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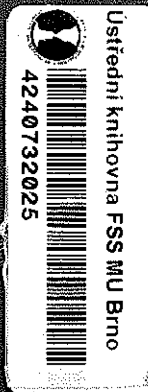

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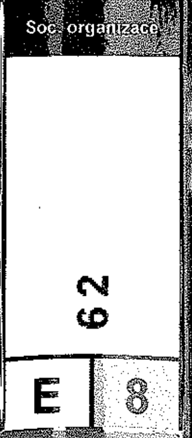

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THE SOCIOLOGY OF ORGANIZATIONS

Classic, Contemporary, and Critical Readings

EDITOR
Michael J. Handel

PART IX

THE EVOLUTION OF BUSINESS ORGANIZATION

From Big Business to Post-Fordism?

A. Alfred Chandler's Account of the Rise of Big Business

B. Post-Bureaucratic Alternatives to Big Business

Although there are many kinds of organizations, business is now the one most widely researched in organization studies, and theories of the development of American business organization have changed in interesting ways. Broadly speaking, the history of the American economy is in many ways one of large organizations replacing decentralized markets from the late nineteenth through late twentieth centuries, followed by a reaction against the institutional order that emerged from this process that began in the 1970s and whose character is still much debated. It is a story of the movement from markets to hierarchies to either markets again, completely new forms of organization, or merely reorganized hierarchies, depending on the theory.

In the early nineteenth century, most businesses had few employees, had low output and productivity, and were run by their owners. Between 1850 and 1930, large sections of the economy came to be dominated by big business, beginning with the railroads. Though organizations varied widely, the following characteristics are variously associated with big business (Schmitz 1993):

- large size measured in terms of assets, employees, and number of branch plants and offices;
- the association of competitors into various kinds of federations and agreements (cartels, trusts, interlocking directorates) in the late nineteenth century and then their direct ownership and unified management by one or a few corporations as a result of mergers and acquisitions (*horizontal integration*);
- concentration of economic power and domination of markets by few producers (*oligopoly*);
- ownership of different stages of the production process, such as raw materials production, semifinished goods, and distribution, by a single organization (*vertical integration*);

- diversification into multiple product lines, initially related to one another, but after the 1950s often in unrelated businesses (*conglomerates*);
- capital requirements beyond the abilities of an owner-entrepreneur or small partnership, leading to a reliance on outside finance, usually bank loans or the stock market;
- diffusion of stock ownership that results in the substitution of owner-managers by a new class of salaried executives and managers (*separation of ownership and control*);
- pricing and allocation of raw materials and semifinished goods performed by the *"visible hand"* of administrative coordination, rather than the invisible hand of the market, as market transactions are internalized within the organization.

These developments have been called the *managerial revolution*, or the shift from proprietary or competitive capitalism to managerial capitalism.

Business historian Alfred Chandler gives one of the most influential explanations for the rise of managerial capitalism (Reading 24). Modern communications and transportation systems, such as steamships, railroads, and the telegraph, integrated local and regional markets into national markets. Mechanized mass production technology rather than craft technology was now feasible and well suited to supply this market cheaply. In some industries, the minimum efficient scale of production was so great that a few firms could meet the market demand. If there were too many producers, excess capacity could result in gluts, low prices, and business failures. Oligopoly was the natural outcome of such situations.

The advantage of mass production rested on *economies of scale*, which are cost savings that result from producing large quantities of a standard good. Whereas labor and raw materials costs increase with the number of items produced, the cost of buildings and equipment remains fixed and adds less to the final price of a product as the volume of production increases, because the costs can be spread across more units. In capital-intensive industries, the cost savings associated with high volume production due to economies of scale are substantial and encourage large production facilities.

But the high level of capital investment meant that equipment needed to be employed continuously to ensure the fixed costs per unit remained low. This meant that firms using new technologies not only were able to produce in mass quantities, but also were compelled to do so if they were to produce cheaply and remain in business. The need for a continuous, regular flow of large quantities of materials through all phases of supplier procurement, production, and distribution required conscious administrative coordination and unified management under common corporate ownership. To keep production and sales at high and predictable levels, firms acquired their suppliers and also created their own wholesale sales forces, dealers and franchisees, retail outlets, brand names, and advertising to win customer loyalty and preserve their company's reputation. A managerial hierarchy coordinated and supervised these functions within relatively autonomous divisions, while a corporate central office set strategy, allocated capital among divisions, and evaluated divisional financial performance.

The size and complexity of the managerial task required a corps of specialists and professionals rather than untrained amateurs trying to handle everything themselves. Salaried managers, chosen on the basis of competence, replaced

personal or family control. By the 1920s, ownership became separated from control in many corporations. Stockholders increasingly became passive investors rather than active participants in the management of the enterprise, and boards of directors increasingly reflected the interests of top management rather than the stockholders they were supposed to represent. The number of business schools and professional associations grew, and modern management techniques, including Taylor's scientific management, increasingly replaced intuition, experiential knowledge, and gut instinct as guides to action. In short, the firm became increasingly rationalized and bureaucratic, with an elaborate hierarchy of offices, a division of labor among technically trained specialists, and the use of formal knowledge and impersonal rules and procedures to guide action. Chandler's view of the managerial revolution shares much with Weber's ideas about bureaucracy and its expansion.

Chandler's explanation of the emergence of big business is also similar to Williamson's account of the substitution of hierarchies for markets in that both see the purpose as reducing the uncertainties of market transactions (Reading 22). They differ insofar as Chandler sees this as mainly a technical problem of coordinating materials flows in a mass production environment, whereas Williamson believes it is a contracting problem that requires the restraint of other actors' opportunism and self-interest. Pfeffer and Salancik's resource dependency explanation of mergers also bears a family resemblance to these accounts (see Reading 18).

Chandler argues that the same factors led to the rise of big business in Germany, Japan, and elsewhere. Nations that continued to rely on smaller, individual- or family-owned firms, such as the United Kingdom, fell behind economically. In Chandler's view, efficiency accounts for the rise of big business and the managerial revolution, and those firms or nations that relied on small business were destined to fall behind economically.

Critics argue that this explanation is too functionalist and underestimates the importance of power motives. Corporations often grew and integrated horizontally to monopolize markets. Chandler ignores the history of antitrust legislation that developed in reaction to the concentration of corporation power in the form of cartels and monopolies. Likewise, vertical integration can restrain competition by excluding rivals from access to natural resources or the economies of scale associated with supplier operations owned by large customers. Chandler also ignores any principal-agency problems associated with the new corporate elite that made autonomous decisions on its own salaries, perks, and staff size. He also emphasizes the role of managerial efficiency in explaining big business success while ignoring the role of scientific management in cheapening labor requirements, which Taylor advocated and Braverman criticized (see Readings 2 and 3).

The criticism of Chandler's efficiency explanation only grew as the golden age of American growth and prosperity during the postwar period, which seemed to be the crowning achievement of the big business system whose development Chandler described, gave way to the stagnation and crisis of the 1970s. American companies faced not only deep recessions and general economic stagnation in the 1970s through mid-1980s, but also a flood of imports, especially from Japan. The recessions and slow growth severely reduced profits, but superior Japanese goods suggested the problem was deeper than the business downturn alone. Over roughly fifteen years, Japanese firms challenged significantly and often overwhelmed

American companies in markets such as transistor radios, cameras, color televisions, videocassette recorders, audio equipment, microwave ovens, computer hardware, photocopiers, steel, and automobiles. In most cases, Japanese quality, as well as price, was considered superior to American products. The onslaught left American industry reeling as it struggled to respond, and a wave of plant closures swept the industrial midwest in the early 1980s. Just as Chandler was formulating his explanation for the triumph of American corporate capitalism, it entered a deep crisis. American firms sought to imitate Japanese practice in various ways, such as by introducing quality control techniques like those in the factory Laurie Graham studied (Reading 11); by creating a more cooperative relationship with labor, as at Saturn (Reading 12); and by trying to build greater employee commitment through strong organizational cultures (Reading 27).

At the same time, dynamic elements seemed to emerge from this bleak picture. While large, traditional, so-called blue chip corporations stumbled, new, smaller startups in high technology fields such as computer software and hardware and biotechnology thrived.

The lethargy and competitive difficulties of large enterprises, such as U.S. Steel, General Motors, and virtually all conglomerates since the 1970s, suggested to many that managers had pursued growth for its own sake rather than to maximize efficiency, often because managerial compensation was tied to organizational size and size seemed to provide security and to buffer firms from market fluctuations. The competitiveness crisis in U.S. industry between 1975 and 1990 suggested that big business was not efficient and that other motives accounted for its emergence and growth. While Chandler (1990) continued to insist that big business was as efficient and important as always, most believe that the period since 1975 represents a new phase in American business organization, though they disagree on its nature.

There are three perspectives on the apparent eclipse of traditional big business in the past twenty-five years. The first argues that smaller, more entrepreneurial firms are replacing the large, oligopolistic corporation. Some argue that small business creates almost all new employment (Birch 1981). This view sees recent changes as a simple rollback of the managerial revolution, as small business and competitive capitalism reassert themselves (Birch 1981; Malone and Rockart 1991). Consistent with this view is the conservative shift toward free market government economic policies since Ronald Reagan's presidency, including measures such as deregulation, free-trade policies, lower minimum wages, and deunionization. Bureaucracy or hierarchies of all sorts, whether in business, labor, or government, are yielding to old-fashioned, almost nineteenth-century, free markets in this view.

The second perspective sees recent developments as potentially the beginning of a more novel form of business and economic organization rather than a return to nineteenth-century laissez-faire. Michael Piore and Charles Sabel (1984) argued that business began to operate in a less stable environment. The new conditions included wider swings in the business cycle, more intense international and domestic competition, growing importance of product quality relative to price, faster development of technology, and more rapidly changing consumer tastes, including a preference for more customization. This put pressure on mass production systems, which required large and stable markets for standardized goods to reap economies of scale and competed mainly on the basis of low price. The greater instability and fragmentation of consumer markets required a more innovative and, above all, flexible corporation. Economies of scale are now less important than *economies of scope*, the cost savings that result from using the same materials and equipment to produce many small batches of a variety of products, rather than large batches of a standard product. New computer-controlled production technology supports this move to greater variety and customization because it dramatically reduces the cost and time required for retooling, which had prevented the flexible use of industrial technology in the past. The new production strategy has been called flexible specialization, or *post-Fordism*, in contrast to the mass production or Fordist model.

Since Burns and Stalker, "innovative" and "flexible" have meant organic rather than traditional bureaucratic forms of organization, and the post-Fordist model is no exception. Faster-changing markets, consumer demand for quality, variety, and customization, shorter product life cycles, and foreign competition require flexible job definitions, cooperation between hierarchical levels and departments, greater worker decision making and skill, and fewer bureaucratic layers of approval to achieve faster response times. Computers and other information technology have the flexibility to achieve economies of scope and require greater mental work from the workers who use them. Piore and Sabel argue that smaller firms with less hierarchy, less rigid division of labor, and more skilled front-line workers are replacing the traditional bureaucratic corporation Chandler celebrated and the Taylorist manufacturing philosophy that often accompanied it. These firms give workers more skill, discretion, and decision-making power along the lines described by Richard Walton (Reading 10), as cooperation between management and labor replaces adversarial relations. Insofar as greater automation contributes to the increased use of skilled workers, Piore and Sabel's work is also consistent with Woodward's predictions.

The new firm also involves greater cooperation among managers and professionals in different departments within the firm who traditionally had limited contact with one another. Design engineers, manufacturing engineers, and sales and marketing professionals work together in interdepartmental teams to make sure that the products that are designed can be manufactured easily and sold to customers. This kind of communication and cooperation, which the Japanese called *concurrent engineering*, would seem like common sense, but was actually rare in American companies. Tall bureaucratic walls in American corporations separated departments, and design engineers were allowed to create product designs without feedback from the manufacturing and marketing departments regarding their feasibility or desirability. The resulting higher defect rates and lower customer satisfaction were some of the reasons Japanese products usually surpassed their American competitors.

Finally, close cooperation between firms in joint ventures, business alliances, and networks allows them to gain the advantages of vertical and horizontal integration without the bureaucratic costs. Competitors can simulate the advantages of horizontal integration by sharing large contracts and the costs of large investments or new ventures. This allows companies to meet large orders, pool capital, and spread risks without assuming high fixed costs. Firms and their suppliers also cooperate through concurrent engineering and the sharing of knowledge, expertise, and sometimes personnel. They gain the advantages of vertical integration

in a looser organizational arrangement, such as that found in Japanese business groups or the interfirm networks in Silicon Valley, which comprise a cooperating community of small producers or *industrial district* (Saxenian 1994).

In the limiting case, organizations as stable entities almost disappear completely. A *virtual organization* might consist of a group of free agents in a professional community who come together for the purposes of a single project and then disband to work on their next projects, without any enduring coordinating central office or actor—almost the logical extension of Henry Mintzberg's adhocracy (1981; Kanter 1991). Michael Storper describes the evolution of filmmaking from mass production to flexible specialization in similar terms (1997). Alternatively, a firm might consist of a very small, stable core that contracts with others to perform most of the functions necessary for the business, such as Nike, which designs and sells athletic shoes but contracts for almost all manufacturing functions with outside factories and makes very little of what it sells itself (Harrison 1994). Computer technology is believed to facilitate this kind of decentralization by reducing the need for some kinds of middle-management record keeping and report generating and improving communication between organizations involved in business relationships (Malone and Rockart 19911; Sproull and Kiesler 1991).

As Walter Powell argues, this is not simply a shift from hierarchies back to markets, in Williamson's terms, because the level of cooperation between firms in such a network goes far beyond a simple market contract (Reading 25). Powell's essay represents an interesting turn in his thinking, because his earlier work with DiMaggio argued that different kinds of organizations throughout society were becoming more bureaucratic, albeit for nonrational reasons, whereas this work argues that debureaucratization is the dominant trend. Although Powell does not explain how entrenched bureaucratic norms became deinstitutionalized, he does argue that the post-Fordist view is one of increasing economic and organizational decentralization without a return to the free-market capitalism of the past. The new model is neither bureaucratic nor entrepreneurial in the traditional sense.

Not everyone is convinced that the emerging form of business organization represents such a fundamental break with the past, and this represents a third view of the recent transition from a stable big business regime, distinct from both the neo-entrepreneurial and post-Fordist views. Bennett Harrison and Barry Bluestone (1988) argued that the profits crisis beginning in the 1970s led businesses to mount an offensive against labor and government regulation in order to cut costs and regain their competitive position. Business lobbied for lower taxes, government spending cuts, privatization of government functions, relaxed consumer and environmental regulation, lower minimum wages, and fewer protections for unions.

The new pressures also led businesses to restructure their internal operations. Firms increasingly used part-time and temporary contract employees to reduce the fixed costs associated with their permanent, full-time workforce, such as fringe benefits or severance pay obligations. The remaining permanent employees were subject to wage freezes, benefit cuts, and greater effort demands in the form of continuous improvement programs or just-in-time production, such as Laurie Graham described (Reading 12). Firms also downsized their own

operations and subcontracted work to smaller, low-wage, nonunion domestic firms and to producers in low wage regions of the United States, Mexico, and Asia, which often operate under sweatshop conditions. In this view, "flexibility" meant a greater willingness to cut jobs, as well as reduce bureaucratic rules and structure.

There is also a change in operating philosophy as a free market rhetoric permeates organizational life and any assumption of permanence or security is discouraged as bureaucratic thinking (Smith 1990). Companies tell their employees they cannot expect a career within the organization and must think and act like independent contractors whose relationship with the organization is subject to continual reevaluation. Departments that used to provide goods or services to other departments internally now must compete for the business of "internal customers" on the same terms as external vendors.

As Harrison's reading in this section argues, he does not believe these developments represent a fundamental change in the underlying principles of business operation, just a harsher or more intense application of them (Reading 26). Harrison argues there is little genuine decentralization of business power or a return to an economy of small businesses, because most employment is still created directly or indirectly by large corporations producing directly or managing a web of subcontractors. Large firms are not offering more creative, fulfilling, or secure jobs, and most small firms are technologically backward, have lower profits and innovative capacity, and offer even lower wages and less job security than large firms. Concentrated economic power and the subordination of labor are not disappearing, they are just changing their character in what has come to be called the *neo-Fordist* theory of recent developments in business organization.

Some argue that the film industry provides effective evidence in favor of Harrison's ideas and against Storper's post-Fordist view as it has reconcentrated into a small number of media conglomerates. Corporations, such as Rupert Murdoch's News Corporation and AOL Time Warner, promote generic commercial films in multiple media outlets—such as television, newspapers, movie theaters, and video stores—depending on the company, and they program and control much of what Storper presents as a neo-craft form of production. The change in business organization is more modest in extent and less desirable in character than either the free market or the post-Fordist models of debureaucratization suggest, in the neo-Fordist view.

Empirical studies of trends in organizational structure, the impact of market turbulence on organizational structure, and the effects of structure on organizational performance and human resource practices also raise serious questions as to whether there is a real trend toward post-Fordist organization and whether the causes and consequences of such an organizational form are consistent with post-Fordist theory (Handel 2000; Handel 2002).