THE ALLEGED SEPARATION OF OWNERSHIP
AND CONTROL IN THE THEORY OF
THE FIRM: A DYNAMIC, HISTORICAL APPROACH

by

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No. 238.

October, 1983

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This paper is circulated for discussion purposes only and its contents should be considered preliminary.
ABSTRACT

The paper suggests that the largely static, ahistorical existing literature on the theory of the firm is inadequate in its treatment of the control issue. It tends to classify firms as either owner or manager controlled using an *ex post* analysis of share distribution. In contrast, this paper reverses the direction of causality, explaining the control of firms in a dynamic, historical framework. It concludes that the observed distribution of shares will suffice to give a subset of owners control. The arguments are illustrated by a series of diagrams, and supported by an examination of recently reported empirical evidence.
Existing literature on the separation of ownership and control in the theory of the firm is largely confined to a static, ahistorical context.\(^1\) It tends to view modern firms as different, both quantitatively and qualitatively, from their predecessors. Whereas the latter are seen as under the control of their owners, the large corporations of today are classified as either owner or manager controlled. This classification is based upon an \textit{ex post} analysis of share ownership\(^2\): if no cohesive group of shareholders - i.e. owners - is found to possess more than a fixed percentage of shares, the conclusion is that owners do not have control, which is assumed to pass to managers.

In contrast, the aim of this paper is to present an evolutionary approach to the theory of the firm.

Section 2 explores the theoretical framework, attempting to establish an alternative perspective on the control problem, and presenting a diagrammatic exposition of the argument and some alternatives. Beginning from the position where an owner(s) has control and recognizing that control is inherently beneficial, it is argued that owners will assess the percentage of shares others can obtain before control is lost. That is, it is suggested that causality in reality runs from control to share distribution. In general, the observed distribution of shares will suffice to give a subset of owners - "capitalists" - control.

The view taken is that this approach is more plausible than alternatives, and as such the burden of empirical proof must lie with those favouring these alternatives.\(^3\) Section 3 considers the existing evidence, both direct
and indirect. The hypothesis that capitalists control firms performs at least as well as the alternatives.

Finally, Section 4 concludes the paper with a brief summary.

2. CONTROL OF THE FIRM: A THEORETICAL FRAMEWORK

2.1 WHAT DOES CONTROL MEAN?

To avoid semantic misunderstandings, it is initially essential to consider the question: what does control mean? 4)

Throughout the paper, control implies the ability to determine broad corporate objectives, despite resistance from others. By broad corporate objectives, we refer to decisions taken over strategic issues, such as "the rules of the game" (i.e. a firm's relationship with rivals), the national or international orientation of the firm, and its relationship with the state, foreign governments, workers (and other non-controlling groups in the firm), sources of raw materials, and markets. See Zeitlin (1974). Control does not imply the making of day-to-day decisions over tactical issues, such as promotional activities, the choice of particular projects from a set of alternatives, etc. Whereas these issues are significant for the short run smooth functioning of the firm, it is our assumption that, subject to rare exceptions 5), it is the long run strategic decisions which determine the success or failure of the firm.

Although the remainder of the paper simply refers to control, it should be noted that such control can in fact be "actual" or "potential".

Thus, from the time a strategic decision is taken, the problem of
the best way of implementing it arises. This is not necessarily the concern of those taking the decision; it may be left to others specifically employed and/or trained for such a purpose. These individuals may be left with discretion as to the exact means of implementation, but this only implies control if two conditions are met:

(i) The exercise of discretion replaces the strategic decision with another, and
(ii) it succeeds in implementing this decision despite resistance from the original decision takers.

This would essentially be a transfer of control, a possibility analysed later in the paper.

If neither (i) nor (ii) is satisfied, control is with the original decision takers. However, if condition (i) is satisfied but (ii) is not, the situation is one of actual control; i.e. a strategic decision is altered but resistance from the original decision takers results in the original decision being implemented. Moreover, it is also possible that these day-to-day decision takers challenging the strategic decision will be punished, for example sacked, or not promoted.

However, in practice prospective challengers to a strategic decision can often be expected to realise the futility of a challenge, or to appreciate that a challenge would merely lead to their punishment. Therefore, they will not attempt to change a strategic decision. That is, control is more likely to be potential rather than actual, albeit this is equally as real. See also Zeitlin (1974), Scott and Hughes (1976), and Nyman and Silverston (1978).
Finally as regards definitions, note that throughout the paper, control exercised via a holding of shares is defined as owner control, whether or not those owners also play a role in the day-to-day decision making of a firm. In particular, the paper makes no attempt to analyse the consequences of control exercised by those who also make day-to-day decisions as against control exercised by those who do not make such decisions. 6)

2.2 AN ANALYTICAL FRAMEWORK

Consider now the following situation. Firm F - a typical firm in nineteenth century capitalism - is a small enterprise owned entirely by individual(s) C - where C represents "capitalist(s)". Workers are employed to perform certain tasks, but C is in total control of the firm. Thus, firm F is indisputably an owner controlled firm.

Suppose now that the firm expands. Will control be lost by C? If so, to whom? The answer to these questions can be sought in an exploration of the two critical needs of an expansion, namely:

(i) finance - e.g. a new factory must be paid for - and
(ii) managers - to administrate the now more complex and bulky firm organization.

The prevailing view amongst economists appears to be that C does lose control, and to management. See, for example, Marris and Mueller (1980). This is based upon the observation that finance is obtained by the issue of shares in the firm to (often) numerous shareholders. The latter own the firm, possessing the right to hire and fire management, and receiving a
dividend on each share. However, because there are (often) so many shareholders, it is argued that, save in exceptional circumstances, the power to hire and fire is to all intents and purposes non-existent. Managers therefore have discretion in following their own objectives. See also Scott (1979).

This managerial approach is deficient on at least three closely related counts:

(i) It is unclear where the notion that exceptional circumstances results in owners' intervention fits within the overall concept of control. Exactly what does this power of intervention entail? This deficiency of managerialism arises from a failure to explore the meaning of control.

(ii) Even if it is accepted that owners lose control, managerialists only assume that managers have control. See Zeitlin (1974). But why not workers, for example?

(iii) In their largely static, ahistorical analysis, managerialists have never adequately explained why the original owner(s) should be expected to lose control to managers. Put another way, the critical issue is: given that C initially controls the firm, why should C, in choosing that the firm expands, choose to give away control?

(iii) is the fundamental issue that will now be addressed.

The first point to note follows from the definition of control. The ability to determine broad corporate objectives despite resistance from others implies something inherently beneficial in possessing control. That is, whoever possesses control can make the firm follow a strategy that
best suits his (or their) interests, rather than one preferred by others. The essence of the issue is consequently distributorial, namely: who is to benefit and who lose as a consequence of the alternative strategies for deploying the often vast resources available to a firm? Moreover, it should also be recognised that control may be desired in its own right, not simply because it enables its possessor to pursue other ends desirable per se, but because the power to make decisions confers utility; see, for example, Rothschild (1971).

Thus, there is an a priori expectation that C will not be willing to give away his (their) control. It would be surprising, assuming C has any option, if he (they) chose expansion and as a result lost control, thereby losing the benefits it confers. More likely is the prospect that expansion and the maintenance of control are chosen.

Such an outcome merely requires a weak non-satiation assumption: assuming the consumer — in this instance C — is not satiated in either of two non mutually exclusive goods — in this instance, expansion and control — then both goods will be consumed.

For obvious reasons, direct evidence on this issue is difficult to acquire; owners will be reluctant to voice their intention not to give away control. However, as a rare instance of this happening, Marglin (1974) reports the case of a nineteenth century owner who did not allow his manager to obtain perfect knowledge of the work process, as a means of preventing the manager from taking his business. This example indicates the will on the part of owners to retain control rather than giving it to managers, the implication being that owners will attempt to invent appropriate means by
which their desire is realised. Unless their failure and/or unwillingness is proved beyond doubt, the expectation should be that C will retain control.

Nevertheless, it must be asked whether or not this a priori expectation can withstand closer scrutiny. The possibilities can be explored by considering an expanding firm's need for finance and managers.

2.3 AN EXPANDING FIRM'S NEED FOR FINANCE AND MANAGERS

First of all, consider the issue of shares. Broad corporate objectives can be voted upon and therefore determined at shareholders' meetings. The ability to win such votes can thereby determine who controls a firm. Thus, possession of sufficient votes can imply control.

Moreover, it is generally accepted that it is not necessary to have 51% of the shares to win a vote. For example, using a probability model Cubbin and Leech (1983) suggest that well under 10% may be more than sufficient, 2% or even 1% being enough in some cases. In practice, therefore, it could well be that in obtaining finance for the expansion of firm F, C retains a sufficient shareholding to maintain control. This is crucial.

Consider again the managerialist approach. This examines the ex post distribution of shareholdings, arguing: if C has less than a fixed percentage of shares - the percentage being assumed, e.g. in Berle and Means (1967), or evaluated, e.g. in Cubbin and Leech (1983) - the conclusion is that C has lost control, which, in the absence of other significant shareholdings, is assumed to pass to managers.
Such reasoning is not plausible. Causality in the managerialist argument runs from share distribution to control; failure to own a specified percentage implies loss of control. Yet it is surely more plausible to begin from the position where owner(s) C has control, recognize that control is inherently beneficial, and assume that C will at most obtain finance from others just to the point prior to the loss of control.^{10}

In reality, however, C may not have access to the financial reserves that allow the purchase of a controlling interest. One of two outcomes can be expected in this situation.

Given the benefits of control, C's first reaction will be to attempt to collude with another shareholder to form a controlling interest. It seems reasonable to assume that the costs of such collusion will, at least amongst a few shareholders, be very small compared to the benefits; a few well-timed business lunches, for example, may suffice. Following, for instance, Cubbin and Leech (1983), the exact number of shareholders needed in the controlling group depends upon the share distribution and the voting behavior of shareholders. However, the only case where collusion amongst more than a few shareholders will be necessary is where there is another group of shareholders competing for control. There would then be a struggle between these groups, one of which would emerge as in control - or, indeed, the groups may join forces. In any event, a group of shareholders - capitalists - will control the firm.

Neither of these expected outcomes will be realized if owners misjudge the critical percentage of shares necessary for control. This is a feasible possibility in exceptional cases but, if managerialism is to be accepted as realistic, it implies acceptance not only of the assumption that, in default
of owners control, managers control, but also of the view that all owners in all firms misjudge the critical percentage. Can it really be believed that all owners are incompetent? Surely not. Moreover, even where an exceptional mistake is made, recognising this owners can be expected to form a new cohesive group and regain control. 11)

The conclusion to be reached thus far is therefore that it is reasonable to hypothesise that a subset of owners - i.e. capitalists - control firms.

A further argument advanced by managerialists focuses upon information, namely: the many small shareholders in a firm do not have the information to monitor managers - i.e. they do not have the information to determine whether or not their interests are being served - and therefore do not control the firm. This directly contrasts with the neoclassical approach, in which all shareholders are taken to have, and to act upon, this information. See, for example, the exposition in Lambrinides (1973). What can be said of these two views?

Firstly, they reveal that our hypothesis of capitalist control implies that capitalists:

(i) can win a vote amongst shareholders, and

(ii) have the information upon which to vote.

That is, (i) and (ii) are both implicit in the statement that, for instance, 1% of shares suffices to control a firm. This is a plausible hypothesis. It seems reasonable to suggest that capitalists will assess and obtain the information they need for control. Why? Although obtaining information is not costless, the reward is the power to determine a firm's strategy. The benefits of the latter can be expected to warrant the acquisition of information.
This is not to say that managers have no discretion in their behaviour. In a world of uncertainty, there will always be discretion. But the crucial factor to realise is that this discretion is analytically parallel to that of workers. Similarly to the way in which the controller of a firm may be unsure what the worker can do, there may be uncertainty surrounding managers. Capitalists will not base their strategic decisions on perfect information, either as regards workers or managers. Nevertheless, imperfect information does not constitute failure to make the decisions.

The reason that less than 51% of shares is needed to control a firm - and thus a reason that the neoclassical approach is incorrect - is that many, indeed the vast majority of shareholders obtain their shares to receive dividends or capital gains, content in the knowledge that other shareholders are concerned with these issues. One possibility is that this vast majority is not interested in monitoring a firm's activities - perhaps, for example, they have complete trust in the minority controlling shareholders. Or it could be that each small shareholder considers futile an attempt to win a vote against a large shareholder. Then again, perhaps the vast majority cannot acquire information about the firm - for instance, they may have no "contacts" in the firm or industry.

But are we to believe this of C? More generally, are we to believe that larger shareholders will simply ignore corporate strategy and give managers, for example, a free hand? Surely not. Whilst their information may not be perfect, it is most unlikely that they get themselves into a position where it is non-existent, given the benefits of control. This view is supported by the fact that high level managers are normally recruited from the ranks of owners, or at least their close environment. That is, they are owners themselves,
and/or owners functionaries. See, for example, Nichols (1969), Nyman and Silberston (1978), and Francis (1980a). From this, it should be expected that high level managers have interests closely connected with owners rather than low level managers, and therefore will assist capitalists in their control of the firm. However, it should not be expected that capitalists only acquire their information from high level managers; rather, they will use outside sources, and indeed, their own wits in reaching their decisions.

Consider now another possible argument for manager control, albeit one apparently absent in the existing literature. This is the view that managers are in such short supply that they can demand control of the firm as the price of their services. C would pay this price if he (they) believed he would be better off as a shareholder in a manager controlled larger firm rather than himself controlling a smaller enterprise.

Note firstly that this is a bargaining problem again analytically parallel to the owner/worker relationship. For example, when a skilled craftsman is employed by a firm, a price is negotiated. It is theoretically possible that skilled craftsmen can demand control of the firm as the price of their services. Similarly, owners negotiate with managers.

Moreover, in reality this theoretical possibility of manager control is at most likely to be no more than a passing phenomenon. In the first place, the supply of managers is endogenous to the system, and at least partly determined by a firm's controllers. Managers are needed to administrate the firm. As with all "talents", the ability to administrate varies across the population, but at least to a large extent it is something that can be learnt.
It is no coincidence that numerous schools of management have emerged simultaneously with expanding firms. It is clearly in the interests of capitalists to encourage such schools. Moreover, firms can introduce internal training schemes, thereby producing their own administrators. Secondly, if the price of managers is control, it is by no means clear it will be paid; after all, the consequence of transferring control is the inability of capitalists to protect their interests, a heavy price indeed.

There is also a third, more important comment to be made. Suppose managers could demand control. Would they leave it at this? By definition of their position, shareholders could, if the supply of managers subsequently increased, sack their existing management and reclaim control. That is, owner control is at least only dormant. If managers have control, it is because it is allowed by owners. Thus, if managers have such a strong bargaining position, they should be expected to require shares as part of their payment. By becoming owners, they safeguard their control. But this is then owner control of the firm, not manager control.

The notion that owner control is at least only dormant is important. It was seen earlier when it was argued that owners could regroup to regain control if they misjudged their position. A crucial conceptual difference between owners and managers is that owners can choose whether or not they determine a firm's strategy. In this sense, managers always take a back seat.

Thus, the conclusion to be reached from the analysis in this and the previous Subsections is that it is reasonable to hypothesise that a subset of owners - capitalists - control firms. An aspect of the analysis deserving
particular emphasis is the inversion of causality as compared to managerialism. Rather than examining *ex post* what percentage of shares capitalists need for control - as managerialists have done - it is better, bearing in mind the benefits of control, to examine what percentage a subset of owners will allow others to obtain before control is lost. The share distribution observed in reality will then be one which suffices to give control to a subset of owners.

Such an approach accommodates two related ideas:

(i) the concept of fixed shareholding percentages as used by managerialists is artificial, and

(ii) the percentage of shares required for control may vary across firms - in one, for example, it may be 1%, in another 5%. The outcome depends upon the distribution of ownership, and groupings amongst shareholders.

The approach to control we are suggesting is similar to managerialism insofar as both assert something about reality without giving proof. However, the approaches contrast in their starting points; managerialism does not have a dynamic, historical perspective. It is this difference in perspective that makes managerialism less appealing than our approach.

A further criterion for choice between the approaches is the empirical evidence that can be marshalled - either direct evidence, or indirect evidence that examines implications of the approaches. This is the concern of the next Section.

First of all, however, it is useful to depict some of the arguments made above by a series of diagrams.
2.4 A DIAGRAMMATIC EXPOSITION

Figures 1-4 show various analyses of the control issue. In each, boxes are used to represent individuals or groups of individuals - "classes" - participating in a firm. As will become clear, the box at the top of each diagram - the box to which all others are linked - represents the controlling class. Thus, Figure 1 represents the starting point of Section 2.2. Firm F, typical of nineteenth century capitalism, is owned and controlled by a capitalist, C. The firm employs workers, W. Box C represents capitalists, box W workers, and box C is drawn above box W to show that, of the two classes, capitalists are in control.

![Diagram of control in a typical nineteenth century firm]

FIGURE 1: CONTROL IN A TYPICAL NINETEENTH CENTURY FIRM

Moving to the twentieth century, there has been an expansion of firms and a consequent controversy surrounding their control. Figure 2 depicts our suggested outcome. The need for finance implies that ownership is divided amongst shareholders. However, either the original controlling individual(s) can be expected to retain control, or control will pass to another subset of shareholders, which may or may not include the original controllers. In either case, the controlling owners can still be referred to as capitalists. Thus, in Figure 2, C and W again denote capitalists and workers respectively. S denotes the non-controlling shareholders, and M managers. 17)
FIGURE 2: CONTROL IN A TYPICAL FIRM TODAY

Figures 3 and 4 show the neoclassical and managerial approaches respectively. In the former, all shareholders have control - there is no dominant capitalist subset. Thus, in Figure 3 $S'$ represents all shareholders. This is a special case of Figure 2, where $C$ controls $S$. Again $M$ and $W$ depict managers and workers. Figure 4 shows the managerial approach. Not only is $C$ absent, but also managers, $M$, control all owners, $S'$, and workers, $W$. The reversal of the roles of $S'$ and $M$ in Figures 3 and 4 is due mainly to information differences.

Whereas Figures 1-4 depict various approaches in a consistent and therefore comparable framework, Figure 5 represents only the approach to the control of the firm advanced in this paper. In brief, beginning with firm $F$ owned and controlled entirely by individual(s) $C$, expansion implies a need for finance and management. The former results in the issue of shares. The original and/or new owners assess the percentage of shares required for control. If their assessment is correct, shareholders are divided into capitalists and others, capitalists having control, if it is
wrong, control passes to non-shareholders, but there will be a reassessment of the critical percentage needed for control. As regards managers, if they are in short supply they may become owners and thus controllers.
FIGURE 5: CONTROL OF THE FIRM
3. CONTROL OF THE FIRM: EMPIRICAL EVIDENCE

3.1 DIRECT EVIDENCE

A crucial, original aspect of the argument in Section 2 is the inversion of the causality used by managerialists. Thus, any empirical "evidence" that merely considers an ad hoc critical percentage of share ownership to determine control type is not really evidence at all. For example,\(^18\) when Berle and Means (1967) note that in 44% of the 200 largest US corporations no cohesive group of shareholders owns at least 20% of shares, this reveals nothing. In fact, the suggestion in Section 2 is that whatever share distribution is observed, this will be that which ensures control for a subset of owners, save if an exceptional mistake has been made and not rectified. That is, virtually all firms are expected to be owner controlled. Thus, as regards direct empirical examination of the issue, the implication is that as analysis becomes more detailed, so more firms will become classified as owner controlled. For example, the 44% of firms Berle and Means (1967) classify as having no cohesive group of shareholders with at least 20% of shares should, on closer examination, be revealed as actually owner controlled.

However, it is not entirely clear what a more detailed study entails. For instance, Scott and Hughes (1976) show that a more careful examination of shareholder groups reveals that the proportion of firms satisfying the managerialists' criteria for owner control is higher than might otherwise be expected.\(^19\) Analysing 220 Scottish registered firms with stock exchange quotations, they initially conclude that in 77% of cases an individual, institution, or cohesive group owns at least 5% of shares, and therefore classify these as owner controlled firms. Moreover, recognising that they
too may actually be owner controlled, some of the residual 23% were
examined in more detail. Sure enough, owner control was found to be more
widespread than initially concluded. For example, the Scottish and
Continental Investment Trust was included in the 23%, but closer study
revealed that nearly 20% of its shares were held by various members of the
Murray Johnstone group of investment trusts.

But what does such a result show? Whereas it may help to persuade some
who believe the managerialists' criteria is useful that in fact owners
control firms, if it is accepted that the criteria is inappropriate, such
studies do not in fact take the analysis much further.

What is needed is a departure from shareholder distribution analysis.
It is necessary to examine the policies actually pursued by companies and
assess whether or not these appear to be determined by owners or managers.
This is clearly a very complex, time consuming task, but it has been
attempted by Francis (1980).

Francis argues that, within a firm, the Chairman of the Board plays
a vital role. This is apparently a clear result of the Oxford Growth of Firms
Project (upon which the analysis is based):

"From observation, from interviewing and from administering a
questionnaire in the companies in our study it was clear that the
Chairman of the company was in a very dominant position. The role was
viewed, both by the incumbent and by senior managers, as the peak of the
firm's organizational hierarchy and not merely a \textit{primus inter pares} at
Board meetings. His influence in decision making was acknowledged by all
to be powerful." (p. 12)
Thus, Francis concludes that a detailed examination of who the chairman is - for example, an owner? - or how he came to be appointed - e.g. by owners? - will reveal the centre of control.

Time constraints restricted his study to a mere 17 firms. Nevertheless, the result is very illuminating: (at least) 15 of the firms were classified as owner controlled, and (at most) only 2 as controlled by their own professional management. These 17 firms were randomly drawn from a sample of 227 of the "top 250" UK companies in the "Times 1000" (1975-1976). Of these 227, in 110 - i.e. 48% - at least 5% of shares were owned by an individual, institution, or cohesive group. Admittedly 17 is a very small sample, but the proportion of owner controlled firms in the more detailed study was classified as 88%!

Such results are consistent with the analysis of Section 2. However, it should be remembered that the latter suggests the two management controlled firms found by Francis are either exceptional cases or, in a still more detailed examination, would be revealed as owner controlled.

Unfortunately, such evidence is not easily acquired. Although Francis' approach is very useful in highlighting the inadequacy of the fixed percentages type of criteria, and indicating that a more elaborate analysis is far from supporting the managerial approach, it is not conclusive.

Other direct evidence consistent with the analysis of Section 2 is reported cases of owners in fact replacing managers. For instance, Nyman and Silberston (1978) discuss the cases of a group of dissatisfied owners bringing about the replacement of senior managers in two UK companies,
Vickers and Debenhams. However, such evidence is also consistent with managerialism, given the latter's acceptance that owners can hire and fire managers in exceptional circumstances - see again the discussion in Section 2.2.

Nevertheless, a way in which the approaches can be distinguished is by considering their differing implications. Such indirect evidence is the concern of the following Subsection.

3.2 INDIRECT EVIDENCE

One indirect means of acquiring support for our approach is to observe changes in the organizational form of firms. As already emphasised, the idea that owners control does not deny the possibility of managers having discretion in the day-to-day decisions of a firm. Although such discretion does not constitute control, it does imply the possibility of managers attempting to change a strategic decision - see again Section 2.1. However, the original controllers can be expected to resist such a change, if it is attempted, and indeed to preempt the possibility of an attempt. Within this framework, the relatively recent phenomenon of the transition of most firms in the UK and Europe from a so-called U-form organization to an M-form organization can be explained.

The U-form organization is characterised by a board of directors and various divisions each responsible for a specific function - such as production, marketing, etc. - throughout the firm. Williamson (1970) has suggested that, as a U-form firm expands, there is a tendency for decisions over broad corporate objectives and the day-to-day operations of the firm to become entangled. In contrast, an M-form organization is characterised by a board
of directors responsible solely for determining strategic decisions, and a series of operating divisions - each responsible for its own production, marketing, etc. - making day-to-day decisions. Thus, the transition from U-form to M-form can be explained in terms of control. In the M-form firm, broad corporate objectives are determined by the board, which is only concerned with such issues. This allows the controlling group to focus upon the relevant control issues more easily than in the U-form organization.

Moreover, there is evidence supporting this view that organizational form is an issue of control. For example, Steer and Cable (1978) have concluded from a study of 82 UK companies over the period 1967-71 that a firm's profitability is affected by whether it has a U-form or M-form organization. This suggests that organizational form does affect a firm's strategic decisions.

These results fit neatly into our theoretical framework; the transition to M-form can be seen as a response by capitalists to an attempt by managers to seize control, or as a means of preempting an attempt.

However, the same cannot be said for the managerial approach. The only way managerialism could offer a sound explanation for this transition to M-form and its resulting constraint of low level managers to nothing but day-to-day decisions would be by arguing that a conflict arose over control between low level managers and high level managers (i.e. those having contact with the board). But this would merely undermine the very foundations of managerialism. Evidence referred to in the previous Section on the class origin of high level managers and their connections/relationships with owners takes on great importance. If, as posited, high level managers
are owners themselves, or owners functionaries, the observed conflict would in fact be one of owners versus managers, not an endo-managerial conflict.

Consider finally an implication which distinguishes our approach from neoclassicism; that is, from the view that all owners have control. Fortunately, empirical evidence on this issue is easier to acquire, at least as regards one of the important implications of the two hypotheses, namely: the consumption-savings decision of households.

In its general form, the private (i.e. personal plus corporate) savings function can be written:

\[ S_{t}^{Prv} = s(y_{t}^{Prs}, S_{t}^{C}, z_{t}) \]

where, in period \( t \) : \( S_{t}^{Prv} \equiv \text{private saving}, y_{t}^{Prs} \equiv \text{personal disposable income}, S_{t}^{C} \equiv \text{corporate retentions}, \) and \( z_{t} \equiv \text{a vector of "other" explanatory variables.} \)

At least in the "Life-Cycle" form expounded by Ando and Modigliani (1963), the neoclassical hypothesis of consumption-savings behaviour by households implies that the estimated coefficients of the \( y_{t}^{Prs} \) and \( S_{t}^{C} \) variables should be the same. This is discussed more fully by Pitelis (1982), (1983). The outcome basically results from the idea that control in particular firms is of no consequence to the observed aggregate saving in an economy since shareholders can always switch from one corporation to another if they realize others control the corporations they own. Such behaviour would constrain potential controllers - for example, a subset of owners or managers - from diverging away from owners decisions. Thus, effective control is always with all shareholders, implying that aggregate savings propensities via both
personal disposable income and their income in the form of corporate retentions will be the same. In short, there is perfect substitutability between personal and corporate savings.

In contrast, if a subset of households control firms, and hence determine the level of corporate retentions, the implication is that the estimated coefficient on $S^c_t$ is significantly higher than that on $y^{prs}_t$. There are various possible explanations for this. For example, for a controlling subset of owners - i.e. capitalists - observed corporate retentions will simply reflect their earlier decision not to consume or save as personal savings a part of their income. Since an ex ante preference for lower retentions is simply reflected in a lower ex post retentions ratio, no substitutability should be expected between observed corporate retentions and personal savings. As regards non-controlling groups, if personal savings are too low to allow any substitutability with corporate retentions - as evidence suggests - then a similar "add-on" phenomenon will be observed - i.e. a rise in retentions will not be accompanied by a fall in personal saving.

The existing empirical evidence conclusively rejects the neoclassical argument. It suggests the propensity to save out of $S^c_t$ is significantly higher than the propensity to save out of $y^{prs}_t$. See, for example, Fitelis (1983) for evidence and a survey.

Although this does not discriminate our approach from managerialism, which, for example, Marris (1964) shows to result in similar implications, it at least offers some conclusive evidence against the neoclassical argument as developed in the Life-Cycle hypothesis.
Thus, the conclusion to be reached from this examination of existing empirical evidence, both direct and indirect, is that our hypothesis performs at least as well as the alternatives.

4. CONCLUSION

By following an evolutionary approach to the theory of the firm, it has been argued that a subset of owners—capitalists—can plausibly be expected to control firms. Particularly important is the inversion of causality that leads to this result: rather than examining ex post the percentage of shares needed for control, it is better, bearing in mind the benefits of control, to examine the percentage capitalists will allow others to obtain before control is lost.

Moreover, although the plausibility of this capitalist control hypothesis implies that the burden of proof lies with those favouring its alternatives, the hypothesis performs at least as well as alternative approaches when confronted with existing empirical evidence, direct and indirect.
NOTES

* Earlier versions of this paper were presented at the Warwick Industrial Economics Workshop and the SSRC Workshop on Work Organization (Warwick, July 1983). Thanks are due to the participants of both of these. In addition, particular thanks are due to John Cable, Keith Cowling, and Athina Zervogianni for their helpful comments and discussion.

1) There are some notable exceptions, such as Francis (1980), and Nyman and Silberston (1978).

2) See Scott (1979) for a survey.

3) See also Fitch (1972).

4) Such a discussion is noticeably absent in other work by economists.

5) That is, a totally incapable management.

6) See the discussion in Cubbin and Leech (1983) of internal versus external control.

7) See the discussion of firms’ organizational form – an issue taken up in Section 3 – in Cowling (1982).

8) It is also possible that the need for finance is met by borrowing from banks and other financial institutions. This is not an issue that will be explored in this paper, where the concern is with owner versus manager control. However, note that the original controllers will not be indifferent regarding the two ways of obtaining capital. In particular, capital possessed by financial institutions is normally more concentrated than that possessed by the vast majority of households. See Zeitlin (1974) for evidence. Such concentration facilitates the possibility of financial institutions asking a higher price for capital. They could, for example, require that a certain strategy be followed, i.e. they could demand control as the price of their funds. In this instance, whilst control is not retained by owners, it does not pass to managers. Such possibilities raise interesting issues that could be pursued further.

9) The value of empirical studies based upon share distributions will be discussed in Section 4.

10) A similar argument is made in Francis (1980), but its implications (i.e. the reverse causality argument) are not explored.

11) Albeit the new controlling group need not include the original controllers.

12) A consequence of this is that capitalists will persuade and cajole workers and managers into adopting their objectives.

13) What is more, the cost of this to firms has been minimal because such schools are often state financed.

14) See also Cubbin and Leech (1983).
15) Similarly to managers and workers, financial institutions may bargain for control as the price of their funds. See note 8.

16) Other theoretical frameworks could also be depicted by such diagrams - e.g. the "Marxist managerialist" approach of Baran and Sweezy (1966).

17) Note that the diagrams are not designed to depict the entire hierarchical organization of firms. They merely show which class has control. Thus, for instance, it is not being suggested that managers do not have some measure of power over workers by virtue of their making tactical decisions.

18) See also Cubbin and Leech (1983) for a non-exhaustive but useful summary.

19) See also Zeitlin (1974), Nyman and Silberston (1978), Scott (1979), and Francis (1980).

20) There is a potential problem with Steer and Cable (1978) vis-à-vis this paper, namely: their regressions of profitability on organizational form also include a dummy variable of owner versus manager control based upon an ad hoc percentage of shares.

21) As noted in footnote 7), the distributional importance of control is discussed with respect to organizational form in Cowling (1982).

22) The ratio of corporate retentions to income.
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