gained wide popularity during decades that followed. In his 1927 speech dedicating the Baker facilities at the Harvard Business School, Owen Young, General Electric's Chairman of the Board, likened the large firm to a public utility and told his audience that managers had a special obligation to serve the public interest.⁵

Large size was not the only problem that the modern corporation posed for the U.S. polity. Separation of ownership from control remade the market in a manner that seemed harmful to both economic and political processes. Creditors began to extend effective control over many of the nation's productive assets. Professional managers who came to run the firms found banker oversight restrictive. As mass financial markets emerged in the 1920s, managers issued equity to retire corporate debt and to diversify into new markets. The consequent merger wave dispersed firm ownership, giving managers control over corporate assets freed from the oversight of financiers. For the most part, the families who once held large stakes in these firms diversified their portfolios and lost control over managerial decisions, as well.⁶

This trend shattered traditional notions that based ownership claims in property on the personal labor performed by the owner. Because owners (now shareholders) neither labored in nor managed their firms, legal theorists wondered whether shareholders could legitimately claim ownership. Many feared that managers themselves would become princes who would use their industrial fiefdoms to secure economic and political privileges, a tendency that others hoped a professional managerial standard would check.

E. Merrick Dodd posed this problem starkly in the title of his 1932 *Harvard Law Review* article "For Whom Are Corporate Managers Trustees?" and gave a startling answer: professional managers should be accountable to the firm's various stakeholders. In Dodd's opinion,

4. Herbert Croly in his 1905 book, *The Promise of America*, had discerningly recognized the destructive consequences of large corporations, but argued that their awesome powers offered a new promise—perpetually rising living standards for all. In Croly's opinion, managers, educated in the scientific method, could become that expert, impartial professional group. See Herbert Croly, *The Promise of American Life* (1909; Indianapolis, Ind., 1965).

5. Owen D. Young. "Dedication Address," *Harvard Business Review* 6 (Oct. 1927): 385–94.

6. Jonathan Barron Baskin and Paul J. Miranti, Jr., *A History of Corporate Finance* (New York, 1997), 171–212; Kevin Phillips, *Wealth and Democracy: A Political History of the American Rich* (New York, 2002), 47–82.

they were, in effect, the real “owners.” By developing means to make sure that managers served these constituents, Dodd believed, the firm could be reconciled both with market and democratic values.⁷

In the much cited, but now rarely read classic, *The Modern Corporation and Private Property*, authors Adolf Berle and Gardiner Means elaborated on Dodd’s ideas.⁸ They devised two regulatory alternatives to reintegrate the propertied personality that the corporation had shattered: one based on market relationships, the other based on a fiduciary relationship. The market option derived from contract law. Under contract law, courts enforce arm-length transactions and intervene only when the terms are too vague, or bargaining is imperfect, or coercion exists. Following a similar principle, policymakers could play an important *ex ante* contractual role to ensure that corporate managers divulged information promptly and honestly, for example by establishing disclosure requirements and independent verification procedures to protect shareholders. Where markets could not be so easily corrected, Berle and Means turned to fiduciary or trust doctrine. Because trust doctrine evolved from considerations of fairness and social norms, the courts could apply these rules *ex post*.⁹

Berle and Means provided the most important academic contribution to the evolving new conception of corporate management in the New Deal era. During the regulatory battles of that era, however, corporate managers also created institutional arrangements and informally honed a fiduciary argument to elaborate on and justify their collective control over corporate assets. Formed in 1942, the

7. Dodd posed this question in his famous 1931–1932 debate with Adolf A. Berle, Jr., in the *Harvard Law Review*. Dodd accepted Berle’s legal realism, but merely countered that no direct link could be ascribed to a firm’s operations and social utility. All the stakeholders had claims on the firm, and all had to be served by the firm’s managers. Adolf A. Berle, Jr., “Corporate Powers as Powers in Trust,” *Harvard Law Review* 44 (May 1931): 1049–74; and E. Merrick Dodd, “For Whom Are the Corporate Managers Trustees?” *Harvard Law Review* 45 (May 1932): 1145–63. Also see Alexander, *Commodity and Propriety*, 346–51.

8. Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (New York, 1933).

9. Though Berle and Means had little direct influence on the regulatory regime that evolved from the New Deal, their ideas provide a coherent framework for understanding the various agencies that subsequently came to handle stakeholder issues. Cynthia A. Williams, “The Securities and Exchange Commission and Corporate Social Transparency,” *Harvard Law Review* 111 (April 1999): 1197–1246; Allen Kaufman, Lawrence Zacharias, and Marvin Karson, *Managers vs. Owners: The Struggle for Corporate Control in America Democracy* (New York, 1995), 42–94; Alexander, *Commodity and Propriety*, 343–50; William W. Bratton, “Berle and Means Reconsidered at the Century’s Turn,” *Journal of Corporate Law* 26 (Spring 2001): 737–70; Mary A. O’Sullivan, *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany* (New York, 2000), 92–96.

Committee for Economic Development (CED) gave corporate managers their first public voice. Surprisingly, this organization arose from business resistance to the New Deal, as some executives sensed growing separation between the Roosevelt administration and the corporate sector.

The CED gained prominence when it helped to coordinate the transition from war to peace by establishing regional offices that reported economic data on local business plans, which allowed for a relatively smooth transfer of power from military planners to private sector managers. However, after much discussion, the CED decided against becoming a mass business association comparable to the Chamber of Commerce. Instead, the CED chose to be a forum in which corporate executives could work with prominent academics and former government officials to articulate policy positions and, in turn, influence public policy debates. For three postwar decades, the CED acted as the corporate sector's policy voice—but it did so via argument rather than by congressional lobbying.

Like-minded views about the corporation's place in public life gained credence beyond the CED through business magazines, in particular, *Fortune*, and educational institutions, the most important being the Harvard Business School.¹⁰ In the early postwar period, scholars surveying business attitudes found a divergence between those who managed large firms and those who managed small and medium-sized companies.¹¹ Where the former saw imperfect markets and fiduciary responsibilities to corporate stakeholders, the latter repeated free market rhetoric and denied any commitment to a broader group of stakeholders. This discrepancy in part arose from

10. The experiences of the Great Depression and World War II predisposed managers—despite their competitive fractures and their antiunion bias—to *Fortune* magazine's clarion for a "Permanent Revolution." See Kaufman, Zacharias, and Karson, *Managers vs. Owners*, 125–27. Curiously, these ideas seemingly put an "end to ideology." Daniel Bell, *The End of Ideology: On the Exhaustion of Political Ideas in the Fifties* (1960; Cambridge, Mass., 1988). Bargaining, as Berle conceded in a postwar article, required that managers act as trustees for the corporation as a going concern—a conclusion with which the courts had concurred. Adolf A. Berle, Jr., "Control in Corporate Law," *Columbia Law Review* 58 (Dec. 1958): 1212–25. See also William Benton, *The Economics of a Free Society: A Declaration of American Business Policy* (New York, 1944); "U.S.A. The Permanent Revolution," *Fortune*, special issue (Feb. 1951), 60–212; Robert T. Elson, *Time, Inc.: The Intimate History of a Publishing Enterprise, 1923–1941* (New York, 1968); Jeffery L. Cruikshank, *A Delicate Experiment: The Harvard Business School, 1908–1945* (Boston, 1987); and David Callahan, *Kindred Spirits: Harvard Business School's Extraordinary Class of 1949 and How They Transformed American Business* (Hoboken, N.J., 2002).

11. Francis X. Sutton et al., eds., *The American Business Creed* (New York, 1962).

the New Deal regulatory agencies, which targeted large corporations rather than small firms.

Managerial Capitalism, Macroeconomic Policy, and Democracy, 1950–1970

Postwar economists generally agreed that managerial control of big business had a beneficent macroeconomic effect. Those who spoke in favor of managers' predominance were responding to the pessimism expressed by Joseph Schumpeter in his 1942 work, *Capitalism, Socialism, and Democracy*.¹² Schumpeter had forebodings about the modern corporation, which gave effective control to the salaried managers. He feared that, without familial control, executives had no incentive to innovate and generate new wealth that could be passed on to future familial owners. Instead, managers had an interest in minimizing risk to maximize security until their own retirement. Such behavior, Schumpeter warned, would usher in socialism and limit human possibilities. Those who wished to defend managerial capitalism had to demonstrate that managers' self-interest would not take the nation down this dismal road.

No one responded more completely than John Kenneth Galbraith. In *The New Industrial State*, Galbraith admitted that a managerial "technocracy" dominated the market. Shareholders no longer functioned to keep managers acting in the firm's best interest. They no longer even provided the economic function of supplying the firm with capital, which now came almost wholly from internal sources. Technocratic managers sought autonomy, but an autonomy dependent on expanding corporate control over resources, not retreating into socialism as Schumpeter had feared. Because growth under competitive markets required able asset management, managerially directed expansion could serve the cause of efficiency.¹³

Efficiency, however, took on a somewhat different meaning than maximizing shareholder wealth. Efficiency now meant that managers coordinated stakeholder bargaining over the firm's surplus until they reached an accord that "satisfied" (to borrow from Herbert Simon) each group of claimants. Management and labor both had "utility functions" that favored risk reduction. In this, stakeholders' interests

12. Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy* (New York, 1942).

13. John Kenneth Galbraith, *The New Industrial State* (Boston, 1967). See also Robin Marris, *The Economic Theory of Managerial Capitalism* (New York, 1964); and Robin Marris, "Galbraith, Solow and the Truth About Corporations," *Public Interest* 11 (Spring 1968): 37–46.

differed from those of shareholders, who favored reinvesting the surplus in risky projects that generated high returns and fostered new technologies. For a nation that still remembered depression and war, bargains that favored risk avoidance could still be seen as reflecting the “public interest.”¹⁴

The internal corporate hierarchies that managers constructed during the 1950s and 1960s followed closely their professed beliefs about technocratic expertise and stakeholders. Managers noted that they possessed special skills and knowledge for negotiating contracts among the firm’s stakeholders and for orchestrating mass production and mass distribution in flawless social operation. By aligning various constituents with the firm’s wealth-creation objective, managers reasoned that they could build the teams needed to develop and introduce new wealth-enhancing practices and technologies.¹⁵ Their technocratic expertise made them neutral, honest brokers in distributional battles among the firm’s various contractual stakeholders. Corporate hierarchies sustained their neutrality and ensured their expertise. Through internal performance criteria, only the most able moved into the firm’s executive heights.

Neither a family-controlled nor an investor-controlled firm could make this claim since each had proprietary claims to the firm’s central governing structure, the corporate board.¹⁶ In a family-controlled firm, for example, corporate assets constituted an industrial estate, perpetuating a family’s “bourgeois” social membership. In an investor-controlled firm, on the other hand, investors lacked the single-minded commitment of managers to the success of any one firm. Investors could compile a diversified financial portfolio of firm assets to minimize risk, unlike managers, whose careers and self-interest were tied to the firm they worked for.

Managers extended these organizational arguments into political ones. As corporate trustees, managers asserted that they preserved decentralized, private negotiations, even in concentrated industries. These negotiations might occur within a regulatory setting, but managers emphasized that the bargaining process still remained a private one among the firm’s contractual stakeholders. Managers admitted that they jealously guarded their position and the process’s private character by sustaining goodwill among corporate stakeholders and by engaging in political activities. But managers reasoned that these

14. Herbert Simon, *Administrative Behavior* (New York, 1976).

15. Committee for Economic Development, *Social Responsibilities of Business Corporations* (Washington D.C., 1971); the Business Roundtable, “Statement on Corporate Responsibility,” (New York, Oct. 1981).

16. Robert F. Freeland, *The Struggle for Control of the Modern Corporation: Organizational Change at General Motors, 1924–1970* (Cambridge, U.K., 2001).

actions limited the federal government's reach and redrew the bright line between private and public authorities that the modern corporation had originally undone.¹⁷

Critics warned that managers' control over concentrated assets and their small numbers made it likely that managers would cooperate to set political agendas and undermine majority rule. Managers responded by noting that market competition incessantly splintered them into competing factions on specific economic issues. Moreover, managers' professional responsibilities forced them to sustain a pragmatic as opposed to partisan or ideological political outlook, which kept them focused narrowly on public policies that affected market conditions.¹⁸

Managers also reasoned that as they enhanced productivity and living standards, they helped to reduce class conflicts that endangered democratic stability. Such promises put managers under public scrutiny. If they failed to enhance the value of their firms, the financial (takeover) markets would respond appropriately. If they failed to improve productivity, or if improved productivity did not flow to most citizens, then the political system would respond to limit managerial prerogatives and autonomy.

In all, managers reasoned that they acted collectively on those infrequent political occasions when public authority directly challenged their control. In doing so, they helped sustain the public-private distinction so important in a liberal society. At the same time, managers contended that they fragmented on most economic issues, making it impossible for them to control the political agenda. For these reasons, managers proclaimed themselves liberty's stewards.¹⁹

Executive Compensation and the Fall of the Technocratic System

Between 1945 and 1973, corporate incentive systems functioned to promote a version of Galbraith's technocratic management team. Compensation differences between chief executive officers (CEOs) and other members of senior management were "marginal," as were

17. Kaufman, Zacharias, and Karson, *Managers vs. Owners*, 128–57.

18. E. E. Schattschneider, *The Semi-Sovereign People: A Realist's View of Democracy in America* (New York, 1960); Edward M. Epstein, *The Corporation in American Politics* (Englewood-Cliffs, N.J., 1969); Mark A. Smith, *American Business and Political Power: Public Opinion, Elections, and Democracy* (Chicago, 2000).

19. Leonard Silk and David Vogel, *Ethics and Profits: The Crisis of Confidence in American Business* (New York, 1976).

their contributions to the firm.²⁰ True, even as early as the 1950s managers' compensation differed in significant ways from that of other employees. Top executives were compensated with stock options, which might have seemed to give them a special proprietary stake in their firms. But at this time stock options did not carry the heavy ideological baggage they would in the 1980s, when top executives began to see themselves as a separate class from other employees. Instead, stock options were used merely as a nonsalary reward that, taxed as capital gains rather than income, minimized CEOs' tax obligations. The leading academic scholar of this subject, Wilbur Lewellen, argues convincingly that corporations attempted to correct for the progressive nature of marginal income tax rates by substituting noncash pay. CEOs found themselves in higher income brackets than other managerial team members. Stock options protected CEOs' after-tax earning power. This early use of stock options, moreover, was only temporary. Stock options declined in popularity during the 1960s and early 1970s. Between 1955 and 1973, the value of CEO stock options dropped by two-thirds (see Tables 1–3).²¹

Table 1 Executive Ranking: Average Percent of Top Executive's Before-Tax Salary and Bonus

Year Average	Second	Third	Fourth	Fifth
1940–44	63	51	45	40
1945–49	68	54	49	45
1950–54	74	60	54	50
1955–59	75	63	56	53
1960–63	75	66	57	52
1964–69	77	62	56	51
1970–73	74	61	55	46

Sources: Wilbur G. Lewellen, *Executive Compensation in Large Industrial Corporations* (New York, 1968), calculated from yearly figures on p. 190; and Wilbur G. Lewellen, "Recent Evidence on Senior Executive Pay," *National Tax Journal* 37 (June 1975): 159–72, at p. 164.

20. We use *marginal* to indicate that the firm administered an internal labor market where managers received a "marginal wage" comparable to one that they would receive on a managerial spot market. Education, years of service, and age all affected pay differentials among managers. See George P. Baker, Michael C. Jensen, and Kevin J. Murphy, "Compensation and Incentives: Practice vs. Theory," *Journal of Finance* 43 (July 1988): 593–616; Michael L. Bognanno, "Corporate Tournaments," *Journal of Labor Economics* 19 (April 2001): 290–315; and David R. Roberts, "A General Theory of Executive Compensation on Statistically Tested Propositions," *Quarterly Journal of Economics* 70 (May 1956): 270–94.

21. Wilbur G. Lewellen, *Executive Compensation in Large Industrial Corporations* (New York, 1968), 211–26.

Table 2 Executive Ranking: Average Percent of Top Executive's After-Tax Total Compensation

Year Average	Second	Third	Fourth	Fifth
1940–44	69	58	50	45
1945–49	72	59	54	49
1950–54	72	61	53	47
1955–59	67	67	43	38
1960–63	68	57	46	39
1964–69	69	54	46	40
1970–73	74	61	52	40

Sources: Wilbur G. Lewellen, *Executive Compensation in Large Industrial Corporations* (New York, 1968), calculated from yearly figures on p. 199; and Wilbur G. Lewellen, "Recent Evidence on Senior Executive Pay," *National Tax Journal* 37 (June 1975): 159–72, at p. 165.

Table 3 Average Composition of After-Tax Compensation

	1955–63	1964–69	1970–73
Salary plus bonus as percent of total			
Executive #1	38	41	55
Executive #2	50	50	57
Executive #3	56	57	59
Pension plan as percent of total			
Executive #1	15	11	16
Executive #2	13	12	15
Executive #3	12	11	14
Deferred pay value as percent of total			
Executive #1	11	14	17
Executive #2	9	11	17
Executive #3	8	9	17
Stock option value as percent of total			
Executive #1	36	34	12
Executive #2	28	27	11
Executive #3	24	23	10

Source: Wilbur G. Lewellen, "Recent Evidence on Senior Executive Pay," *National Tax Journal* 37 (June 1975): 159–72, at p. 166.

The performance of equity markets also helps to explain why stock options declined in popularity and did not create divisions between the top executive and other firm members. From 1955 to 1964, the Dow Jones average increased nearly 90 percent. From 1964 to 1969, it increased by only less than 10 percent. The comparable changes in the Standard & Poor's index were 200 percent versus 20 percent. In other words, the value of the options themselves, rather than the number of options granted, affected their after-tax value as a part of the overall pay package. The Tax Reform Act of 1969 narrowed the differences between taxes on earned income and those on capital gains. This occurred as stock markets continued their bearish performance beginning in the mid-1960s. Top executives thus had

incentive to shift the composition of their pay from options to salary and bonuses.²²

Although corporate managers were among the highest income earners in the country, managerial hierarchies did not typically permit them to accumulate large family fortunes. Had this been the case, managers could hardly have spoken of their class neutrality, as they quite liked to do at this time. Consequently, managers' entry into the wealthiest income brackets did not provoke social outrage, for managers ran their firms as growth engines that, they claimed, generated prosperity and elevated incomes for all, even for the less advantaged.²³

Compensation packages from this period facilitated team cohesion among the senior managers, who, like the CEO, had membership "rights" to the board over which they as a team, controlled.²⁴ Though constrained by antitrust regulations, managers shared know-how across industries and built a corporate-wide identity through a system of interlocking board directorates. Although this network educated participants in corporate-wide issues, those within it still identified, first and foremost, with their own firm, where they spent most of their careers. By acting according to these "professional" standards, managers reasoned that they effectively served as corporate fiduciaries and as *de facto* public agents or technocrats in administering the nation's productive resources.

Thus, by 1973, the top three executives of any large firm received roughly the same percentages of their compensation in bonuses and salary. Over these decades, as the value of stock options fell as a portion of the CEO compensation package, the difference between CEO total compensation and the next two highest paid executives shrank, as well. This narrowing of the CEO-senior executive compensation ratio conforms to our account of how managers built technocratic incentive systems during the first decades of the postwar period.

22. *Economic Report of the President* (Washington, D.C., 2002), B-95.

23. During World War II, CEOs made substantially more than the second-highest-paid executive did. After the war, however, the gap between top executive and senior management compensation narrowed for more than a quarter of a century. The primary source of data for the postwar years through 1973 is Wilbur G. Lewellen's work for the National Bureau of Economic Research. See Wilbur G. Lewellen, *Executive Compensation*; Wilbur G. Lewellen, *The Ownership Income of Management* (New York, 1971); Wilbur G. Lewellen, "Managerial Pay and the Tax Changes of the 1960s," *National Tax Journal* 35 (June 1972): 111–32; Wilbur G. Lewellen, "Recent Evidence on Senior Executive Pay," *National Tax Journal* 37 (June 1975): 159–72. For the period from the mid-1970s to the end of the century we used annual reports generated by the Conference Board.

24. Myles Mace, *Directors: Myths and Reality* (Boston, 1986), 11–119, 198–99; Robert W. Hamilton, "Corporate Governance in America 1950–2000: Major Changes but Uncertain Benefits," *Journal of Corporation Law* 25 (Winter 2000): 349–73.

Management compensation had a somewhat “egalitarian” character; CEOs had no status as a “special class” of shareholders.

The technocratic system was also reflected in the structure and functioning of corporate boards of directors. During the technocratic period, management dominated corporate boards, particularly in manufacturing industries. Even though there were nominal “outsiders” on these boards, many of them represented firms that had “business connections” with the corporations on whose boards they sat.²⁵ Boards ranged in size from a handful of directors at small companies to over twenty in other firms, particularly banks. The size of the corporation (as measured by sales) influenced the size of the board, with larger firms averaging nearly one-third more members. By the 1970s, boards of larger firms were averaging fifteen members, with six or seven “inside” managers serving on the board.²⁶ Although nearly three-quarters of manufacturing firms had a majority of “outside” directors in 1973, as compared to a little more than half twenty years earlier, survey data in the period did not carefully distinguish the backgrounds of these outsiders. Many of these “outsiders” were former managers of the companies on whose boards they sat. Others ran firms that had business dealings with the companies whose boards they served on.

This particular board structure—many current managers and individuals who worked either inside the company or in businesses that had direct dealings with the firm—represented the essence of the technocratic system. Top managers not only received compensation commensurate with their positions in the company, but the board served two equal functions. The first was to monitor the financial performance of the company, which was the board’s fiduciary responsibility to the shareholders. But, secondly, although the board would not oversee the day-to-day company’s operations, it would serve an integral role in the strategic planning process, work with management in evaluating long-term capital investment decisions, and oversee the relationships with the company’s stakeholders.

25. National Industrial Conference Board, *Corporate Directorship Practices*, Business Policy Study No. 125 (New York, 1967): 7, 14. As an indicator of how directors were classified, the Conference Board studies on corporate boards considered former employees to be “outsiders” until 1973. The Conference Board, *Corporate Directorship Practices: Membership and Committees on the Board* (New York, 1973), 5.

26. Most of the studies on boards have been conducted by executive search firms. The first Korn/Ferry International study, “Boards of Directors Annual Study,” (Nov. 1973) found that more than half of the 327 firms they surveyed had between 10 and 15 board members and of those 4 to 6 were insiders.

Executive Compensation and Corporate Board Composition, 1973–2000

Technocratic compensation patterns slowly eroded after 1973. Beginning in 1975, the gap between CEO and senior management compensation steadily widened. In 1975, on average, the second-highest-paid executive received 72 percent of the top-paid executive. By 2000 the percentage fell to 61. For the third-highest-paid executive, the percentage fell from 57 to 47 between 1982 and 2000. Even more dramatic was the decline of *after tax* compensation of other managers versus the CEO. By 2000, the second-highest-paid executive dropped to 55 percent of the CEO's after-tax compensation, and the number three dropped to 40 percent.

From 1982 until 2000, firms increasingly used stock options to compensate top managers.²⁷ Beginning in 1982, top executives received stock options worth approximately 80 percent of their salaries. By 1987 that percentage had increased to 141 percent; by 1993, to 173 percent. During these years, CEO stock options as a percentage of salary rose at a faster rate than for other senior executives. In 1985 the average CEO and the second highest-paid executive both had stock options worth 99 percent of their salary. By 2000, the CEOs had options worth, on average, 636 percent of their salary, compared to the top four executives, whose stock options were less than 400 percent of their salaries (see Table 4). On average, CEOs have earned considerably more than the other top managers of their firms. In short, the 1980s and 1990s witnessed a transformation in the senior

Table 4 Executive Ranking of Manufacturers, Median Percent of CEO's Total Compensation: Salary, Bonus, Stock Option Grants, Restricted Stock, and Long-Term Performance Plans

Year (sample size)	Second	Third	Fourth	Fifth
1997 (730)	58	46	40	35
1998 (801)	58	45	39	35
1999 (821)	57	43	37	32
2000 (803)	55	40	35	29

Source: The Conference Board, *Top Executive Compensation* (New York, 1998), 24; *Top Executive Compensation* (New York, 1999), 19; *Top Executive Compensation* (New York, 2000), 16; and *Top Executive Compensation* (New York, 2001), 14.

27. This was also supplemented by other forms of stock-related pay, such as stock appreciation rights (SARs) and restricted stock. SARs allowed executives to receive the increased value of share prices without having to purchase the stock as they were required to with stock option grants. Restricted stock is awarded to an executive at no cost to the executive. The shares earn dividends but cannot be sold until the restriction lapses, at which time they become common shares.

executive compensation system, a transformation that turned managers into a special class of shareholders and the CEO position into a proprietary payoff.²⁸

The Business Roundtable and the Formation of a CEO “Coterie”

How did this alteration in the firm’s promotional hierarchy occur? What economic and political forces allowed for this transformation? Did managers collectively lead this reformation? Or, did the change occur firm by firm, in an imperceptible manner? In redesigning their organizations, did managers collectively revise their doctrine of corporate social responsibility, moving away from the technocratic model? If so, what now acts as their professional norm? Definitive answers cannot be given here. Corporate archives and the personal papers of most CEOs of the period are simply not yet available to document this process. The archives of those business associations that facilitated a corporate-wide discussion on the firm’s incentive system are also not yet available. Still, a plausible story emerges from the available primary and secondary sources.

The story begins when the postwar American economic boom sputtered in the late 1960s. Unchallenged by foreign competitors, many U.S. industries had operated in the 1950s and 1960s as *de facto* oligopolies or, in the case of regulated industries, as publicly administered “cartels.”²⁹ These industrial structures allowed managers and public regulators to administer prices that satisfied both labor and capital. However, by the late 1960s, these barriers were crumbling. Budget deficits, trade deficits, and a revamped monetary policy weakened the dollar.³⁰ Then came the Arab oil embargo in

28. Stuart L. Gillan, “Option-Based Compensation: Panacea or Pandora’s Box,” *Journal of Applied Corporate Finance* 14 (Summer 2001): 115–28, documents how options can transfer wealth from existing shareholders to managers and how managers can reprice options when share prices fall below the exercise price. Although Gillian notes that options can make economic sense, shareholders have become increasingly sophisticated in calculating their costs and have increasingly voted against option plans.

29. Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions* (1970–71; Cambridge, Mass., 1988), 1–19. Richard H. K. Vietor, *Strategic Management in the Regulatory Environment: Cases and Industry Notes* (Englewood Cliffs, N.J., 1989), 23–39.

30. Robert M. Collins, *More: The Politics of Economic Growth in Postwar America* (New York, 2000), 109–31; Douglas Hibbs, *The American Political Economy: Macroeconomics and Electoral Politics in the United States* (Cambridge, Mass., 1987).

1973 (along with food shortages and the reverberations of Vietnam-era tax policies) that sent the nation into an inflationary cycle for nearly a decade. The energy shock aided Japanese and German competitors who had already made gains in numerous markets, particularly in steel, autos, and consumer electronics. As the economy slowed, the nation witnessed a new economic phenomenon—stagflation. Contrary to standard economy theory, rising unemployment was unable to wring out inflation. Unions, it turned out, still had sufficient power to sustain wages, and managers still had sufficient market power to pass these costs on to consumers in the form of higher prices. Stagflation turned into a disabling malady that caused capital investment to decline and productivity growth rates to slow. With them fell the living standards of many, including union members.³¹

Even before stagflation set in, managers recognized that the economy's problems threatened to undermine public satisfaction with their economic stewardship. So too did the civil rights, antiwar, and other social movements. In fact, conflicts among interest groups and cultural discord had turned the postwar policy consensus into a cacophony of competing and conflicting voices.³² Amidst this din, the CEO's voice was hardly heard. Aware of their diminished political influence and at the same time interested in changing the direction of macroeconomic policy, top executives looked for a way to amplify their collective voice.³³

The solution emerged in 1972 when three small business associations merged to form the Business Roundtable. Two of these groups sought a remedy for the inflation that war and ineffectual monetary and fiscal policies had unleashed. But the two associations also sought ways to reduce labor's bargaining power and stifle the inflationary spiral. The Construction Users Anti-Inflation Roundtable, composed of big and medium-sized construction companies, aimed to bring down rising construction costs; and the Labor Law Study Committee Group, an association of big firms, aimed to counter organized

31. Frank Levy, *The New Dollars and Dreams: American Incomes and Economic Change* (New York, 1998).

32. David Vogel, *Fluctuating Fortunes: The Political Power of Business in America* (New York, 1989); Kim McQuaid, *Uneasy Partners: Big Business in American Politics, 1945–1990* (Baltimore, Md., 1994); Judith Stein, *Running Steel, Running America: Race, Economic Policy, and the Decline of Liberalism* (Chapel Hill, N.C., 1998).

33. David Vogel, *Lobbying the Corporation: Citizen Challenges to Business Authority* (New York, 1978); Allen J. Matusow, *The Unraveling of America: A History of Liberalism in the 1960s* (New York, 1984), 30–59, 395–435. The CED, challenged by social regulation and the slacking economy, formally articulated a professional creed that reflected what they called a “changing social contract” between business and society. See also Committee for Economic Development, *Social Responsibilities of Business Corporations*.

labor's political clout. The third association of the Roundtable, the March Group, worked to improve the corporate sector's media image and relationship to government.³⁴

From the start, the Business Roundtable differentiated itself from other business associations by restricting its membership to the CEOs of the nation's largest firms. Unlike the older CED, the Roundtable registered as a lobby—taking CEO power directly to Capitol Hill. Among the most active early leaders were men like Reginald Jones of General Electric (GE), Thomas Murphy of General Motors, John Harper of Aluminum Company of America, and Irving Shapiro of DuPont.³⁵ They belonged to a generation of business leaders whose careers had started during World War II and who had been educated in the managerial practices of that period.

Perhaps more than anyone else, Irving Shapiro testified to the public, fiduciary sensibility that permeated this corporate leadership.³⁶ According to *Fortune* in the 1930s, Owen Young's leadership at GE had symbolized the democratic pluralism of American society in which competing groups bargained with one another for mutual advantage. In contrast, at DuPont, the founding family held fast to a class-based, paternalistic society. As leaders of the business reaction to Franklin Roosevelt and the broker state that his administration was constructing, the DuPonts became the symbol of recalcitrant proprietary interests.³⁷

Shapiro's appointment in 1973 as chairman of DuPont's board of directors and executive committee stunned the business community,

34. Thomas K. McCraw, "The Business Roundtable (A)," HBS Case Services, 9–379–119, Harvard Business School (Feb. 1979); McQuaid, *Uneasy Partners*; Mark Green and Andrew Buchsbaum, *The Corporate Lobbies: Political Profiles of the Business Roundtable and the Chamber of Commerce* (Washington, D.C., 1980); Marc Linder, *Wars of Attrition: Vietnam, the Business Roundtable, and the Decline of Construction Unions* (Iowa City, Iowa, 2000); David C. Jacobs, *Business Lobbies and the Power Structure in America: Evidence and Arguments* (Westport, Conn., 1999); Sar A. Levitan, *Business Lobbies: The Public Good & The Bottom Line* (Baltimore, Md., 1984); Williams, "The Securities and Exchange Commission," 1246–73; Vogel, *Lobbying the Corporation*, 71–125.

35. George David Smith documents John Harper's role in *From Monopoly to Competition: The Transformation of Alcoa, 1888–1986* (Cambridge, U.K., 1988), 349–63. See also John A. Byrne, *Whiz Kids: The Founding Fathers of American Business and the Legacy They Left Us* (New York, 1993); and Callahan, *Kindred Spirits*.

36. Irving S. Shapiro, *America's Third Revolution: Public Interest and the Private Role* (New York, 1984).

37. "DuPont Part I: An Industrial Empire," *Fortune* (Dec. 1934), 81–85; "DuPont Part II: A Management and Its Philosophy," *Fortune* (Dec. 1934), 86–89. For an account of DuPont's resistance to the New Deal, see Robert F. Burk, *The Corporate State and the Broker State: The DuPonts and American National Politics, 1925–1940* (Cambridge, Mass., 1990).

for it ended DuPont's 171-year-old tradition of family control.³⁸ During his reign at DuPont, Shapiro devoted nearly 30 percent of his time to matters outside the company. As Chairman of the Business Roundtable, he participated in discussions on how to overcome the membership's biases against collective action. The rewards seemed plain enough. A united managerial front might ward off more business regulation after a wave of regulatory agencies were created in the years preceding the Roundtable's founding.³⁹ This effort would supplement the already dense interactions among corporate executives through the complicated system of interlocking directorships that still marked the corporate sector, as well as memberships in prestigious business associations like the CED and the Business Council.⁴⁰

By 1977, the Business Roundtable had roughly fifteen task forces, each a small committee devoted to a single issue, such as antitrust, corporate governance, government regulation, and environmental affairs. Because the Business Roundtable's staff numbered only between ten and fifteen, committee chairs were expected to use their firm's staffers for research. The task forces directed their work to the forty-member Policy Committee, which met several times a year to work out the Roundtable's general strategy. Before a policy decision was made, the Roundtable generally sponsored several conferences with both members and outside experts, and then issued a white paper for the membership's consideration and commentary.

This participatory structure proved quite efficient in ensuring frequent contact among the Roundtable's membership, as well as easy access to information on salient issues. The Roundtable was surprisingly successful in mounting campaigns to defeat proconsumer and labor reform in the late 1970s.⁴¹ But, the Roundtable's success relied on the moral suasion that its members had on one another, as well as on the committee chairs' skills in building *ad hoc* political coalitions.

38. Although in the past top DuPont executives generally had scientific backgrounds, Shapiro was a company lawyer who had spent about a third of his career in Washington with the Justice Department. Peter Vanderwicken, "Irving Shapiro Takes Charge of DuPont," *Fortune* (Jan. 1974), 78–81.

39. Agencies included the Equal Employment Opportunity Commission, 1964; National Transportation Safety Board, 1966; Council on Environmental Quality, 1969; Environmental Protection Agency, 1970; National Highway Traffic Safety Administration, 1970; Occupational Safety and Health Administration, 1970; and the Consumer Product Safety Commission, 1972. See Vogel, *Fluctuating Fortunes*.

40. Beth Mintz and Michael Schwartz, *The Power Structure of American Business* (Chicago, 1985).

41. McCraw, "The Business Roundtable (A)"; McQuaid, *Uneasy Partners*; Green and Buchsbaum, *Corporate Lobbies*; Linder, *Wars of Attrition*; Jacobs, *Business Lobbies and the Power Structure*; Levitan, *Business Lobbies*.

Although commentators noted the power that the Roundtable accumulated through CEO membership, few recognized that it had laid the foundations on which CEOs were able to rise as a distinct group, with interests separate from other managers and from their particular firms. Given the technocratic creed of the times, this slip seems understandable. By the mid-1990s, however, CEOs had established themselves as a special class of shareholders and had abandoned their former impartial technocratic identity, presenting themselves instead as shareholder partisans.⁴²

Managerial Macroeconomics and the Investment Banker Challenge

As inflation turned to stagflation in the 1970s, the CED and the Business Roundtable generated numerous reports and public policy proposals with nearly identical diagnoses of the economic malady and recommended cures.⁴³ Although managers acknowledged their responsibility to find an antidote, they disclaimed responsibility for the economy's condition. Instead, they located the sources of distress in the nation's egalitarian cravings and the federal government's efforts to satisfy them through deficit spending and broadened regulatory powers. Since taxes were not adjusted for inflation, managers argued, private firms had been forced to transfer unprecedented sums to the public sector, making it impossible for them to invest in new, productivity enhancing capital equipment. Without these investments, the nation went into an inflationary spiral as competing groups sought to sustain their living standards at the expense of each other.

By 1980, managers had mobilized to break this vicious cycle. Politically, managers supported candidates for federal office who promised to trim government spending, cut corporate taxes, and

42. Bill George, *Authentic Leadership: Rediscovering the Secrets to Creating Lasting Value* (New York, 2003).

43. Committee for Economic Development, *Social Responsibilities of Business Corporations*; Committee for Economic Development, *Fighting Inflation and Promoting Growth: A Statement on National Policy* (New York, 1976); Committee for Economic Development, *Productivity Policy: Key to the Nation's Economic Future* (New York, 1983); Alfred C. Neal, *Business Power and Public Power: Experiences of the Committee for Economic Development* (New York, 1981). For the Business Roundtable's views see McCraw, "The Business Roundtable (A)"; the Business Roundtable, "Analysis of the Issues in the National Industrial Policy Debate: Working Papers" (New York, 11 Jan. 1984); and the Business Roundtable, "Strategy for a Vital U.S. Economy: Industrial Competitiveness and Legislative Proposals for a National Industrial Policy," (New York, May 1984).

reduce the electorate's grand expectations.⁴⁴ At the same time, managers began to adopt new technologies and lean production practices that disgorge large numbers of workers from well-paying jobs.⁴⁵ In an effort to reduce overcapacity, managers entered into a frenzied round of mergers and acquisitions, which further shrank corporate payrolls. Ironically, these actions brought together a coalition of interests that would challenge autonomy and efficiency claims of the managerially controlled firm.⁴⁶ After targeting government economic policy for its ill effects, managers and the large corporations they controlled suddenly came in for criticisms of their own.

Challenges to managerial autonomy in the 1980s came from institutional investors, investment bankers, and takeover specialists, all of whom found in "hostile" tender offers the opportunities for extraordinary gain. While managers labeled takeover firms such as Kohlberg Kravis Roberts & Company (KKR) mere marauders, a group of distinguished finance professors defended the leveraged buyout strategy as a market-efficient way to revitalize a moribund corporate sector. Under new theories of principal-agent conflict, managerial mismanagement was once again identified as the number one danger posed by managerial capitalism.

The new charges against corporate managers undercut the prevailing technocratic rationale for large corporations. Managers, financial agency theorists alleged, had not used a wealth-maximizing standard

44. McQuaid, *Uneasy Partners*; Kaufman, Zacharias, and Karson, *Managers vs. Owners*, 167–94; Thomas Byrne Edsall, *The New Politics of Inequality* (New York, 1984), 128–36.

45. David Gordon, *Fat and Mean: The Corporate Squeeze of Working Americans and the Myth of Managerial Downsizing* (New York, 1996).

46. The challenge to managerial control of corporate boards predates institutional investor activism. The call for reform followed the bankruptcy of the Penn Central Railroad in 1970, the illegal campaign contributions to the 1972 Nixon reelection campaign, and the overseas payoff scandal. In response to the scandals, the SEC initiated a series of investigations to uncover false reporting and possible criminal actions, and the Business Roundtable gave a qualified endorsement to the proposition that the majority of board members should be nonmanagement directors. Moreover, the Roundtable stated that corporate boards should oversee both the firm's financial performance and its commitment to social responsibility—thereby reaffirming managers' technocratic creed. See Vogel, *Lobbying the Corporation*, 71–125; George Thomas Washington and V. Henry Rothschild, *Compensating the Corporate Executive* (New York, 1962), 260; Joel Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance* (Boston, 1982), 547; Roswell B. Perkins, "Thanks, Myth, and Reality," *The Business Lawyer* 48 (April 1993): 1313–17, esp. 1313; Business Roundtable, "The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation," *Business Lawyer* 33 (July 1978): 2083–113; Heidrick & Struggles, "The Changing Board" (Chicago, 1981); and Francis W. Steckmest, *Corporate Performance: The Key to Public Trust* (New York, 1982), 186.

when allocating capital into new investments.⁴⁷ Where earlier theorists had seen nonmaximizing behavior, “satisficing,” as a way to stabilize the economy and create jobs, agency theorists condemned this practice as one that merely benefited managers at the company’s and the economy’s expense. Satisficing led managers to increase their firm’s size through ill-conceived diversifications and acquisitions, often in areas unrelated to the firm’s other business activities. Size and conglomeration reduced the risk of bankruptcy and enlarged the industrial empires over which managers reigned, temporarily reinforcing managerial power. But these investments failed to improve the firm’s productive capabilities, making stagflation a likely outcome so long as workers had sufficient power to secure wages that outpaced productivity gains. Takeovers and leveraged buyouts were then seen not as a danger, but as a solution to the nation’s economic woes.⁴⁸

As hostile takeovers increased in number and importance, managers acted to protect their firms. Takeovers generally occurred in industries not subject to foreign competition, such as consumer food products, and in deregulated industries. Managers in these industries protected themselves by adopting various new governance strategies with ominous names—poison pills, shark repellents—that lessened their firms’ attractiveness to buyout artists.⁴⁹ Some managers, however, responded by internally restructuring their firms, divesting less profitable units and consolidating profitable ones.⁵⁰

Even though hostile takeovers were confined to a few industries and were few in number, managers recognized that they now faced a threat to their control of the firm. They acted as a group through the Business Roundtable to defend their role as technocratic managers.

47. Stephen Ross, “The Economic Theory of Agency: The Principal’s Problem,” *American Economic Review* 63 (May 1973): 134–39; Eugene F. Fama, “Agency Problems and the Theory of the Firm,” *Journal of Political Economy* 88 (April 1980): 280–307; Eugene F. Fama and Michael C. Jensen, “The Separation of Ownership from Control,” *The Journal of Law and Economics* 26 (June 1983): 301–25; Henry Manne, “The Higher Criticism of the Modern Corporation,” *Columbia Law Review* 62 (March 1962): 401–32; Henry Manne, “Mergers and the Market for Corporate Control,” *Journal of Political Economy* 73 (April 1965): 110–20; William Meckling and Michael Jensen, “A Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,” *Journal of Financial Economics* 3 (Oct. 1976): 305–60.

48. Michael C. Jensen, “The Eclipse of the Public Corporation,” *Harvard Business Review* 67 (Sept.–Oct. 1989): 61–75.

49. Michael C. Jensen, “The Takeover Controversy: Analysis and Evidence,” in *Knights, Raiders and Targets: The Impact of the Hostile Takeover*, ed. John C. Coffee, Jr., Louis Lowenstein, and Susan Rose-Ackerman (New York, 1988), 314–54.

50. General Mills provides such an example. See Gordon Donaldson, “Voluntary Restructuring: The Case of General Mills,” *Journal of Financial Economics* 27 (Sept. 1990): 117–42.

These moves included the pursuit of regulatory relief from state and the federal government, and, aligned with labor, passage of stakeholder laws that allowed managers to take other interests besides shareholders into account when they considered offers for takeovers and purchase of stock.

In 1987, the Senate Banking Committee and the House Committee on Energy and Commerce opened hearings, which continued into late 1989, to sort out the economic consequences of hostile takeovers. On October 3, 1989, Andrew Sigler, CEO of Champion International and chair of the Business Roundtable Task Force on Corporate Governance, stood before the Senate subcommittee.⁵¹ His position in the Roundtable made him the ideal representative. Before testimony began, the subcommittee's chair, Christopher Dodd (D-CT), reminded Sigler and his colleagues that they were convened to seek an answer to a broader question than mechanics of takeover regulation: "How do we [Congress] promote good corporate management?"

Though the decade's battles had wearied and embittered many corporate chiefs, the senators found Sigler a confident spokesperson. In fact, his vitality must have surprised those who were sure that managerial capitalism was on its way out, soon to be replaced by modern finance capitalism.⁵² Sigler had good reasons to be upbeat. The corporate restructuring that managers had initiated apparently helped to deflate stagflation and promote growth. By 1986, aggregate productivity figures had improved sufficiently that some experts had regained confidence in U.S. management. And Sigler came with a well-honed and time-tested account of why Congress should prefer managerial rather than investment banker control. He recounted the managerial stakeholder thesis that both the CED and the Roundtable had formally articulated. From this stakeholder perspective, Sigler forcefully denounced corporate raiders as self-serving vandals. Their raids, even when unsuccessful, harmed target firms. To arrest an assault, managers frequently capitulated to extortion. To keep their firms from falling prey, managers restructured their firms in ways that imposed costs on employees and communities. Managers had to take these sorts of action if they were to honor their fiduciary duty to the firm and its shareholders, but the costs were borne by other stakeholders. Sigler did not lay all blame on the takeover marauders. He accused, as well, the public pension funds, which substantially

51. U.S. Senate, Committee on Banking, Housing, and Urban Affairs, Subcommittee on Securities, *The Impact of Institutional Investors on Corporate Governance, Takeovers, and the Capital Markets* [hereafter *Impact*] (3 Oct., 1989), 101st Cong., 1st sess.

52. Baskin and Miranti, *A History of Corporate Finance*, 258–302, provides an excellent overview of this period.

helped finance hostile tenders.⁵³ Sigler argued that pension funds were the primary source of Wall Street's demand for higher short-term profits. In turn, the stock market pressured corporate managers to produce immediate results, foregoing the long-term investments that ensured the firm's future competitiveness. Sigler took the logical step of asserting that pension fund managers' actions had lost perspective on their beneficiaries' interests. By weakening the economy, pension funds would, over the long run, be less likely to generate cash flows for meeting beneficiary obligations.⁵⁴

In all, Sigler argued that Congress should trust managers. Unlike corporate raiders and institutional investment fund managers, corporate managers had long adhered to a professional obligation to create new wealth by minimizing harm and maximizing benefits for all the firm's stakeholders. Their challengers, by contrast, cared little for the corporation as a going concern or for the social contributions that large firms made to U.S. democracy. Of the two challengers, Sigler identified public pension funds as the more likely foe to undo managerial control. Institutional funds had swelled over the previous decades, providing them with the economic clout to oversee managers. For Sigler, legal restraints and the limits of collective action formed the only checks against "pension fund socialism." And Sigler warned that institutional fund managers would soon attempt to undo these restraints and to directly challenge managerial control.

Managers' Diminishing Prospects

As corporate restructuring progressed during the 1980s, managers witnessed their displacement from the U.S. top income bracket. During this merger wave (the fourth in U.S. history), managers' welfare rose absolutely but fell relative to other high-income earners. This trend dislodged corporate executives from the nation's top one percent of household wealth holders. Between 1983 and 1992, the number of self-employed household heads in the top wealth percentile nearly doubled, from 38 to 69 percent. The increasing presence of the self-employed was even more pronounced in the top income percentile, climbing from 27 percent to 64 percent. As the fortunes of the

53. U.S. Senate, *Impact*, 89–90, 94.

54. Moreover, pension funds used the proxy to further their ambitions by opposing poison pills. To correct this abuse, Sigler recommended that public pension funds that indexed investments should return to their beneficiaries proxy voting power and that private pension should return this power to the plan sponsor. U.S. Senate, *Impact*, 325.

self-employed rose, a shift occurred in the composition of this elite group's earnings. For these household heads, income from proprietary earnings, self-employment, partnerships, and unincorporated businesses rose from 27 to 47 percent. The richest one percent of households readjusted their portfolios, substituting corporate and government bonds and pension accounts for stocks, mutual funds, and trusts. Stock holdings fell from 17 to 12.1 percent; mutual funds, from 6.9 to 4.6 percent. In contrast, financial securities rose from 5.7 to 9.9 percent and pensions from 0.9 to 3 percent.⁵⁵ While tax advantages undoubtedly explain the shift to pension funds, the buoyant buyout market probably explains much of the increase in financial securities.

Taken together, these numbers indicate that a new group had entered Schumpeter's fabled proprietary class. Who were these fortunate few? A partial answer comes when one looks at the new entrants into the top one percent by employment category. Among these various categories, individuals working in finance, business, and business services showed the largest gain in the top one percent, increasing from 47 percent in 1983 to 58 percent in 1992.⁵⁶ These numbers indicate that the new proprietors included traditional entrepreneurs and those investment bankers and corporate attorneys who facilitated both friendly and unfriendly mergers. Moreover, proprietors' advances came at managers' expense. In 1983, professional, managerial, and administrative workers accounted for 62 percent of household heads in the top one percent of wealth holders. By 1992, this percentage had fallen to 29 percent.⁵⁷

Managers, of course, refused to let their reversal of fortune continue, either in terms of income or social standing. How, they wondered, could takeover marauders and their investors confiscate so much wealth without provoking a general public outcry? How could prominent academics, particularly in the field of corporate finance, portray managers as self-dealing bureaucrats that only takeover markets could keep in check? And, how could anyone accept the outrageous scholarly manifestos in which raiders were included among the nation's most valuable entrepreneurs?

55. Edward N. Wolff, "Who are the Rich? A Demographic Profile of High Income and High-Wealth Americans," in *Does Atlas Shrug? The Economic Consequences of Taxing the Rich*, ed. Joel B. Slemrod (New York, 2000), 74–113. See also Edward N. Wolff, *Top Heavy: The Increasing Inequality in America and What Can Be Done about It* (New York, 2002); and Lisa A. Keister, *Wealth in America: Trends in Wealth Inequality* (Cambridge, U.K., 2000), 55–106.

56. Wolff, "Who are the Rich?" 85–86.

57. *Ibid.*

The Proprietary Creed, 1990–2000

Only three months after Sigler's testimony in the fall of 1989, investors exited the takeover arena, as both the junk bond market and the savings and loan industry collapsed.⁵⁸ This effectively put a halt to congressional debate over takeover regulation. Institutional investors, as Sigler had predicted, now moved onto the front lines of the battle for corporate control. From their dealings with corporate raiders, institutional investors recognized their potential power and learned much about how to exercise it, both formally through proxy battles, and informally through private negotiations with management.⁵⁹ However, divisions among them and regulatory constraints imposed on them created obstacles that made institutional investors an ineffectual corporate control contestant.

Although institutional investors had sufficient clout to force managerial action, they did not have sufficient organizational coherence to supplant (or even seriously contest) managers' control of their firms.⁶⁰ Managers reacted vigorously by putting up defenses and, when necessary, making concessions. However, these alterations did not supplant managerial authority. In the 1980s, institutional investors increasingly used proxy statements to undo antitakeover provisions and to reform corporate boards. Once the takeover market collapsed, institutional investors forced underperforming firms to make strategic changes and, as in some highly visible cases, to oust top managers.⁶¹

As institutional investors gained momentum, trade union power waned, transferring the managers' principle stakeholder constraint from labor to shareholders.⁶² Labor unions had refrained from exerting

58. See Allen Kaufman and Ernest J. Englander, "Kohlberg Kravis Roberts & Co. and the Restructuring of American Capitalism," *Business History Review* 67 (Spring 1993): 52–97; Baskin and Miranti, *A History of Corporate Finance*, 292–96.

59. TIAA-CREF, however, found informal negotiations more effective than proxy confrontations. See Randall S. Thomas and Kenneth J. Martin, "The Effect of Shareholder Proposals on Executive Compensation," *University of Cincinnati Law Review* 67 (Summer 1999): 1021–72, esp. 1044. Also see James E. Sailer and Katharina Pick, "California PERS (B)," HBS Case Services, 9–201–091, Harvard Business School (5 Feb. 2001).

60. Diane Del Guercio and Jennifer Hawkins, "The Motivation of Pension Fund Activism," *Journal of Financial Economics* 52 (June 1999): 293–340.

61. Thomas and Martin, "The Effect of Shareholder Proposals," 155–59.

62. In fact, labor unions have increasingly acted as shareholders through pension funds to challenge managers. See Stewart J. Schwab and Randall S. Thomas, "Realigning Corporate Governance: Shareholder Activism by Labor Unions," *Michigan Law Review* 96 (Feb. 1998): 1018–90; Marleen A. O'Connor, "Organized Labor as Shareholder Activist: Building Coalitions to Promote Worker Capitalism," *University of Richmond Law Review* 31 (Dec. 1997): 1345–97.

power to influence managerial decisions, whether over work-related issues, in promotion hierarchies, or in corporate strategy. Instead, unions concentrated on dividing up surpluses for workers. In contrast, institutional investors assumed that their residual claims (their shares) allowed them to exercise disciplinary authority over managers, both through the market for corporate control and through corporate governance procedures. Thus, even if institutional investors were unable to secure effective control of the corporation, they exerted considerably more influence over it than had labor during the technocratic period. Media coverage and judicial rulings aided institutional investors in forcing managers to reform corporate boards.⁶³

By the mid-1980s, managers no longer had to cling to their stakeholder doctrine. In every confrontation with shareholders, this doctrine had failed to persuade regulators. Luckily, managers had no need of crafting an alternative. Agency theory—the paradigm most hostile to management’s technocratic neutrality—was well suited for both public regulatory discourse and for managers’ new proprietary culture. The manager for the new millennium was not an impartial technocrat, but a shareholder partisan. To prove loyalty, managers devised a promotional system that allegedly linked their interests to shareholders and defined their fiduciary duty to a single stakeholder, the shareholder. Managers saw in shareholder advocacy the opportunities that had eluded them as impartial, public-spirited technocrats.

This new self-definition neatly intersected with that other group of investors who had market power—wealthy families. Family ownership of equity had increased in tandem with that of institutional investors. In 1989, U.S. households accounted, directly and indirectly, for 31.6 percent of equity shares. By 1995, the number had grown to 40.3 percent. As public participation in the stock market increased, the equity share of family wealth rose, regardless of income. This growth in stock market participation hardly made for a shareholder democracy. Ownership claims were concentrated among a very few. In 1992, 0.5 percent of the households owned, directly and indirectly, 36.8 percent of all equity. The top 10 percent owned 89.4 percent.⁶⁴ This concentration left the bottom 80 percent holding only 1.8 percent. Thus, there remained a private network of wealthy families that made for a class structure similar to the one found at the beginning of the twentieth century. These families, when mindful,

63. Ira M. Millstein and Paul W. MacAvoy, “The Active Board of Directors and the Performance of the Large Publicly Traded Corporation,” *Columbia Law Review* 98 (June 1998): 1283–321.

64. O’Sullivan, *Contests for Corporate Control*, 161.

were capable of challenging management on specific corporate strategic decisions.⁶⁵ Moreover, these families also constituted a “class” to which money market and corporate managers aspired.

Among the public pension funds, the California Public Employees’ Retirement System (CalPERS) led the advance against technocratic management. Even before the junk bond market crash of 1989, CalPERS had been engaged in various campaigns to reign in wayward managers through proxy initiatives to reform corporate governance.⁶⁶ From these clashes, CalPERS’s leadership became acutely aware of how Security and Exchange Commission (SEC) rules favored managers and in November 1989 submitted a letter to the SEC’s Division of Corporation Finance, asking for a comprehensive review of SEC proxy rules.

Thus began an acrimonious three-year public debate that included four congressional hearings and two SEC releases, and generated an unprecedented number (more than seventeen hundred) of comment letters.⁶⁷ The political forces weighed heavily on the institutional investors’ side. Even those academics who doubted that institutional investors had any substantial economic interest in corporate oversight championed reform on the simple grounds of procedural even-handedness. Moreover, in the early 1990s, managers had still not revitalized the ailing economy. Gains had shown up by 1986, but optimism faded as the economy stumbled once again into a recession. Furthermore, managers’ strident advocacy for antitakeover legislation during the late 1980s had weakened their credibility with Congress.

The Business Roundtable, of course, fought vigorously against the CalPERS’ initiative. In previous academic, legislative, and SEC disputes, the Roundtable had proven itself a capable political competitor.⁶⁸ The Roundtable had also shown skill in influencing the

65. A fact that was displayed in the battles over the Hewlett Packard–Compaq merger in 2002 and William Ford’s succession at the Ford Motor Company in 2001.

66. Sunil Wahal, “Pension Fund Activism and Firm Performance,” *Journal of Financial and Quantitative Analysis* 31 (March 1996): 1–23. See also Thomas and Martin, “The Effect of Shareholder Proposals,” 1055–57; and James E. Sailer, “California PERS (A),” HBS Case Services, 9–291–045, Harvard Business School (rev. 11 Nov. 1993).

67. Advocates and opponents fell along expected “party” lines. Institutional investors, especially activist public pension funds, rallied behind CalPERS. The Business Roundtable and the American Society of Corporation Secretaries anchored the opposing side. For a broader discussion see John C. Coffee, Jr., “The SEC and the Institutional Investor: A Half-Time Report,” *Cardozo Law Review* 15 (Jan. 1994): 837–907, esp. 841–42.

68. Marc J. Loewenstein, “The SEC and the Future of Corporate Governance,” *Alabama Law Review* 45 (Spring 1994): 783–815, esp. 804–805; and Roberta S. Karmel, “Limitations on SEC Rule-Making,” *New York Law Journal* 16 (16 Aug. 1990): 6.

American Law Institute's *Principles of Corporate Governance*.⁶⁹ During the 1980s, the Roundtable had initiated a very successful campaign to secure state antitakeover and corporate stakeholder statutes, and had prevailed in previous SEC battles against institutional investors.

From these engagements, the Business Roundtable had gained much experience that prepared it for the proxy confrontation. Its argument revolved around the legal concept of fiduciary duty. Managers had long maintained that the corporate control group had a fiduciary duty to the corporation as a going concern. According to the Roundtable, institutional investors, and, in particular, public pension fund trustees, had neither the training nor the inclination to act as effective and impartial corporate overseers. Yet, the proxy reform proposals would permit institutional investors to collude and vastly increase their power over firms.⁷⁰

The Roundtable warned that this would allow institutional investors to preempt managerial authority for narrow, financial gains. If pension funds were to gain corporate control, the funds' trustees, the Roundtable analysis continued, would put themselves into a legal quandary. The trustees would have to ask themselves: to whom were they accountable? Were they fiduciaries for their funds' beneficiaries or for the corporation? The Employee Retirement Income Security Act (ERISA) statutorily defined private pension fund trustees to be fiduciaries for their funds' beneficiaries. This obligation, the Roundtable reasoned, made it impossible for these trustees to consider the corporation, in which they had invested, as anything other than an instrument for enhancing their funds' beneficiaries.

The Roundtable made a similar case for public pension fund trustees. Although ERISA did not directly apply to public pension funds, its provisions reinforced the common law dictates that defined trustees' responsibilities. Here, the Roundtable brought to the SEC's attention an important fact: public pension fund trustees were political appointees. This, the Roundtable insisted, shifted public pension fund trustees' obligations away from their plans' beneficiaries to local political "bosses" who were responsible for the trustees' appointments. This political dependency made it impossible for the trustees to oversee the corporate enterprise impartially. In fact, the Roundtable

69. American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (St. Paul, Minn., 1994).

70. Robert Rosenbaum, a partner in Washington D.C. law firm Arnold & Porter, elaborated this argument when he represented the Business Roundtable in its fight over SEC proxy reform. See Robert Rosenbaum, "The Fight Over Proxy Reform; Institutional Investors: On a Control Trip," *Legal Times* (9 Dec. 1991), 26; and Robert Rosenbaum, "Big Investors' Push for Power," *Connecticut Law Tribune* (16 Dec. 1991), 16. For the opposing view see Nell Minow and Kit Bingham, "The Fight over Proxy Reform: Shareholders Are More Than Gate-Crashers," *Legal Times* (9 Dec. 1991), 26.

warned that proxy reforms based on the CalPERS letter might allow state officials to exercise indirect control over corporate strategic decisions. After all, during the 1980s, various state politicians and interest groups had sought legislation to require public pension funds to invest in projects that would spur local growth and job creation.

In addition, the argument continued, pension fund trustees lacked the expertise to make corporate policy. Funds had diversified their investments widely. They were invested in so many different firms, in fact, that no individual or team from the funds could effectively monitor the strategic operations being carried out by all the firms they invested in. The funds' orientation to the money market made takeovers an attractive option. If institutional investors were allowed to communicate freely, they could readily support hostile bids and leave managers with few countermeasures. In fact, under the proposed reforms, a corporate raider contemplating a hostile takeover could meet with or have telephone conversations with large institutional investors before filing an intent with the SEC. Because pension funds had grown into financial titans, the Roundtable asked the SEC to disallow communication among institutional investors that held 5 percent or more of a firm's outstanding votes.

The clash between corporate executives, who claimed control under the stakeholder banner, and institutional investors, who invoked shareholder rights rhetoric to gain power over managers, put the SEC into a quandary.⁷¹ In its final ruling, on October 16, 1992, the SEC appeared to yield much to CalPERS' original petition, but these reforms were, at best, a modest first step to undoing managerial control. However, because these reforms greatly reduced shareholder proxy costs, they appeared as a triumph for institutional investors.⁷²

71. When SEC Chairman Richard C. Breeden announced the commission's proxy review at a meeting of the Council of Institutional Investors on 2 April 1990, he ignored the CalPERS reform request and, instead, diplomatically cited individual shareholder complaints about leveraged buyouts as the cause for the review. This effort at recasting the issue had no immediate consequences for the battle taking place on the ground—a battle that forced the SEC to issue two releases.

72. Coffee, "The SEC and the Institutional Investor," summarizes all these arguments succinctly. Also see Carol Goforth, "Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late," *American University Law Review* 43 (Winter 1994): 379–465; Norma M. Sharara and Anne E. Hoke-Whitherspoon, "The Evolution of the 1992 Shareholder Communication Proxy Rules and Their Impact on Corporate Governance," *Business Lawyer* 49 (Nov. 1993): 327–57; Lori B. Marino, "Comment: Executive Compensation and the Misplaced Emphasis on Increasing Shareholder Access to the Proxy," *University of Pennsylvania Law Review* 147 (May 1999): 1205–48. Thomas W. Briggs, "Shareholder Activism and Insurgency under the New Proxy Rules," *Business Lawyer* 50 (Nov. 1994): 99–153; Joseph Evan Calio and Rafael Xavier Zahralddin, "The Securities and Exchange Commission's 1992 Proxy Amendments: Questions of Accountability," *Pace Law Review* 14 (Summer 1994): 459–539.

The position of managers had not changed, but the ruling once again put managers on the defensive. The SEC's favorable inaction did not occur because of the Roundtable's persuasive case. Rather, the SEC acted conservatively, in a manner that would neither cause much disruption nor put small shareholders at a disadvantage. This recognition would merely set the preconditions for managers' embrace of shareholder wealth maximization. For managers to abandon their old technocratic perspective, they had to find shareholder ideology congruent with their interests. Corporate and executive compensation reform brought manager's interests into alignment with agency theory—though for reasons that agency theorists would eventually decry as opportunistic.

Executive Composition, Board Composition, and Managerial Hierarchies

Even Andrew Sigler could not have predicted the ideological reorientation that the Business Roundtable would undergo, from a stakeholder to a shareholder advocacy group. In the 1990s, tax law changes, a skyrocketing equities market, and corporate governance reforms linked managers to shareholders, even if imperfectly, and prompted managers, especially CEOs, to think of themselves as shareholders—albeit of a special class. Together, these changes fostered a tournament for the CEO title and bestowed on its winner the right to a proprietary fortune.

The Tax Reform Act of 1993 triggered the wide adoption of stock options. Ironically, the act arose from Democratic concern over growing inequities between corporate executives and workers. The concern about top executive pay arose as shareholder and union groups issued compensation surveys that documented the rapid increase in executive pay, especially when compared to declining blue collar gains. These stark comparisons revealed how prosperity benefited a few and imposed costs on many.⁷³

Although Congress did not pass legislation, the SEC initiated several reforms. In 1992, it revised executive compensation disclosure rules, requiring firms to compare executive compensation and performance to an industry benchmark, to estimate the present value of top executive option plans, and to issue a report from the compensation committee detailing its measures for evaluating executive performance.⁷⁴ In

73. Levy, *The New Dollars and Dreams*.

74. Tod Perry and Marc Zenner, "CEO Compensation in the 1990s: Shareholder Alignment or Shareholder Expropriation," *Wake Forest Law Review* 35 (Spring 2000): 123–45, especially 128.

the same year, the SEC reversed itself and allowed shareholders to issue proxy statement proposals on executive compensation.

Despite shareholder activist protests, the Democratic-controlled Congress passed a tax bill in 1993 that raised the top tax rate to 39.6 percent on individual income over \$250,000. The act also limited corporations' ability to expense executive salaries over a million dollars. These egalitarian measures forced managers to recalculate the tradeoff between capped salaries and uncapped but "risky" options. Managers had little trouble in doing the math. They quickly shifted compensation from salary to stock options, and it came at a propitious moment. Beginning in 1993, the stock market began to grow at rates that would defy the historical record and allow top-tier executives to amass personal fortunes. This convinced managers that aligning their interests with shareholders made good economic sense.

Still, institutional investors and managers disagreed on how to best structure these options and report them as a cost to the corporation. If companies were required to actually deduct the expected cost of the stock options from their earnings statements those earnings could be significantly reduced. This, in turn, posed the threat that reduced earnings would lower stock share prices and, in turn, reduce the stock option gains that CEOs were now expecting to receive as an ever-increasing proportion of their compensation packages. This issue sparked another political roil between managers and shareholders. In January 1992, the Financial Accounting Standards Board (FASB) revived a dispute that began in the 1980s and was, then, put aside under pressure from corporate management. At issue was FASB's consideration of whether and how stock options should be revealed and expensed on corporate balance sheets. In May 1992, FASB, at SEC urging, proposed rules on accounting for stock options and, in turn, the Business Roundtable unleashed the full array in its political arsenal to successfully counteract the moves and retain the right to bury the estimated cost of stock options in the footnotes of their reports to the SEC and the shareholders.⁷⁵

By the end of the 1990s, the SEC, the New York Stock Exchange, and the NASDAQ had all called for reforming corporate boards in attempts to limit the power of corporate managers who maintained

75. Robert Van Riper, *Setting Standards for Financial Reporting: FASB and the Struggle for Control of a Critical Process* (Westport, Conn., 1994). Institutional investors rarely engaged in proxy battles around executive pay. Institutional investors typically voted for management, presumably to express confidence in management's ability to sustain the stock market's steep increase. See Marino, "Comment: Executive Compensation," 1207–31. See also Schwab and Thomas, "Realigning Corporate Governance," 1052–75.

effective board control. These proposals advocated smaller corporate boards and boards in which outside or independent members outnumbered the management insiders, both overall and on key committees. These calls for change, however, had little practical importance for the Business Roundtable member firms, since they had already done much to comply with the “Statement’s” recommendations. In fact, the Roundtable’s member firms were setting an example for the rest of the corporate sector.⁷⁶ On close scrutiny, however, these enlightened practices actually fit the self-interest of CEOs. In responding to institutional investor demands, tax reforms, and a bull market, the Roundtable’s CEOs had captured control of the corporate boards and awarded themselves handsome compensation packages, while claiming that they were merely deferring to shareholder demands.

This sleight of hand becomes apparent when one examines the changes in board composition and executive compensation among the Business Roundtable’s 140 members between 1987 and 2001. In reviewing these data, remember that four categories provide our standards for distinguishing between the technocratic and the proprietary managerial hierarchies: (1) the CEO compensation package relative to senior management, (2) the ratio of insider to outsider board directors, (3) the ratio among outsider CEOs (current and retired) to non-CEOs, and (4) the substance of managers’ professional creed. The first measures how closely CEOs stand to their fellow senior managers. The second measures the degree of managerial control versus external control. Technocratic firms exhibit solidarity in pay scales among managers and grant managers a high degree of control. The third measures the strength of an independent “oversight” group on management. The last expresses how widely (or narrowly) managers define their public responsibilities.

SEC 10K filings by the Roundtable firms between 1987 and 2001 revealed that the average CEO salary began at approximately \$750,000 in 1987 and ended just under \$1.2 million in 2001. The second-highest-paid executive started at \$600,000 in 1987 and capped at just over \$650,000 in 2001. Thus, in 1987, the average salary for the second-highest-paid executive was approximately 84 percent of the CEOs’ average. By 2001, the proportion had fallen to approximately

76. During the 1980s, the large corporate boards and the number of insiders shrank among big firms. In a study of Standard & Poor’s (S&P) 400 companies, Jay Lorsch and Elizabeth MacIver found that 74% of these firms’ directors were outsiders and, of these, 63% were CEOs. Jay Lorsch with Elizabeth MacIver, *Pawns or Potentates: The Reality of America’s Corporate Boards* (Boston, 1989), 17–19. These trends continued through the end of the 1990s and were endorsed by the Business Roundtable. See the Business Roundtable, “Statement on Corporate Governance,” (Washington, D.C., Sept. 1997), 10–16.

55 percent. This widening differential would be much higher if we had incorporated stock options. Because dollar evaluations are so controversial, we collected the absolute number of options granted. When converted into dollars, these options greatly augment executive compensation.⁷⁷

As the compensation differential increased over the period, board size decreased, from an average of sixteen directors in 1987 to twelve in 2001. Among these board members, current or retired CEOs from other companies increased their average number on boards from three seats in 1987 and to six in 2001.⁷⁸ More important, CEOs within this network facilitated the displacement of insiders for outsiders.⁷⁹ Although most large companies created official nominating committees on their boards, the anecdotal and available empirical evidence suggests that CEOs dominated the process of identifying, nominating, and choosing new members as they did in

77. Based on data from the Corporate Library and public company filings with the U.S. Securities and Exchange Commission.

78. Other studies find similar patterns. In 1998, Spencer Stuart found an average of 12 board members with 3 insiders from proxy data of the S&P 500. Korn/Ferry found an average of 11 directors with 2 outsiders. In their 2001–2002 survey, the National Association of Corporate Directors found an average of 8 directors and 3 insiders. Among manufacturing firms, the CEO had the only guarantee of a board seat. See Directorship, *Significant Data for Directors: Board Policies and Governance Trends* (Greenwich, Conn., 1999), which is a study of *Fortune* 1000 proxy statements; James Kristie, “Board Trends 1970s to the 1990s: ‘The More Things Change . . . ,’” presentation to the Institutional Shareholder Services, Washington, D.C., Feb. 1999; and Hamilton, “Corporate Governance in America.” In other industries, one or two senior executives would join the CEO on the board. The Conference Board, *Directors’ Compensation and Board Practices in 2000* (New York, 2000), 34. On recent views, see Jill E. Fisch, “Corporate Governance: Taking Boards Seriously,” *Cardozo Law Review* 19 (Sept. 1997): 265–90; April Klein, “Firm Performance and Board Committee Structure,” *Journal of Law and Economics* 75 (April 1998): 275–301; Allen Kaufman and Ernest J. Englander, “A Team Production Model of Corporate Governance,” Working Paper, Social Science Research Network (July 2003) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410080. Some argue that inside directors are needed to restrain excesses that executive tournaments can foster. See Donald C. Langevoort, “The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability,” *Georgetown Law Journal* 89 (April 2001): 797–832.

79. Edward Zajac and James D. Westphal, “Accounting for the Explanations of CEO Compensation: Substance and Symbolism,” *Administrative Science Quarterly* 40 (June 1995): 283–302; James D. Westphal, “Collaboration in the Boardroom: Behavioral and Performance Consequences of CEO-Board Social Ties,” *Academy of Management Journal* 42 (Feb. 1999): 7–24; James D. Westphal and James W. Frederickson, “Who Directs Strategic Change? Director Experience, the Selection of New CEOs, and Change in Corporate Strategy,” *Strategic Management Journal* 22 (Dec. 2001): 1113–37; Mason A. Carpenter and James D. Westphal, “The Strategic Context of External Network Ties: Examining the Impact of Director Appointments on Board Involvement in Strategic Decision-Making,” *Academy of Management Journal* 44 (Aug. 2001): 639–60.

the technocratic era.⁸⁰ In this new proprietorship era, fewer and fewer directors were chosen, and the CEO wielded even more influence in bringing in board members, most of whom were not fellow senior managers from the firm, but fellow CEOs from other firms. The result was to solidify CEO control of the board, at the expense of both outsiders and fellow inside managers.

The Business Roundtable and the New Managerial Creed

By three measures, then, the technocratic model had been unseated. CEOs had become a distinct class, received higher compensation, and wielded more power than their fellow managers. Yet they had also fended off challenges to their autonomy from outsiders. What about the final measure—business creed?

Like other *Fortune* 500 firms, the Business Roundtable's member firms participated in the diffusion of this network of corporate boards with increasingly smaller size and an increasingly larger percentage of current and former outside CEOs. But, in contrast to its nonmembers, the Business Roundtable systematically reflected the intra/inter-corporate structural reforms. These considerations led the Roundtable to rework the managerial thesis from a technocratic to a proprietary creed.

From the 1980s on, Business Roundtable members witnessed a dramatic alteration in their boards' structures and composition. In 1987, Business Roundtable member firms had an average board size of thirteen, of which four were insiders and nine were outsiders. By 2003, the board average had shrunk to eleven members with an average of only two insiders to accompany the nine outsiders. Of these outsiders, active and retired CEOs from other companies made up 31 percent of the board in 1987 and nearly doubled to 57 percent

80. See Lorsch, *Pawns*, 20–31; Robert A. G. Monks and Nell Minow, *Watching the Watchers: Corporate Governance for the 21st Century* (Cambridge, Mass., 1996), 182–87; Ralph D. Ward, *21st Century Board* (New York, 1997), 226–33; Anil Shivdasni and David Yermack, "CEO Involvement in the Selection of New Board Members: An Empirical Analysis," *Journal of Finance* 54 (Oct. 1999): 1829–53; Benjamin E. Hermalin and Michael S. Weisbach, "Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature, Working Paper 8161, National Bureau of Economic Research (Cambridge, Mass., March 2001); James D. Westphal, "Board Games: How CEOs Adapt to Increases in Structural Board Independence from Management," *Administrative Science Quarterly* 43 (Sept. 1998): 511–37; Eliezer M. Fich and Lawrence J. White, "Why Do CEOs Reciprocally Sit on Each Other's Boards?" Working Paper No. 01–002, New York University Center for Law and Research (New York, Dec. 2000).

in 2003. Moreover, the all-important nominating committee averaged approximately 4 members, of whom almost all, on average, were outsiders.

As this organizational reformation proceeded amidst economic restructuring and downsizing, the Business Roundtable gradually shunned its technocratic creed for a proprietary one. Looking backwards, one sees the Roundtable now appears to have been ideally suited for articulating the new managerial creed.

The shift was unexpected, if one starts with the Roundtable's position circa 1980. By that point, the Roundtable had identified labor unrest, social regulation, and welfare transfers as stagflation's fomenters. This analysis easily persuaded the politically eager Business Roundtable to engage as Republican partisans in the 1980 Presidential and congressional elections. The Republican victory in the Senate, the gains made in the House, and Reagan's capture of the White House relegated liberalism to minority status, diminished labor's political credibility, and elevated the Business Roundtable as a political coalition broker.⁸¹

Still, at this point, the Roundtable repeated its commitment to impartial stewardship in the technocratic mode. The Watergate scandal and its impact on American society had first prompted the Roundtable to consider issues of corporate governance and managerial accountability. In 1978, the Roundtable issued a statement on the role and composition of the corporate board. Although rejecting most of the criticisms and the calls for wholesale changes that had surged after the Watergate revelations, the Roundtable agreed that the majority of board members should be nonmanagement directors. But, the position of the Roundtable remained that corporate boards should oversee both the firm's financial performance and its commitment to social responsibility. Only one year after the Reagan revolution, the Roundtable formalized its adherence to the technocratic creed when it issued a "Statement on Corporate Responsibility."⁸² There, it spoke both of managers' obligations to the firm's various constituencies and of managers' responsibilities to broker deals among these stakeholders. Thus, despite the Roundtable's political assaults and despite ongoing efforts by corporations to exact profit-enhancing concessions from labor, the Roundtable reiterated managers' technocratic neutrality.

81. Kaufman, Zacharias, and Karson, *Managers vs. Owners*, 135–39, 161–194; Walter Dean Burnham, "The 1980 Earthquake: Realignment, Reaction or What?" in *The Hidden Election: Politics and Economics in the 1980 Presidential Election*, ed. Thomas Ferguson and Joel Rogers (New York, 1981), 98–140.

82. The Business Roundtable, "Statement on Corporate Responsibility."

Of course, this credo was well suited for the Business Roundtable's vigorous lobbying campaign against takeovers. But once the takeover threat disappeared, the Roundtable soon abandoned its neutrality clause. The proprietary incentive system, spurred by the Tax Reform Act of 1993, labor's decline, and institutional investors' rise, convinced the Roundtable that a new doctrine was needed. In 1997, it issued a new report on corporate governance.⁸³ This report radically departed from the managerial thesis that had—since the 1920s—justified managers' control over the modern corporation.

The document discarded managers' explicit fiduciary obligation to the firm's contractual and noncontractual stakeholders, and managers' implicit obligation to sustain economic opportunity and stabilize democratic government.⁸⁴ Managers, according to the Business Roundtable's new doctrine, owed only shareholders a fiduciary duty. Even this duty was questionable. After all, executive compensation packages included generous stock option plans. These effectively turned managers into shareholders, albeit a special class of shareholders. The new compensation plans allegedly reconnected ownership with control and reinstated market rules for trustee obligations. Such property-based managerial incentives beguiled managers (and policymakers) that their pursuit after personal gain was *de facto* serving the greater good.

Some critics charged that these new incentives were merely a ruse for excessive managerial compensation. This charge the Roundtable did not address.⁸⁵ CEOs themselves had to counter such criticisms, even those that had emerged among their erstwhile supporters, financial agency theorists.⁸⁶ For example, Jack Welch, GE's Chairman during this period, repeatedly defended his and his fellow CEOs' high pay, both in the press and in his autobiography.⁸⁷ Unlike his predecessors at GE, most notably Owen Young, Gerald Swope, and Reginald Jones (whom the Business Roundtable quoted in its 1981 document), Welch claimed that the CEO acted separately from GE's hierarchy. The CEO was in effect the intrafirm entrepreneur, who had battled managerial bureaucrats to uncover new wealth-creating opportunities. Managers competed against one another to prove

83. The Business Roundtable, "Statement on Corporate Governance."

84. Allen Kaufman, "Managers' Double Fiduciary Duty: To Stakeholders and to Freedom," *Business Ethics Quarterly* 12 (April 2002): 189–214.

85. Lucien Arye Bechuk and Jesse M. Fried, "Executive Compensation as an Agency Problem," *Journal of Economic Perspectives* 17 (Summer 2003): 71–92.

86. Brian J. Hall and Kevin J. Murphy, "The Trouble with Stock Options," *Journal of Economic Perspectives* 17 (Summer 2003): 49–70.

87. Jack Welch and John Byrne, *Jack: Straight from the Gut* (New York, 2001); Jack Welch, "My Dilemma—And How I Resolved It," *Wall Street Journal*, 16 Jan. 2002, A-14.

themselves the “best” champion of change, and to win the CEO prize. As intrafirm entrepreneurs, those few who won the tournament deserved rewards proportionate to the risks they had taken

Welch and others who defended CEOs’ post-1993 compensation packages forgot to remind the public that high salaries brought another incentive: to establish a family fortune that could extend over generations. In this respect, CEOs refashioned the firm’s hierarchy to imitate the Schumpeterian proprietary model. But, unlike Schumpeter’s analysis, in which the entrepreneur acted largely alone and was the sole owner, the CEO acted as part of a group, part of a complex organization. CEO contributions could hardly be disentangled from the contributions of others, because the firm functions as a wealth-creating team. Team production, particularly in the 1990s, made marginal contributions impossible to disentangle from the aggregate.

The Business Roundtable and its member CEOs adhered to their proprietary view of the firm, even in the wake of proprietary-caused scandals, such as the collapse of Enron. As the Enron scandal deepened, President George W. Bush lobbied the Roundtable for help. In a well-publicized meeting, the president cajoled the Roundtable to take positive steps in restoring investor confidence.⁸⁸ The Business Roundtable responded with statements, documents, and actions, but all reaffirmed the governance principles and practices formulated in 1997.⁸⁹ After all, CEOs were doubly hurt by managerial malfeasance: corporate sector CEO reputations were soiled from the corrupt practices of a few executives. As shareholders, CEOs financially suffered from corporate misreporting and investor defections.

The End of Managerial Ideology

By historical standards, the twentieth century’s concluding decades were ones of prosperity and peace. Nevertheless, during the 1980s and 1990s, the institutions and norms that had structured the post-World War II technocratic doctrine came undone. When reconfigured, the modern corporation had an incentive system that prompted managers to renounce technocratic neutrality. In its place, managers

88. Mary Williams Walsh and Claudia A Deutsch, “Is Reform Possible Here?” *New York Times*, 14 July 2002, sec. 3, p. 1.

89. The Business Roundtable, “Principles of Corporate Governance,” (Washington, D.C., 14 May, 2002); the Business Roundtable, “Statement of the Business Roundtable: The Business on Corporate Governance Principles Relating to the Enron Bankruptcy” (11 Feb. 2002), at <http://www.brtable.org/document.cfm/650>; the Business Roundtable, “A Message to the American People from America’s CEOs” (9 July 2002), at <http://www.brtable.org/document.cfm/732>.

crafted a proprietary doctrine that neatly elaborated a justification for their increasing use of stock incentive plans.

The organizational reshuffling revolved, as it had since the early twentieth century, around the firm's size and its governance structure. The economic shock that put things ajar was slight compared to the Crash of 1929, yet the underlying forces—technological advancements, global competition, and reified regulatory institutions—had sufficient power to propel corporate managers to radical action. On the political front, the Business Roundtable formed a CEO phalanx that joined with conservative Republicans. On the economic front, managers engaged in corporate restructurings—which in manufacturing frequently ended in downsizing and in the retail and service sectors ended in upsizing.⁹⁰

Among the conservatives whom the Business Roundtable allied politically, there were many who from the first had rejected the technocratic managerial thesis. Inspired by the work of Frederick A. von Hayek, economists and legal scholars, primarily at the University of Chicago, looked to competitive market principles, property rights, and the individual natural rights as the correct basis for firm governance structures.⁹¹ Together these scholars chided regulatory proponents for establishing institutions that suppressed market mechanisms and individual liberty in favor of inefficient technocratic neutrality.⁹²

On the matter of corporate social responsibility, these critiques were particularly sharp.⁹³ Markets tempered managers, leaving them no discretionary room. Those who attempted to respond to the demands of other stakeholders were merely putting their firms at a long-term disadvantage. And these managers themselves were misappropriating resources for either personal or political gain. In fact, these property-rights theorists warned that, should managers vigorously pursue corporate social responsibility, they would inevitably use their considerable economic power to subvert democratic processes.

90. William J. Baumol, Alan S. Blinder, and Edward N. Wolff, *Downsizing in America: Reality, Causes, and Consequences* (New York, 2003).

91. Friedrich A. von Hayek, *The Road to Serfdom* (1944; Chicago, 1994); Friedrich A. von Hayek, *The Constitution of Law* (Chicago, 1978).

92. Ely, *The Guardian of Every Other Right*, 135–56; Bernard H. Siegan, *Economic Liberties and the Constitution* (Chicago, 1980); Richard A. Epstein, "Toward a Revitalization of the Contract Clause," *University of Chicago Law Review* 51 (Summer 1984): 703–51.

93. Milton Friedman, "The Social Responsibility of Business," in *Business and Society: Economic, Moral and Political Foundations*, ed. Thomas G. Marx (Englewood Cliffs, N.J., 1985), 145–50.

When financial agency theorists modeled managers' self-serving behavior, they presented the modern corporation (as Berle and Dodd had done) as an incongruity: those who owned the firm did not control it. And those who controlled had no interest in promoting the owners' welfare.⁹⁴ To resolve this conflict, these theorists argued that managers should either have property-based incentives (stock grants) or they should own the firm via a leveraged buyout.⁹⁵ Either would reunite ownership with control and reconstitute the firm as an efficient market institution. The Business Roundtable shied away from this conservative (classical liberal) school at first. But, the confluence of economic forces and political choices created powerful managerial opportunities that overcame "socially responsible" resistance to property-based rhetoric.

By 2001, the CEOs who sat on the Business Roundtable had adapted many of the principles of the agency theorists to their firms. The corporate tournament had converted top executives into proprietors, and the CEO prize had created an intercorporate board network in which the new managerial proprietors crafted an identity. In fact, despite their homage to market theory, the CEO class was rather adverse to market risks in their compensation, and made sure they protected themselves there, as well. The socially biased corporate boards repriced the stock options of CEOs that fell below the exercise price, and awarded executives options independent of the firm's performance relative to the industry benchmark.⁹⁶

Through the generous compensation packages, CEOs frequently had stakes large enough to establish family fortunes. Like the entrepreneurs of the late and early twentieth century, managers looked at the firm as a vehicle for familial social positioning and attacked progressive taxation as deterrent for passing on wealth.⁹⁷ But, unlike the entrepreneurs of earlier times, the propertied CEOs of the twenty-first century did not rely on investment bankers and the social register to reproduce their wealth and assure their position. The CEO prize brought its winners into the intercorporate directory and its dense social network.

Ironically, CEO cohesion first congealed through political solidarity in the Business Roundtable. Managers, confronted in the 1980s by

94. Fama, "Agency Problems and the Theory of the Firm"; Eugene F. Fama and Michael C. Jensen, "Agency Problems and Residual-Claims," *Journal of Law and Economics* 26 (July 1983): 327–50.

95. Jensen, "The Eclipse of the Public Corporation."

96. Lucian Arye Bebchuk, Jesse M. Fried, and David I. Walker, "Managerial Power and Rent Extraction in the Design of Executive Compensation," *University of Chicago Law Review* 69 (Summer 2002): 751–846.

97. Phillips, *Wealth and Democracy*.

takeovers and by their declining economic status, rallied to protect managerial capitalism. But, as they gradually adjusted public policy and their firms to the new circumstances, they found the managerial thesis wanting. When the Roundtable reflected on the new order that had emerged, these CEOs scrapped their technocratic creed for a simpler proprietary doctrine. They responded rhetorically to newly empowered institutional investors. By accommodating these economic institutions, managers distanced themselves from an enfeebled trade union movement. Managers' proprietary calling demanded that they actively aim to maximize shareholder wealth, even if this entailed a transfer of wealth that left workers and others with stagnant and even declining incomes.

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