



# The Social Organization of Work

FIFTH EDITION

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How Do Jobs Become Marginal?	331
<i>Marginal Occupational Groups</i>	331
Employers Who Marginalize Jobs	337
<i>By Industry</i>	338
<i>By Firm</i>	339
<i>By Employment Contract</i>	340
Unemployment	340
<i>Occupational Differences in Unemployment</i>	341
<i>Layoffs</i>	341
<i>Coping with Unemployment</i>	346
Why Are Some Workers Considered Marginal?	347
<i>Geographic Isolation</i>	347
<i>Educational Level</i>	348
<i>Disabling Conditions</i>	348
<i>Job Displacement</i>	348
<i>Age</i>	349
<i>Race and Ethnicity</i>	349
<i>Gender</i>	350
<i>Interacting Characteristics</i>	350
Marginal Workers and Social Class	350
The Future of Marginal Jobs	351
<i>Dual Labor Markets</i>	352
<i>Internal Labor Markets</i>	352

## **PART V   Work in the Twenty-First Century   357**

### **15 The World of the Large Corporation   359**

Corporate Power	360
<i>Public Concerns about Corporate Power</i>	361
<i>Types of Corporate Market Power</i>	362
<i>Corporate Law</i>	365
<i>Owners versus Managers</i>	366
Merger Mania	367
<i>The First Five Merger Waves</i>	367
<i>The Current Megamerger Frenzy</i>	368
<i>Increased Conglomeration</i>	370
<i>The Effects of Size and Concentration</i>	371
<i>A Modest Backlash?</i>	375

Intercompany Linkages	376
<i>Interlocking Directorates</i>	376
<i>The Role of Banks</i>	376
<i>Outsourcing</i>	377
The Small-Firm Sector	378
<i>Satellites, Loyal Opposition, and Free Agents</i>	378
<i>The Creation of New Jobs</i>	379
<i>Economic Revitalization</i>	380

## **16 Globalization 384**

Theories of Industrial Development	385
<i>Emergence of an Integrated Global Economy</i>	388
The World Economy Today	391
<i>The Role of Multinational Corporations</i>	391
<i>Slowed Growth in the Industrialized Nations</i>	393
<i>The End of U.S. Economic Dominance</i>	394
<i>Protectionism, Free Trade, and Fair Trade</i>	395
<i>Trading Blocks: Regional Solutions to Lagging Growth</i>	396
<i>Combined and Uneven Development in Less Developed Nations</i>	397
<i>Rising Stars</i>	399
Differing Work Practices Around the Globe	399
<i>Least Developed Nations</i>	399
<i>Developing Nations</i>	400
<i>State-Regulated Capitalism</i>	401
<i>German Codetermination</i>	402
<i>Scandinavian Autonomous Work Groups</i>	403
<i>Work Hours Across the Western Industrialized Nations</i>	404
<i>Macropanning in Japan</i>	405
<i>The Four Little Tigers</i>	408
<i>China</i>	409
<i>Eastern Europe and Russia</i>	410
<i>Competing Organizational Forms</i>	411
<i>International Labor Solidarity</i>	412

## **17 The Future of Work 417**

Pivotal Work Trends	418
<i>Computer Technology</i>	418
<i>An Integrated World Economy</i>	419



# Work in the Twenty-First Century

The three chapters in Part V discuss the forces that are shaping the future of work. Chapter 15 examines huge corporations and their continuing movement toward both greater size and greater diversification. Chapter 16 shows how events in any one part of the global economy have consequences for all the other parts. Along with technologically based automation (Chapter 9), corporate concentration and globalization represent some of the most significant challenges to the jobs of workers in industrialized nations. Chapter 17 projects current developments into the future in an attempt to understand the face of work for future generations.

Chapter 15 focuses on the emergence of the large diversified corporation as the dominant organizational form in the modern economy. We discuss both positive and negative consequences of large corporations for workers and for society. Workers are frequently paid better in large firms than in smaller firms and have better benefit and retirement packages. Their work, however, may be more alienating and repetitive. The buying and selling of subsidiary companies by large corporations also creates new vulnerabilities for workers as jobs appear and disappear overnight for reasons that may be quite remote from workers' own efforts and productivity. Mergers, acquisitions, and divestitures also absorb financial and human resources that might be better invested in innovation and in activities that directly increase productivity. What is good for any given conglomerate may be destructive for the economy as a whole. In the concluding section of Chapter 15, we examine the small-firm sector and its potential importance for the future.

Chapter 16 explores the origins of a world economy in the colonial empires developed by Britain and other European states. We examine the replacement—after the Second World War—of direct political control of colonies by a system of economic neo-imperialism with the United States at its head. Under neo-imperialism, former colonies are at least nominally politically independent but are often still highly economically dependent. Economic development, which is highly uneven across world regions, has greatly increased the complexity of the world economy. In conjunction with the rebuilding of Europe's industrial base after the Second World War, these economic and political developments have created a world economy with greater diversity than ever before. In the concluding section of Chapter 16, we examine some of these diverse systems of industrial organization, including those typical of Japan, China, Sweden, Germany, and the former Soviet Union.

Chapter 17 discusses possible futures for advanced industrial societies. These futures include both the possibility of a large innovative sector with rapid growth and good jobs and the possibility of a large marginal sector with low pay and unstable jobs. We argue that the choice between these futures depends on the concerted actions and political choices of all of us as producers, consumers, and citizens.



## The World of the Large Corporation

“It’s mine. I built it. You bump it down—I’ll be in the window with a rifle. You even come too close and I’ll pot you like a rabbit.”

“It’s not me. There’s nothing I can do. I’ll lose my job if I don’t do it. And look—suppose you kill me? They’ll just hang you, but long before you’re hung there’ll be another guy on the tractor, and he’ll bump the house down. You are not killing the right guy.”

“That’s so,” the tenant said. “Who gave you the orders? I’ll go after him. He’s the one to kill.”

“You’re wrong. He got his orders from the bank. The bank told him, ‘Clear those people out or it’s your job.’”

“Well, there’s a president of the bank. There’s a board of directors. I’ll fill up the magazine of the rifle and go into the bank.”

The driver said, “Fellow was telling me the bank gets orders from the East. The orders were, ‘Make the land show a profit or we’ll close you up.’”

“But where does it stop? Who can we shoot? I don’t aim to starve to death before I kill the man that’s starving me.”

“I don’t know. Maybe there’s nobody to shoot. Maybe the thing isn’t men at all. Maybe, like you said, the property’s doing it. Anyway I told you my orders.”

FROM CHAPTER 5 OF *THE GRAPES OF WRATH* BY JOHN STEINBECK. COPYRIGHT 1939, RENEWED © 1967 BY JOHN STEINBECK. USED BY PERMISSION OF VIKING PENGUIN, A DIVISION OF PENGUIN GROUP (USA) INC.

In the world of work, you may find that your life is strongly influenced by economic forces outside your control. You may not be able to see who or what these forces are or to personalize them so you can understand them. As an individual, you may be nearly powerless in the face of these forces. At some point in your career, you may well work for a large, seemingly impersonal corporation. Such corporations exercise immense power because of their size. They exercise this power in relation to their employees, their customers, smaller firms, and even nations. Their actions determine the availability and quality of employment opportunities, environmental quality, health care, and other needs for the citizens of the nations in which they operate.

In this chapter, we discuss the increasing size of corporations and its implications, focusing on the issue of corporate power. We also examine how large corporations have expanded their influence over time. These ways include mergers, diversification across product lines, overlapping boards of directors, and the use of subcontracting. A clear understanding of the nature and power of large corporations is essential for students as they grapple with issues concerning both their own careers and the economic future of our nation and the world. We conclude the chapter with a consideration of the continuing importance of small firms and their role in the economy of the future. Together, the giant corporations and the constantly reemerging small-firm sector set the organizational stage for the economy of the twenty-first century.

## CORPORATE POWER

Some workers are self-employed. Some work for small employers. Others work for huge corporations with holdings around the world. As one moves along this continuum, the worker and the owner of the enterprise are increasingly distant. When the worker labors alongside the owner in a

small shop, there is often a personal link between them (although it may be a paternalistic link and entail very unequal power). In the large corporation, workers may not even know who the owner or owners are. They may know their immediate supervisor or the plant manager’s name, but they typically have little knowledge of who actually owns and controls the corporation.

## Public Concerns about Corporate Power

Large corporations have immense power in society. Concerns about their role in society were enunciated during the earliest stages of industrial capitalism by Adam Smith (1776), who believed that monopolies were detrimental to the free development of productive forces. These concerns have led the governments of industrialized nations to enact legislation to prevent or regulate monopolies. Most businesses would like to be monopolies if they could, and it has become one of the roles of the government to prevent this. In spite of these concerns and regulatory actions, corporations have continued to grow in size, and their sheer size alone often gives them many of the powers of monopolies (Carruthers and Babb, 2000).

The power of large corporations creates the possibility of corporate actions with grave consequences. Public concerns about the abuse of corporate power involve many issues, including (1) the exercise of concentrated economic power, (2) the exercise of concentrated political power, (3) the creation of highly bureaucratized organizations that are inflexible and resistant to change, (4) downsizing of workforces and the intensification of work, (5) the exploitation of consumers, (6) the degradation of the environment, and (7) control of the media (Jacoby, 2004).

Public concern about the **economic power** of large corporations arises from their powerful influence on smaller businesses and on aggregate employment levels. Large firms have the economic power to prevent the entry of smaller firms into their industries and to undermine the viability of small firms already operating there. This power rests on economies of scale and on control of technologies and markets. Such exclusionary power reduces price competition, innovation, economic growth, and job creation. In aggregate, it displaces economic resources from other segments of society to large corporations (Connor, 2001).

The downsizing of large companies through cutting back employment has become a source of public concern in the twenty-first century.

Downsizing can entail plant closings (discussed in Chapter 8), technological displacement (discussed in Chapter 9), the intentional increase of marginal employment positions (discussed in Chapter 14), and the movement to “lean” managerial structures (discussed in Chapter 12). Downsizing can also be achieved through moving production to lower-wage locations around the world (see Chapter 16). Taken as a whole, these tendencies have produced chronically high unemployment rates and eroded the quality of available jobs. In the twenty-first century, the largest U.S. firms have achieved increasing profits but are employing fewer workers.

Large corporations exercise **political power** first and foremost through lobbying to promote favorable legislation and through campaign contributions to influence elections. To avoid federal and state limits on corporate political contributions, this money often flows indirectly through lobbyists, law firms, and corporate executives rather than coming directly from the corporation. Exercise of political power by corporations results in subsidies for favored industries and often produces control of regulatory bodies by the very corporations they were intended to regulate (Mizruchi, 2004). At the local and state level, this power translates into favorable tax treatment and state subsidies for infrastructure, such as roads and utilities, for new private facilities.

There is a general public awareness that large corporations are frequently able to shape government policy in their own interests. For example, oil companies are seen as having inordinate influence on America’s energy policies—moving these toward development of new gas and oil fields and away from energy conservation. Banks have acted aggressively to resist regulation of their high risk behaviors that produced the great recession of 2008–2010. The executives of these banks have also fiercely defended the billions paid in bonuses to themselves (using public monies)—in spite of the fact that their leadership brought the economy close to collapse (Carmassi, Gros & Micossi, 2009). Lobbyists for the health insurance industry are argued to have had an inordinate hand in shaping health care



reform that favored the profits of insurers over the health (and pocketbooks) of Americans (Kail, Quadagno & Dixon, 2009). Large corporations have also sometimes damaged America's image abroad by manipulating local governments toward policies that favor foreign corporations and away from policies more favorable to their own citizens and workers (Anderson and Cavanagh, 2005).

Fears about the **inflexibility** of large corporations focus on the possibility that they may become inefficient, overly bureaucratic, and overly generous with salaries for top executives. Such organizations may be unable to change rapidly, adapt to new situations, or innovate. In some ways, large organizations may be less efficient and less nimble than smaller ones (Kanter, 2001).

Many people also fear the power of large corporations to exploit workers and to reduce the quality of working life. Large corporations can undermine the sense of community among workers. As you saw in Chapter 3, people dislike working for large corporations because of alienating and rigid procedures and reduced opportunities to use their abilities. Many employees in large corporations have also experienced an intensification of work and increased expectations for extraordinary effort as a part of corporate downsizing.

Finally, many people are concerned that large corporations exploit customers through high prices and the production of shoddy goods and that they damage the environment. These outcomes can occur through a disregard for the long-run consequences and side effects of economic activity. For example, a corporation may lower its costs of production by avoiding environmental regulations and allowing the public to absorb these costs in the form of increased pollution, noise, ugliness, and degraded recreational resources. Many people believe that large corporations stress profit to the point of neglecting moral, social, and aesthetic values (Ritzer, 2008). Large corporations have also been argued to have excessive influence on the media and on public discourse through concentrated ownership of the print and broadcast media and through their ability to influence the terms of debate about the issues of our times. See particularly

the works of Noam Chomsky (2001) and Richard Sennett (1998) for elaboration of these and related themes on corporate social and cultural power. The twenty largest U.S. corporations—ranked by sales—are listed in Table 15.1, along with their profits, assets, and employment. Note that the largest private employer in the United States is Walmart, with more employees than the next ten largest corporations combined, including such giants as Exxon Mobil, General Electric, Bank of America, and Ford Motor Company.

### Types of Corporate Market Power

The power of the large corporation—including its influence on government policy and public debate in the media—is ultimately based on its economic power. Social scientists conceptualize economic power in terms of large firms having either a **monopoly** or **oligopoly** position in relation to their environments. In addition, in and of itself, large size confers many elements of power. Today, most large companies have operations spread across several nations, further increasing their ability to leverage governments and employees into concessions. This basis of expanded power is the central focus of Chapter 16 on globalization.

**Monopoly Power** A monopoly firm holds a dominant position in the market for the goods it produces. Where a few firms dominate an industry, these firms can also be said to hold monopoly power. For example, if the top four firms in an industry control more than 70 percent of industry sales, we would consider these firms to have monopoly power (Borjas, 2005). Technically, such a situation is called an oligopoly (dominance by a few firms), but the economic power these few firms exercise is virtually identical to that of a true monopoly. Steel manufacturing in the United States was organized in this way before the introduction of foreign competition in the 1980s. On the basis of market domination, monopoly firms are able to restrict competition and charge higher prices for their goods. The result is that goods are sold at higher prices, output is reduced, jobs are lost,

TABLE 15.1 The 20 Largest U.S. Corporations (ranked by sales)



2000 Rank	Company	Sales	Profits	Assets	Employment
1	Walmart	\$408,214,000,000	14,335,000,000	170,706,000,000	2,100,000
2	Exxon Mobil	284,650,000,000	19,280,000,000	233,323,000,000	104,700
3	Chevron	163,527,000,000	10,483,000,000	161,165,000,000	66,716
4	General Electric	156,779,000,000	11,025,000,000	785,818,000,000	323,000
5	Bank of America	150,450,000,000	6,276,000,000	2,213,299,000,000	243,075
6	Conoco-Phillips	139,527,000,000	4,858,000,000	152,588,000,000	33,800
7	AT&T	123,018,000,000	12,535,000,000	268,752,000,000	302,660
8	Ford Motor	118,308,000,000	2,717,000,000	194,850,000,000	213,000
9	J.P. Morgan	115,632,000,000	11,728,000,000	2,031,989,000,000	224,961
10	Hewlett-Packard	114,552,000,000	7,660,000,000	114,799,000,000	321,000
11	Berkshire Hathaway	112,439,000,000	8,055,000,000	297,119,000,000	246,083
12	Citigroup	108,785,000,000	-1,006,000,000	1,856,646,000,000	324,850
13	Verizon Communications	107,808,000,000	3,651,000,000	227,251,000,000	223,880
14	McKesson Pharmaceuticals	106,632,000,000	823,000,000	25,267,000,000	32,500
15	General Motors	104,589,000,000	Not Available	136,295,000,000	243,600
16	American International Group (AIG)	103,180,000,000	-10,949,000,000	847,585,000,000	291,545
17	Cardinal Health	99,612,000,000	1,151,600,000	25,118,800,000	47,600
18	CVS Caremark	98,729,000,000	3,696,000,000	61,641,000,000	170,000
19	Wells Fargo	98,636,000,000	12,275,000,000	1,243,646,000,000	285,300
20	International Business Machines	95,758,000,000	13,425,000,000	109,022,000,000	398,455

SOURCE: [www.fortune.com](http://www.fortune.com)

and the real income of consumers declines (North, 2005). In a competitive economy, such industries would be flooded with potential producers. What keeps this from happening in monopoly industries?

**Barriers to Entry** A variety of barriers keep competing firms out, thus protecting the monopoly firm's profits. One important barrier is provided by economies of scale, which make it difficult for small firms to compete with large firms. Large batches are generally less expensive to produce per unit than small batches. Monopoly firms may also own important sources of supplies and may make it difficult for competing firms to secure access to these supplies; this is called a **backward linkage**. They may also

control wholesale or retail outlets for goods, called a **forward linkage**. Companies with forward and backward linkages are said to have a **vertically integration**. Monopoly firms may also have privileged access to credit. A firm can also achieve monopoly power through advertising. If the firm is able to differentiate its products from competitors' products through advertising, customers may come to prefer these products and consider them superior to otherwise equivalent goods. Monopoly firms may even engage in **predatory pricing**, in which they intentionally underbid competitors until they drive them out of the market. At that point—no longer facing any competition—the monopoly firm recoups its losses by charging higher prices.

Industries with monopolistic structures typically have several distinctive characteristics (Borjas, 2005). These industries operate independently of suppliers, wholesalers, and distributors because they own their supply sources and control their own sales networks. They engage in a larger-than-average share of research and development. They set wage standards against which other firms have to compete. And they have a strong influence on the overall health of the economy because so many subordinate and supporting firms depend on their economic success.

Monopoly control is unlikely in some industries. For example, residential construction prevents monopoly structure because entry is relatively easy, the work is relatively unstandardized, and production sites are geographically dispersed. Monopolies are also difficult to secure and maintain in personal services and in other services that cannot be standardized, such as repair. In the United States, antitrust laws have retarded the growth of monopolies in other industries, such as interstate trucking.

Perhaps surprisingly, concentration within industries has not increased greatly over time. In 1935, the average four-firm **concentration ratio** in manufacturing industries was 37 percent. In other words, on average, the four largest firms in a typical manufacturing industry controlled 37 percent of industry sales. By the 1970s, this figure had risen only to 39 percent and has remained relatively stable since then (Census, 2010). One reason for this relative stability is that antitrust laws have limited the growth of concentration in key industries. As a result, large companies have grown by moving into related (and sometimes unrelated) industries rather than by further increasing their share of their primary market. In this way, antitrust laws may have actually promoted the growth of large conglomerate corporations sprawling across several industries. Such corporations are the focus in the section on mergers.

**Oligopoly Power** An industry is considered dominated by oligopolistic corporations if its output is controlled by few enough firms that they can engage in collaborative price setting. Such price fixing would be illegal if done openly. However, collaborative pricing more typically involves informal

agreements to hold prices at a specified level and is rarely caught or prosecuted. The maximum number of companies that can effectively coordinate such collaborative practices varies from industry to industry but may be as high as a dozen or more in some industries. This practice creates market conditions similar to those in monopoly industries. Cigarettes and processed foods are familiar examples of industries with oligopolistic structures.

Two types of activity are particularly distinctive of oligopoly corporations. First, oligopolies tend to divide the available market into spheres of influence. These spheres may be defined by geographic regions or by different product lines. Second, oligopolies take advantage of reciprocal buying agreements in which suppliers or purchasers are pressured into allowing the oligopoly company privileged access to their markets (Scherer, 2000). For example, a wholesaler may be pressured to sign an agreement to buy high-priced microwave ovens from an oligopoly manufacturer as a prerequisite for obtaining their popular washing machines at the volume and price desired. The oligopoly company is thus able to use its power base in one industry to increase its profits in other industries.

**Size as Power** Large firms, regardless of their market share, have a great deal of power. This power is similar in many respects to monopoly or oligopoly power. For example, before Japanese firms began competing in the automobile industry, a third of the labor force in the United States was engaged in the manufacture, sale, or distribution of automobiles or automobile parts. This gave the industry tremendous leverage in Washington:

[If a large firm were to fail,] the effects on workers, shareholders, creditors, suppliers, and distributors of and tangent to the stricken organization would be intolerable....

Moreover, the dominant position of the giant firms demands that public policy-makers avoid at all costs decisions which could conceivably jeopardize the financial integrity of the mammoth. As a practical matter this means that most doubts in divestment proceedings, in antitrust prosecutions,

or levies on unreasonable accumulations of surplus, or the vigor with which certain regulatory statutes will be applied ... will be resolved in favor of the corporation in question. In a real sense the giant enterprises have achieved many of the privileges accorded the publicly regulated utilities without at the same time being burdened even by formal restraints imposed on the latter. (Baratz, 1971, pp. 151–153)

Thus, in and of itself, size confers tremendous power on large corporations—both in relation to the government and in relation to competitors, customers, and employees. For example, Walmart has come under public scrutiny for pressuring its suppliers to lower their prices to the extent that they are forced to move to China or other low-wage locations to meet Walmart's demands (see *walmartwatch.com*). Although microeconomic theory focuses on market share as the basis of monopoly power, sociologists and institutional economists point out that many aspects of economic power—such as those benefiting large corporations such as Walmart—result directly from size alone.

In the great recession of 2008–2010, banks and automobile industries were deemed by the government as being “too big to fail” and were thus bailed

out with billions in taxpayer dollars. The federal government believed that failure of these economic giants would result in significant deepening and lengthening of the recession. In the aftermath—and given the backlash against these bailouts—the government has sought to regulate the banks to ensure less risky behavior on their part (Barth, Caprio & Levine, 2008).

### Corporate Law

Business corporations in the United States, including the very largest ones, have had legal protection as “persons” for over a century (*Santa Clara County v. Southern Pacific Railroad Co.*, 1886). This legal status serves at least two important functions. First, the owners of the corporation (stockholders) are protected from bearing full legal or fiscal responsibility for the actions of the corporation. Because the corporation is recognized as a person, debts, bankruptcy, and lawsuits are restricted to the corporate entity itself and do not carry over to its owners. This concept is known as **limited liability**. Critics argue that the lack of full accountability for owners allowed by limited liability encourages irresponsible actions on the part of large corporations. Some of the worst abuses of corporate power are described in Box 15.1.

#### Box 15.1 World's Worst Corporations



*Each year in their December issue, the Multinational Monitor presents a list of the world's ten worst corporate “price gougers, polluters, union-busters, dictator-coddlers, fraudsters, poisoners, deceivers and general miscreants.” Five of these are listed below. See the website in the source line of this box for the remaining five and for yearly updates. (Click Archived Issues and then go to the latest December issue.)*

**AIG:** Even while they were accepting over \$100 billion in government bailouts, AIG sent company executives to a \$1,000 per night resort in Orange County, California.

**Cargill:** The company engaged in price gouging for their food products even while farm prices are falling with strong negative effects on the poor in developing countries.

**Chevron:** Abuses include human trafficking in Burma and oil spills and land poisoning in Ecuador.

**Constellation Energy:** In a deregulation deal established during the 1990s, this nuclear energy company was able to overcharge nuclear energy rate payers the equivalent of \$1.5 billion.

**Chinese National Petroleum Company (CNPC):** By continuing to drill oil in Sudan and accept 80% of Sudan's oil exports, CNPC has helped support the current Sudanese government whose members have been charged by the International Criminal Court with committing acts of genocide.

SOURCE: Multinational Monitor, Robert Weissman, “The Ten Worst Corporations of 2008,” December 2008, *multinationalmonitor.org*.

**The Cloak of Privacy** A second consequence of their legal status as persons—along with limited liability for owners—is that corporations receive certain rights granted to people, including the right to privacy. This right is particularly important for the large modern corporation. It allows many corporate activities to be kept secret, including activities that lead to price fixing, shoddy products, and evasions of environmental protections (O'Reilly, 2009). Such secrecy, however, is not granted to public bodies; indeed, it would be considered a breach of democratic principles. The legal status of corporations as persons—along with the principle of employment at will, which allows the firing of employees without justification (see Chapter 4)—provides a legal framework for corporations that allows them immense power in modern society.

**Antitrust Regulations** In an effort to prevent single companies or small groups of companies from using their monopoly power to eliminate competitors and exploit consumers, the government attempts to regulate the existence and behavior of monopolies through the activities of the Federal Trade Commission (FTC, [www.ftc.gov](http://www.ftc.gov)). This agency performs important functions in deterring unfair practices of large companies against both their competitors and against consumers. Antitrust regulations are a bulwark in maintaining a competitive market system through pre-empting its tendency of unregulated market systems to self-destruct through the excessive concentration of economic power. For example, in 2000, the FTC found Microsoft guilty of anticompetitive practices against its competitors by putting “technological roadblocks” in its Windows operating system that prevented competing programs from operating effectively.

### Owners versus Managers

The owners of a large corporation (the stockholders) do not, in general, directly control the daily activities of the corporation. Rather, hired managers control daily activities. Control by hired managers has been alternatively interpreted as

encouraging lesser and greater corporate responsibility. Economists Adolf Berle and Gardiner Means coined the term **management-controlled firms** in 1932 to describe corporations in which the stockholder with the largest holding owns less than 20 percent of the corporation's stock. Using data from 1929, they found that 44 percent of the two hundred largest United States nonfinancial corporations were management controlled. They were concerned that this management control might make corporations less responsible (in relation to their stockholders). Berle and Means (1932, p. 9) argued that management control “destroys the basis for the old assumption that the quest for profits will spur the owner of industrial property to effective use.”

These findings have been intensely debated since Berle and Means put them forward over half a century ago. Reanalysis of the data suggest that only 22 percent (rather than 44 percent) of the corporations studied by Berle and Means were actually management controlled under their own definition. Furthermore, researchers have argued that management-controlled corporations may, in fact, be just as oriented toward maximizing profits as owners ever were (Mizruchi, 2004). If profit rates are not as high as possible in a management-controlled corporation, owners may withdraw their holdings from the company and invest in other companies. This will cause a decline in the price of the corporation's stock and jeopardize the interests of management. Under this thesis, the profit motive is built into the system of ownership and investment; it does not reside in individual owners' desires for accumulation.

Other researchers argue that managers are more interested in maximizing revenues than profits because maximizing overall revenues enhances their own power, prestige, and earnings. This thesis may explain in part the corporate drive toward increased size. Corporate executives who successfully increase the size of their companies are paid salaries unthinkable to the average wage or salary worker. As noted in Chapter 4, chief executives can be paid up to 25,000 times the salary of an average worker in their company (see Table 15.1).

## MERGER MANIA

Corporations have increased in size and concentration in a halting and irregular fashion patterned by periods of rapid growth and relative quiet. Corporate growth occurs not only through expansion of a firm's operations but also through the acquisition of other firms, and these **mergers** tend to occur in distinct cycles. The history of these cycles reveals not only dramatically changing merger rates but also the emergence of different kinds of corporations during six distinct periods.

### The First Five Merger Waves

The first wave of mergers occurred in the early 1890s in metallurgy, chemicals, and electrical machinery. Technological breakthroughs in these industries made large-scale mass production more efficient than smaller-scale production. Large firms also benefitted from their domination of emerging national distribution and marketing systems based on transcontinental railway and telegraph lines. With these advantages, large firms succeeded in forcing smaller ones out of business by using practices that would clearly be illegal under today's anti-trust legislation. Such practices included buying up railroads and charging competitors higher freight rates in order to put their products at a price disadvantage. Large firms also increased profits by using new mass-production technologies to replace skilled workers with less-well-paid semiskilled workers. This merger wave resulted in a dramatic increase in the size of firms in the affected industries (Zunz, 1998). Westinghouse, International Harvester, and Standard Oil emerged as industrial giants at this time.

The second merger wave occurred at the beginning of the twentieth century and was again based on economies resulting from large-scale production, marketing, and transportation systems. This wave had a wider industrial base than the first one and created monopolies in industries such as tobacco and food processing that are still in existence today. Companies emerging as giants at this time include American Can, United Fruit, and

American Tobacco. The first billion-dollar merger occurred in 1901 when the Carnegie Steel Corporation combined with its leading rivals to form United States Steel ([www.ussteel.com](http://www.ussteel.com)) (Geisst, 2004).

**Vertical Integration** During the first two merger waves, large companies acquired smaller companies engaged in similar lines of production. The third merger wave occurred in the 1920s and introduced a new corporate form: the vertically integrated company. Vertically integrated corporations come into being with the acquisition of firms supplying raw materials or component parts (backward linkages) and firms engaged in further processing or in selling the manufacturer's products (forward linkages). Steel companies were central actors in this wave of vertical integration. They acquired ownership of mines, ore transportation networks, finishing mills, metal fabrication plants (which turn raw steel into pipe, construction girders, and other products), and even transportation and distribution systems for finished steel products. Bethlehem Steel and Republic Steel emerged at this time.

**Diversification** The fourth merger wave stretched across two decades—starting in the Great Depression and extending into the early 1950s (Chandler et al., 1997). **Diversification** was the keynote in this merger wave, and the first multi-industry companies emerged at this time. During the Great Depression, large companies were scrambling for opportunities to remain profitable. Many smaller companies were facing bankruptcy and could be purchased for a song. Mergers tended to follow lines of technologically similar products or production processes and resulted in the expansion of companies into related product lines. The movement continued through the boom period of the Second World War, when the larger and more diversified companies were able to take advantage of the heightened demand for new military weapons and supplies more effectively than were smaller companies. This merger wave created E.I. du Pont and many other corporate giants of today's economy.

**Industrial Conglomerates** The fifth merger wave, which occurred in the late 1960s and early 1970s, created a new type of company: the industrial conglomerate. These mergers occurred between firms engaged in completely distinct product lines; for example, in 1973, Mobil Oil purchased the Montgomery Ward retail chain, which it subsequently sold as unprofitable. Later, Montgomery Ward was acquired by General Electric, which dismantled the company and liquidated its assets through bankruptcy proceedings in 2001. These mergers were motivated by the desire of large firms to move into profitable areas regardless of the field. Vastly different levels of economic power between the acquiring companies and their acquisitions allowed many “hostile takeovers” to take place. In such takeovers, the acquiring company subsequently exploits the cash reserves and market position of the newly acquired company for its own profit without necessarily making even minimal investments to maintain the acquired company’s productive capacity.

The history of corporate mergers has witnessed a movement from growth through expansion within product lines, to forward and backward linkages, to expansion into related product lines (diversification), to expansion into totally different product lines (conglomeration). Large companies today operate across a variety of related and sometimes unrelated product lines. Diversification and conglomeration are essential concepts for understanding the modern corporation and the modern economy.

### The Current Megamerger Frenzy

The fifth merger wave ended with the recession of the mid-1970s brought on by the end of the Vietnam War and rising oil prices. However, after a very brief respite, a sixth wave took off in the early 1980s, quickly accelerated to even higher levels of activity, and has continued unabated since then, creating a seemingly permanent culture of mergers. The sixth wave is distinguished by what have come to be known as megamerger between some of the largest companies in the economy, such as Conoco Oil and E.I. du Pont.

By the twenty-first century, a high level of merger activity had become an established fact of economic life in the United States and Canada. As a result, top managers and rank-and-file employees alike have become increasingly nervous about the future of their companies as corporations came to be defined as salable bundles of assets (Krantz, 2006). Takeover bids have assumed an increasingly hostile character. In this section, we explore the nature, causes, and consequences of this megamerger frenzy.

Why is a wave of megamerger occurring at this time? One reason is that it had become cheaper to buy a company in financial trouble than to build new plants and facilities. Many such troubled companies exist in North America because of increased international competition. The value of the acquired company on the stock market may greatly underestimate the actual value of its assets. Tax laws also encouraged conglomerate mergers. Part of what may make a company an attractive acquisition is its package of tax losses, write-offs, and depreciations. These are also acquired—along with the plant and equipment—and can be used to offset the taxes of the acquiring company. In some cases, it has even been possible to purchase bankrupt companies for less than the value of their tax losses and use the losses to offset income of the acquiring company (Geisst, 2004).

Alternatively, a successful company with a secure market niche but a low growth potential (and therefore a low price) may provide a desirable target for a corporation interested in growth through conglomerate expansion. Such a company can serve as a **cash cow**. The acquiring corporation can use the regular profits and depreciation allowances of the acquired company to fund expansion in other areas rather than setting them aside to maintain or upgrade the productive capacity of the acquired company (Bluestone and Harrison, 2000). In short, mergers have become popular with large corporations because they are a very quick way to increase short-term profits through cannibalizing other companies rather than through the more arduous, time-consuming, and uncertain route of developing and implementing better

products or more productive techniques. Stockholders and executives can gain huge financial windfalls in this process, but long-term productive capacity and jobs are often lost in the process.

**A Permissive Legal Environment** Changes in the interpretation and enforcement of antitrust laws have also encouraged the megamerger frenzy. In the 1980s, the Federal Trade Commission stopped targeting industries as a whole for antitrust investigation and instead only went after companies already identified as having engaged in specific illegal activities (Blau and Moncada, 2005). Antitrust cases were left to the Justice Department, where presidential appointees gave low priority to enforcement of this legislation:

There is no doubt that the administration of President Ronald Reagan brought with it a different attitude toward antitrust legislation.... [The] case against IBM, the world's largest computer company, was dropped. A case against the eight largest oil companies in the United States was abandoned just before the trial was set to begin. And an investigation of the major American automobile companies was closed. In their place, the FTC sued a small group of attorneys who represent indigent criminal defendants in Washington, DC and started investigations of state boards that license taxicabs and optometrists and of labor unions that represent actors. (Davidson, 1985, p. 125)

The fact that mergers between large corporations are today less often legally contested greatly accelerates their occurrence.

**Merger Targets** How are targets identified for corporate mergers? One criterion is technological compatibility between two companies. Other criteria include shifting consumer preferences or a desire to control resources critical to the acquiring company's survival. In conglomerate mergers between companies in unrelated industries, the target company is selected by financial advisers who appraise it

as a "good buy" (Mizruchi, 2004). Conglomerate firms interested in acquiring subsidiaries will often pay a premium for their purchase—typically buying large blocks of the company's stock at between 40 percent and 50 percent more than their current market price. This provides a lucrative, almost irresistible situation for shareholders in the company being acquired who are interested in quick profits. Even if the firm wishes to avoid such a takeover bid, its only option may be to search out a "white knight"—a more congenial firm with which to merge. A highly colorful language has emerged to describe the takeover process: "White knights' rush to rescue 'sleeping beauties' from 'black knights'—or end up 'paying ransom' as a last defense" (Hirsch, 1986, p. 814). (Some contemporary merger jargon is decoded in Box 15.2.)

In the early 1980s, the airlines also began to move toward a diversified structure as they bought hotel chains, restaurant chains, and car rental companies. By the mid-1980s, the merger frenzy seemed to be consuming the industry. In 1986, Southwest Airlines bought Muse Air. People's Express bought Frontier. Texas Air bought People's Express. Piedmont acquired Empire Airlines. Northwest agreed to buy Republic. By the summer of 1986, the sizes of the acquired companies had gotten even larger. Texas Air agreed to buy Eastern for \$800 million, and this deal was quickly followed by TWA's offer to purchase Ozark Airlines. By the 1990s, virtually all these recombined airlines had entered bankruptcy proceedings at least once.

The impact of these mergers extends beyond the immediate companies and workers involved. The fifty to one hundred hostile takeover attempts of large firms each year indirectly affect virtually *all* companies because companies must spend a great deal of time, money, and energy to make themselves unlikely or difficult takeover targets. This pressure moves their investment decisions toward more conservative options (Taggart, Berry & McDermott, 2001). It also drives up the price of credit, making productivity enhancing investments more expensive.

In 1998, two of the world's largest automakers combined when Chrysler and Daimler-Benz merged. In 2000, the largest merger ever occurred



**Box 15.2 Merger Jargon**

*The following terms describing key merger events were identified by the sociologist Paul Hirsch. His research attempts to unravel the symbolic social meanings through which those involved in mergers make sense of the merger events and their aftermath.*

**afterglow** postmerger euphoria of acquirer and/or acquiree—usually soon lost.

**ambush** swift and premeditated takeover attempt.

**bear hug** hostile tender offer—usually with considerable muscle behind it.

**big-game hunting** plotting and executing takeovers of large companies.

**black knights** unfriendly acquirers drawn to a target by news that the company is already being propositioned by others.

**bring to the altar** consummate a merger—usually friendly.

**chain letter effect** apparent growth through acquisition of other companies rather than high internal performance and productivity.

**confetti** stock traded by acquirer for that of acquiree, particularly if thought of as having little value.

**dowry** outstanding assets that the target may carry into a merger (e.g., low-interest loans, long-term contracts).

**friendly offer** merger proposal cleared in advance with the target company's board and top management; usually leads to the firm's recommending it favorably to shareholders for approval.

**golden parachutes** provision in the employment contracts of top executives that assures them a lucrative financial landing if the firm is acquired in a takeover.

**greenmail** a firm's purchase of its own stock—at a premium—from an investor who it fears will otherwise seek to acquire it or else initiate a proxy fight to oust its present management.

**hired guns** merger and acquisition specialists, other investment bankers, and lawyers employed by either side in any takeover.

**junk bonds** high-risk, high-yield debt certificates traded publicly; so called because they are rated below investment grade—either by Moody's or by Standard &

when two telecommunication giants—Time Warner and America Online—combined their resources. The combined company was valued at \$350,000,000,000—nearly ten times the value of the Chrysler-Daimler conglomerate. More recently, Internet giant Google has been rapidly acquiring subsidiary companies. Some of the companies of the Google telecommunications empire are listed in Box 15.3.

In this context of heightened megamergers, workers, shareholders, and communities have come to fear that top managers are motivated more by greed and ambition than they are by the security and prosperity of the organizations they head. Top executives control important information that they use to plan their own career strategies but that they may choose to share only selectively with stockholders or employees. They may even engage in whitewashing the facts and in

stonewalling (withholding information) while working furiously to feather their own nests. More concretely, they may hide real operating costs as costs of mergers and reorganizations, thus making profits appear high (because ongoing costs of production are hidden). The result is a speculative rise in the stock price of the company for which the executives take credit but which is eventually paid for by lost wages for employees or by lost income for investors (Krier, 2005).

### Increased Conglomeration

Many large firms have become increasingly diversified across a variety of industries. This tendency has intensified dramatically during the megamerger wave of the 1990s and 2000s. Corporations view diversification as providing protection from vulnerabilities in any one industry and as leading to greater

**Poor's**; junk bonds are often used to help finance hostile takeovers.

**mushroom treatment** postmerger problems from an acquired executive's standpoint: "First, they bury us in manure, then they leave us in the dark, then they let us stew, and finally they can us."

**pigeons** highly vulnerable targets.

**rape** forcible, surprise hostile takeover—sometimes accompanied by looting of acquiree's profitability.

**safe harbor** antitakeover advantage: company owns a subsidiary in a heavily regulated industry (such as broadcasting or interstate trucking). The long time required for government approval to transfer its ownership delays the acquisition process and decreases the chances for successful takeover.

**Saturday night special** a fast and predatory merger.

**scorched earth** policy whereby the target company would rather self-destruct than be acquired (e.g., all personnel threaten to quit).

**shark repellent** protective strategies for preventing or combating a hostile tender offer.

**sharks** takeover artists.

**shootout** climax of a takeover battle—usually conducted by "hired guns."

**sleeping beauties** vulnerable targets (see also "pigeons").

**summer soldier** executive of target company offering only token resistance against a takeover.

**takeover** the purchase of majority ownership in a corporation; usually resisted by the target company but accomplished nonetheless by paying a premium above the current market price for the firm's shares.

**white knight** acceptable acquirer sought by a potential acquiree to forestall an unfriendly takeover; the preferred suitor.

**wounded list** executives of an acquired firm who develop health or career problems from the deal.

SOURCE: Adapted from Paul M. Hirsch, 1986, "From Ambushes to Golden Parachutes: Corporate Takeovers as an Instance of Cultural Framing and Institutional Integration," *American Journal of Sociology* 91:800-837. Used with permission of The University of Chicago Press.

stability for their assets and profits. Business schools have also promoted this view and trained two decades of managers in its tenets. This distinctly American view of corporate strategies has encouraged a shift of attention away from production and toward the financial manipulation of assets.

Growth through increasing conglomerate diversification is largely responsible for the increasing domination of the economy by a few large firms. Industrial concentration has two distinct meanings. In many industries, a few key firms hold a dominant market share but operate solely or primarily within that industry. This type of concentration has been relatively stable since the Second World War. The second type of concentration results from a few huge firms that operate across a variety of industries, controlling a large share of the economy. This type of concentration has increased dramatically. Economic theory has largely ignored the growing importance

of the concentration of economic power in diversified conglomerates (Scherer, 2000).

Growth within an industry (and growth through vertical integration) occurs either through expansion of the core firm or through the acquisition of enterprises doing related work that subsequently become **divisions** of the larger corporation. Growth through conglomerate mergers occurs through the incorporation of acquired companies as semiautonomous subsidiaries. This autonomy may only mean having a separate corporate name or it may entail substantial latitude in decision-making for the subsidiary company.

### The Effects of Size and Concentration

What effects have the increasing size and concentration of enterprises had on workers and on organizations? Overall, the effects have been enormous.

**Box 15.3 The Companies of Google**

As the core of the economy has shifted from the production of goods to the production of services, megamergers have followed into these new industries. Companies acquired by Google from 2001 to 2010 are listed here.

Last Software

2Web Technologies

Aardvark

AdMob

Adscape

Akwan Information Technologies

allPAY GmbH

America Online

Android

Applied Semantics

Baidu

bruNET GmbH

Current Communications Group

Deja

dMarc Broadcasting

DocVerse

Dodgeball

Double Click

Endoxon

Feedburner

Genius Labs

Gizmo5

GrandCentral

Green Border

Ignite Logic

Image America

Jaiku

JotSpot

Kaltix

Keyhole, Inc

Marratech

Measure Map

Neotonic Software

Neven Vision

Omnisio

On2

Orion

Outride

Panoramio

PeakStream

Phatbits

Picasa

Picnik

Postini

Pyra Labs

reCAPTCHA

reMail

Reqwireless

Skia

Sprinks

Teracent

TNC (Tatter and Company)

Trendalyzer Tonic Systems

Upstartle

Urchin Software Corporation

Where2

Xunlei

YouTube

Zenter

Zingku

ZipDash

SOURCES: [www.hoovers.com](http://www.hoovers.com); [www.moodys.com](http://www.moodys.com)

One need only reflect for a moment on the difference between working in a small corner grocery and a new multiservice shopping center that is part of a national retail chain. These changes can have both positive and negative aspects.

**Effects on Organizations** Size has a huge impact on the organization of the workplace for two major reasons. First, specialization (division of labor) and complexity increase as more activities have to be coordinated (Carruthers and Babb, 2000). Second, bureaucratic rules and procedures replace direct control by owners, as you saw in Chapter 7. Increasing specialization, formalization of rules, and the prevalence of impersonal authority may result in reduced employee identification with the enterprise. Reduced identification makes employees reluctant to take on the values and goals of their increasingly impersonal employer. In addition, workers in large corporations often have fewer opportunities to develop their abilities across a wide range of activities than do workers in smaller firms (Kalleberg, 2006).

On the positive side, large firms typically pay their employees more than smaller firms. This difference allows large firms to compete successfully for the best workers and also helps motivate these workers. Large firms also typically have fairer and more equitable compensation schemes than smaller firms, resulting partially from the prevalence of bureaucratic rules and procedures that help limit favoritism. The unionization of large firms and the role of unions in negotiating compensation contribute to pay equity. Large firms also typically have better affirmative action records. Again, this results from their formalized procedures, which limit blatant forms of discrimination, and also from their greater public visibility. Finally, workers in large firms are typically more highly rewarded for their formal education than are workers in small firms. This difference results from the premium placed on educational credentials in bureaucratic settings.

In recent years, increasing size and concentration have taken on new implications for job security, replacing the image of the large corporation as a source of opportunities for lifelong careers with

the image of the large corporation as faithless to its workers. Many large corporations have searched for flexibility to confront rapidly changing product markets by reducing their core labor force, employing workers on short-term or temporary contracts, and subcontracting many production and support functions. Such strategies also cut the total wage bill, thus increasing short-term profits and making the company appear attractive to investors. While this strategy may achieve some flexibility for the firm, it does so at the cost of decreased job security for employees. Such arrangements are sometimes called **lean production** in recognition of their reduced use of a core labor force and intensification of work for the remaining employees (Cohen and McBride, 2003).

Critics of lean production suggest that this organizational strategy may be shortsighted (Watson, 2003). Making a distinction between short-term and long-term flexibility, they argue that lean production may achieve short-term flexibility but at significant costs in terms of long-term adaptability. Adapting to rapidly changing market conditions requires retaining employees and investing in their human capital development to create the conditions for increased commitment and innovation. Without employee loyalty and commitment, innovation and adaptation become harder, not easier.

**Effects on Society** Mergers between economic organizations can have both positive and negative consequences for society. The buying and selling of companies may help move capital from stagnant industries into growing ones. Conglomerate mergers can even intensify competition in an industry that has been dominated by a few giant firms. Large, multi-industry conglomerates may be able to compete on the home turf of monopoly companies in a way not possible for smaller companies.

Profit-making organizations, however, do not undertake mergers with the public interest in mind. Mergers are rarely peaceful, and they can have many negative consequences for society. Conglomerate mergers can hurt the economy because they divert resources from productive investment to the buying and selling of corporate properties.

Managers who are focused on these transactions may overlook opportunities to increase productivity more directly. This preoccupation can retard innovation. And it results in skyrocketing prices for companies that look like good merger targets, thus adding to inflationary pressures. Most researchers believe that excessive mergers damage the underlying health of the economy (Mizruchi, 2004). Mergers have also been implicated in the pattern of “jobless growth” typical of the early twenty-first century; economic activity appears to be increasing and the stock market rises, but few if any new jobs are being created.

Conglomerate mergers can also damage the social fabric of local communities. If a conglomerate buys a local plant and then shuts it down after a few years, the loss of jobs and revenue can devastate a community. (Recall the discussion of layoffs and plant closings in Chapter 8.) Outside ownership of local enterprises also undermines the participation of local business leaders in civic affairs. The welfare of the large, outside-owned corporation and its managers does not depend on the cultivation of local contacts. Local civic participation declines accordingly. Outside-owned firms are also less likely to look to local sources for supplies, labor, and expertise than are locally owned firms.

An additional long-term consequence of mergers is that they damage public confidence in the economy. The movement toward mergers is based on the pursuit of profits through financial manipulation rather than through producing products or services of economic value. In addition, a great many mergers are obvious failures. Employment is often reduced, and stock prices of the acquiring company sometimes plummet. For the company being acquired, there is little indication that negative outcomes are reversed at any point in the future. A noted historian of corporate mergers observes: “Mergers produce wonderful results for ... the executives involved as well as the investment bankers. Shareholders in the new companies created by merges are less than thrilled by many of the subsequent results, however” (Geisst, 2004, p. 310).

The telecommunications giant WorldCom provides a useful example. Following a period of aggressive acquisitions, WorldCom entered the largest

bankruptcy proceeding ever after the disclosure that the company had fabricated \$11 billion in profits. The litigation resulted in creditors being paid thirty-six cents on the dollar to clear \$35 billion in debt. The squandered capital was then unavailable for other potentially more productive uses. The remnants of WorldCom were reorganized as MCI, with a workforce of 55,000—down from 85,000 before the bankruptcy (Padgett, 2005).

**Effects on Employees** Top managers often fare very well in merger situations. Mergers increase the size of the company and thus provide justification for higher pay for chief executives. Managers in the acquired firms are increasingly protected by **golden parachutes** that guarantee compensation to top corporate executives if their firm is taken over (see Box 15.2). The provisions are basically lump sum severance packages and are called golden because they are so generous. For example, when Gillette was acquired by Procter & Gamble in 2005, its chief executive, James M. Kilts, was awarded a severance package worth \$165 million (Symonds and Berner, 2005).

The potential effects on lower-level employees, however, can be devastating. Both material and psychological losses are likely. Employees may be laid off or transferred against their wishes—often abruptly. Seniority acquired over years or even decades may mean nothing in such situations. Benefit programs are also likely to be disrupted. New work rules and disciplinary procedures are likely to be implemented. Pensions, sick leaves, vacations, holidays, and employee stock purchase plans may all be subject to change. Pension funds have been a frequent target in mergers. Reorganization of these funds often makes large amounts of money available to the new owning firm at the expense of workers who had counted on these funds for their retirement. Mergers are thus especially dangerous for the well-being of older workers—who may have few options for regrouping—and workers with families—who may heavily depend on health insurance and other benefits that are put at risk by mergers. Some of the euphemisms companies use to describe terminations in the wake of corporate downsizing are presented in Box 15.4.

**Box 15.4 Euphemisms for Termination**

*Michael Moore compiled the following euphemisms for employment termination in the wake of downsizing for his bestselling book *Downsize This!**

A save (as in a "savings" to the company)

Degrown

Dehired

Destaffed

Disemployed

Dislocated

Displaced

Downsized

Involuntarily separated

Personnel surplus reduction

Redundancy elimination

Resource reallocation

Rightsized

Transitioned

Workforce imbalance correction

SOURCE: Michael Moore, 1997, *Downsize This!* New York: Harper.

One of the most notorious examples of the loss of benefits, jobs, and retirement savings occurred in the early twenty-first century with the collapse of energy giant Enron. This company had grown rapidly through the acquisition of other companies in the oil industry. The company's problems resulted from the gross exaggeration of its assets by its chief executives in collusion with its accounting firm, Arthur Andersen—both of which were found guilty of fraud (Dahl, 2004). Revelation of the misaccounting caused Enron's inflated stock to collapse, sending the company into bankruptcy. Retirement accounts in the company had been heavily invested in now worthless Enron stock and became virtually of no value. And because the company was basically a holding company for other oil firms, there were no physical assets to reorganize into a new postbankruptcy enterprise (Vollmer, 2004). Some small measure of justice was achieved in 2006 when Jeff Skilling, Enron's former CEO, was sentenced to twenty-four years in a federal penitentiary for fraud connected to misrepresenting Enron's assets to inflate its value for his own personal gain.

A merger can also result in reduced trust among all levels of employees (Cook, 2001). Employees are likely to doubt that the company has their best interests at heart and may adjust their own commitment downward in response.

Ambiguity in role expectations is also likely to increase after a merger, and the company may seem relatively aimless during the transition period. Morale and motivation typically decline (Taggart et al., 2001). Mergers threaten employees' relations to their jobs and their economic security. Fear spreads.

Even contractual labor relations may be disrupted by mergers. The National Labor Relations Board recognizes only the obligation of a new parent company to bargain with an existing union, not an obligation to recognize existing labor contracts. The "obligation to bargain" gives legal recognition to the union as the workers' legitimate representative. It does nothing, however, to help secure a new contract. The terms of any new contract are completely open for renegotiation, and the increased power of the enterprise as part of a larger organization may substantially alter the terms of the agreement. Bankruptcy—as well as mergers—also renders labor contracts, including pensions and benefits, open for renegotiation—often under highly unfavorable circumstances (Sullivan, Warren & Westbrook, 2000).

### **A Modest Backlash?**

By the twenty-first century, forty states had enacted some form of antitakeover legislation (Taggart et al., 2001). These laws provide safeguards against

the most financially irresponsible and predatory takeovers. In addition, unions and consumer and environmental groups have increasingly publicized illegal and morally questionable practices of large corporations, such as the exploitation of child labor in poor nations and the pollution of ground water resources by oil and gas drilling operations. Inside large corporations, whistle-blowing by employees has also increased. Whistle-blowing refers to employees reporting illegal activities inside the organization to law enforcement or regulatory agencies. This activity sometimes halts the activity and brings about change, but it also typically results in significant emotional, financial, and personal losses for the person blowing the whistle (Rothschild, 2000).

Increased scrutiny and demands for accountability by the government, by employees, and by the public have forced companies to become increasingly interested in corporate ethics. As a result, large corporations have had to reconsider many of their activities. Many large corporations have hired experts in ethics to help internally monitor their own behavior; books and business school courses on ethics have flourished. The lasting impact of these developments is yet to be evaluated. History suggests that the driving force of corporate activity—profits—is strong but that corporate activity can be channeled and regulated if there is sufficient public will.

## INTERCORPORATE LINKAGES

We have observed that large corporations have tremendous power in relation to customers, competitors, and workers. If a corporation is spread across several industries, however, its employees may have difficulty even in understanding who their employer is. Interlocking directorates, bank ownership of majority shares, and subcontracting provide other sorts of linkages between firms that may be even more difficult for employees and communities to perceive and comprehend (Useem, 2004). These links, however, may be very important in determining investment decisions and, thus, in

determining the fates of employees and communities (Keister, 2000). They also further concentrate economic power (and consequently rewards) in fewer and fewer hands.

## Interlocking Directorates

Many executives sit on the boards of directors of several different corporations, creating interlocking directorates. For example, many members of the Rockefeller family—and other wealthy families—are incumbents of the boards of directors of a variety of corporations. Such interlocking directorates can coordinate the policies of supposedly competing large corporations. Thus, they are important in facilitating various oligopolistic practices. The networks defined by such interlocking directorates are often quite intricate. Banks or enterprises competing in one country may be parts of international networks collaborating with one another in markets elsewhere in the world. Employees may find it extremely difficult to understand and support the goals of their company when those goals are in part determined by its role in an international network of corporations and banks.

## The Role of Banks

Bank control of large corporations removes ownership and investment decisions yet another level from the actual site of production (Fligstein, 2001). The Chase Manhattan Bank alone has predominant control in more than 10 percent of the two hundred largest industrial corporations in the United States. Such power provides investment bankers with the ability to influence the allocation of resources over a significant portion of the economy. Such influence has contributed to the ascendancy of short-term financial considerations in production decisions over all other factors, including human capital development and investment in the long-term adaptability of the firm (Krippner, 2007). The banking industry is concentrated much as industrial enterprises are. As of 2010, the one hundred largest commercial banks in the United States held approximately 80 percent of all

the deposits in the almost 8,000 commercial banks in the country (Census, 2010). This concentration of financial power is widely seen as a pivotal development leading to the great recession of 2008–2010 and to the continuing difficulties of the long and slow recovery period.

### Outsourcing

A final type of corporate linkage is based on **subcontracting** (also called outsourcing; see Chapter 10 on services). Subcontracting arrangements exist in two forms. In industrial subcontracting, the subcontractor manufactures parts that will be incorporated into a final product made by the principal company. This type of subcontracting is common in the manufacturing of equipment and machinery, including automobiles. In commercial subcontracting, the subcontractor manufactures an entire finished product that the principal company markets—typically under its own brand name. Commercial subcontracting occurs in an even wider range of industries, including clothing, footwear, toys, plastic articles, and many other consumer goods. Many large firms also subcontract peripheral support functions, including food service, security, janitorial services, and accounting services.

**Lower Wages and Reduced Benefits** The motivation for subcontracting is often to avoid the higher wage and benefit packages secured by workers in the principal firm. Subcontracting sets up relationships of subordination between companies. The job security of workers in the subcontracting firm may be highly vulnerable to decisions made by the principal firm. Workers in subcontracting firms face problems resulting from their employer's weak position in relation to the principal firm. Subcontracting firms often achieve a competitive price for their product or service by cutting back on wages and sometimes by failing to pay Social Security, medical insurance, pensions, unemployment insurance, and other worker benefits. The companies involved in subcontracting arrangements—because of their small size—are frequently exempted from legislation protecting workers and working conditions. Subcontracting may also be a tool for undermining a union in the

principal company. The union may find that its membership is being eaten away by employment losses as work is subcontracted outside the company. Unions generally bargain for some say in the subcontracting arrangements entered into by their employing company. Unless the union is very strong, however, it rarely succeeds in securing a contract that excludes subcontracting.

The growth of subcontracting undercuts the sort of permanent employment relations that once typified jobs in industrialized nations. Insecure employment contracts have contributed to the stagnation or decline of real income for workers in these nations. Many of those who lost jobs previously considered permanent have been able to secure employment only at much reduced wage rates (Newman, 2006). This tendency has contributed to the growth of contingent and peripheral employment discussed in Chapter 14.

Even when the subcontracting arrangement is relatively favorable, the subcontracting firm still exists in a very precarious relationship to the market for its product. In the face of an economic downturn, orders from subcontractors can be cut to preserve available work for the principal firm. Subcontracted production is relatively easy to enter into because of the specialized nature of the production process involved and because of the guaranteed market. But for these same reasons, it is also extremely vulnerable to market downturns. In the early twenty-first century, many developing countries encouraged the rapid development of semiconductor component subcontracting as a route to industrial development. However, cyclical downturns in the semiconductor industry have caused widespread cutbacks in this industry, and many nations—most notably South Korea—have been left with large, expensive plants standing idle.

Subcontracting relationships are not necessarily exploitive. In the international context, such arrangements can have positive consequences for developing nations (Gereffi et al., 2002). Such arrangements may provide an opportunity for the developing nation to manufacture items it was previously importing as well as advancing raw material production and component production



for international markets. Because relationships between international corporations and domestic subcontractors in developing nations generally involve a strong imbalance of power, Gereffi et al. argue that the governments of developing nations should closely regulate such agreements in order to ensure they are economically beneficial.

### THE SMALL-FIRM SECTOR

Our discussion in this chapter has so far focused on the increasing importance of large corporate entities that can swallow up individuals in huge, monolithic organizations. This focus should not lead us to assume, however, that the small-firm sector is on the verge of extinction. Small companies come into existence every day, and although many of them also quickly pass out of existence, their aggregate effect on employment is quite significant. This is especially true in the service sector, which employs an increasing proportion of the labor force. The subcontracting relationships we have just discussed are also important in the ongoing reproduction of a small-firm sector. One factor that heightens the significance of small firms is that employment is relatively stagnant in large firms in spite of the increasing proportion of production that takes place there; large firms typically use capital investment to increase productivity, and the employment-generating consequences of this strategy can be marginal or even negative (O'Connor, 1998).

Small firms are generally run by a single individual or family. Profits and retained earnings are typically lower than those in larger firms. Long-term borrowing is difficult and expensive, and the firms are heavily affected by local economic conditions. Production and marketing strategies may be outdated, and the firm generally maintains its competitive position by cutting costs rather than by brand-name recognition or by the other forms of competition available to large firms.

Such small firms, however, employ a significant share of the labor force and are thus an important

part of the economy. The competition between small, medium, and large firms contributes significantly to the dynamism of the economy. The small firms sector also provides opportunities for those with entrepreneurial abilities and adds to the economy's potential for innovation and creativity (Keister, 2005).

### Satellites, Loyal Opposition, and Free Agents

Three types of small firms exist in the economy: satellites, the "loyal opposition," and free agents (Averitt, 1968). **Satellite firms** engage in subcontracting relationships with larger firms, supplying either components or distribution and marketing services. Satellite firms may either be attached to a particular principal company or may "float"—being dependent on sales to a certain industry but not to any particular firm in that industry. Companies supplying glass, upholstery, and electrical components to the automobile industry are good examples of satellite firms. **Loyal opposition firms** provide competition to larger firms in their own industries. Such companies rely heavily on local sources of supply, have technically inferior equipment, have limited access to foreign markets, surrender the power to set prices to the larger firms, and as a group have lower profits than larger firms. American Motors occupied such a position relative to Ford, Chrysler, and General Motors for decades. (In the early 1980s, the remnants of American Motors were divided between the French automobile manufacturer Renault and Chrysler.) **Free agents** are a diverse group of firms that spring up in the nooks and crannies between large firms. In manufacturing, free agents often specialize in small-batch production. In retail trade and services, they serve markets in which it would be difficult for larger firms to achieve economies of scale. The economic niches occupied by free agents typically have too low a profit rate or too small a volume to attract larger firms. Specialty tool shops, repair services, and residential construction firms are all examples of free agents.

**How Important Is the Small Firm Sector?** Simply counting the number of firms in the economy would suggest that small firms are of overwhelming importance (Freel, 2003). Eighty-five percent of U.S. businesses have fewer than twenty employees (Census, 2010). However, recall that in earlier sections on the increasing concentration of corporate assets, we arrived at different conclusions. Large firms control the greatest share of productive assets in industrially advanced societies and are responsible for most economic production. How are we to resolve this seeming anomaly? What are the economies of industrially advanced nations actually like? Are they dominated by a few large corporations or by many small firms? By looking at the distribution of employment, we can arrive at a clearer answer to these important questions.

The proportion of manufacturing employees in establishments with fewer than one hundred employees declined from 39.2 percent in 1900 to 27.2 percent in 2010. An establishment is a plant or other place of employment (see Chapter 2). But as you have learned, employment growth has increasingly shifted toward services and wholesale and retail trade over this period. In these sectors, small firms are more typical and have a greater share of employment. For example, in services, the proportion of employees in establishments with fewer than one hundred employees decreased from 83.5 percent in 1948 to less than 60 percent in 2010. In the economy as a whole, approximately 50 percent of the labor force is employed in establishments with fewer than one hundred employees, and 50 percent is employed in establishments with more than one hundred employees (Census, 2010).

**Different Places, Same Company?** These figures are for employment in different physical establishments. Such figures, however, do not take into account the reality of **multiplant companies**. For example, individual Walmart discount stores may have less than one hundred employees at any one establishment, but Walmart has over two million employees nationwide. Nor do these figures take into account the type of concentration in which one company owns the production facilities of

other subsidiary companies. Thus, in manufacturing, only 16.2 percent of employees actually work in firms with fewer than one hundred employees. In the economy as a whole, while approximately 50 percent of the labor force is employed in establishments with fewer than one hundred employees, only 40 percent work in firms with fewer than one hundred employees (Granovetter, 2000).

How many workers are employed in the largest industrial corporations? The list of the largest U.S. corporations published in *Fortune* magazine provides a common frame of reference. If we include the top 1,500 *Fortune* companies (identified by total revenue)—made up of the top 1,000 industrial companies; the top one hundred firms in diversified services, commercial banks, and diversified financial companies; and the top fifty firms in life insurance, retail, transportation, and public utilities—approximately a third of the labor force is employed in the 1,500 largest industrial, financial, and service firms (Hodson, 1983).

What do these figures tell us about the organizational locus of work in modern society? There are a great many small firms in industrially advanced societies. Assets and sales, however, are concentrated in the very largest corporations. Approximately a third of the labor force is employed in small firms (those with fewer than one hundred employees). Another third is employed in intermediate-sized firms (those with between 100 and 5,000 employees). The final third is employed in large firms (such as those identified in the *Fortune* list). Thus, employment positions are spread relatively evenly across the three types of organizations. Many workers are employed by one of the huge corporate giants. Numerous others work in one of the small firms that fill the niches between these giants. And many others are employed in intermediate-sized firms—often firms operating across multiple locations.

### The Creation of New Jobs

The news media regularly gives a great deal of attention to the importance of small firms in creating jobs. Much of this discussion was sparked by

research by economist David Birch (1987). His most widely cited conclusion was that firms with fewer than twenty employees create two-thirds of the new jobs in the U.S. economy. We must interpret this conclusion with caution, however. Many of these jobs disappear just as quickly as they are created. Accordingly, some of these jobs represent a circulation of workers among small firms as new firms are born, struggle, and die rather than a lasting contribution to the supply of available jobs (Bednarzik, 2000).

Small firms create many jobs. Some of these jobs, however, are of short duration; many others are relatively marginal and offer only low wages and meager or nonexistent benefits. Seasonal hiring in small retail stores of temporary workers provides a good example of this latter type of job.

### Economic Revitalization

As researchers and policymakers have increased their awareness of the continuing importance of small firms in creating and maintaining employment, many have expressed hopes that this sector will provide a solution to the lingering economic doldrums of the twentieth-first century. For example, Charles Sabel and Jonathan Zeitlin (2004) argue that production strategies pursued in the past by large firms in the industrially advanced nations are no longer viable. The cornerstone of past strategies was the production of large numbers of standardized products through the use of product-specific equipment. This strategy is sometimes called **Fordism** because of its successful use by Henry Ford to revolutionize the automobile industry. Over time, however, this strategy tends to de-skill workers, rendering industries based on Fordism attractive to low-wage competitors, such as South Korea, Taiwan, Brazil, and Mexico.

The solution proposed by Sabel and Zeitlin (2004) and others is that the industrially advanced nations concentrate on specialized products with high value added that imitators find difficult to copy. Sabel and Zeitlin offer an example of an existing system of this type in central and

northeastern Italy. Many small factories employing from five to fifty people have sprung up in this region. These shops specialize in the production of custom textiles, automatic machines, machine tools, and specialty automobiles, buses, and agricultural equipment. Although these firms often started as industrial subcontractors, they have been able to escape their dependence on larger firms through diversifying their marketing operations to include other small producers in the local area and in the broader European market. As a result, they have altered their status to become independent innovators, developing new products for a wider market. In the past, the subcontractor's customers arrived with a blueprint to execute; they now arrive with a problem for the subcontractor to solve. The magnitude of potential employment growth from such specialization is open to debate, but such strategies are becoming an important part of development plans in many industrialized nations.

**Size and Innovation** Part of the optimism concerning small firms results from their demonstrated ability to innovate more quickly and less expensively than large bureaucratic organizations. The National Science Foundation finds that small firms are about six times more effective in creating technological innovations than are large firms (U.S. Senate, 1986). A frequently cited example of this phenomenon comes from the steel industry:

The oxygen converter is one of the most important advances ever developed in steelmaking. It was invented and used in Europe prior to the Second World War. It was introduced in the United States in the 1950s—not by big firms, but by McLough Steel, a small independent firm based in Detroit. A comparable case is continuous casting, a revolutionary process in steel production, which was introduced by ninth-ranked Allegheny Ludlum. (Reid, 1976, p. 50)

Some other important innovations made by individuals and small firms are listed in Table 15.2. Public policy encouraging small firms as a source of

**TABLE 15.2** Some Important Innovations by Independent Inventors and Small Organizations

Invention	Inventor
Xerography	Chester Carlson
Insulin	Frederick Banting
Vacuum tube	Lee De Forest
Penicillin	Alexander Fleming
Cyclotron	Ernest O. Lawrence
Catalytic cracking of petroleum	Eugene Houdry
Automatic transmission	H.F. Hobbs
Jet engine	Frank Whittle and Hans von Ohain
Frequency modulation radio	Edwin Armstrong
Helicopter	Juan De La Cierva, Heinrich Focke, and Igor Sikorsky
Mercury dry cell	Samuel Ruben
Kodachrome	L. Mannes and L. Godowsky Jr.
Air conditioning	Willis Carrier
Polaroid camera	Edwin Land
Tungsten carbide	Karl Schroeter
Oxygen steel-making process	C.V. Schwarz, J. Miles, and R. Durrer
Video games	Noland Bushnel
Artificial heart	Robert Jarvik
Solar-powered car	Hans Tholstrup and Larry Perkins
Computer chip	Jack Kirby
Oral contraceptive	Gregory Pincus
Laser disc	David Paul Gregg
Microprocessor	Marcian Hoff and Frederico Faggin
Human in vitro fertilization	Patrick Christopher Steptoe
Internet	Multiple developers

SOURCES: U.S. Department of Commerce, 1967, *Technological Innovations: Its Environment and Management*. Washington, DC: U.S. Government Printing Office. Also, Kevin Desmond, 1986, *Inventions Innovations Discoveries*, London: Constable; and Rodney Carlisle, 2004, *Scientific American Inventions and Discoveries*, Hoboken, NJ: John Wiley, p. 401.

innovation have gained increasing support in recent years. Great hopes are being placed on this sector and on the belief that “decentralization is the great facilitator of social change” (Naisbitt, 2001). A contemporary example is provided by steel mini-mills that convert scrap metal into specialty steel products. These are being proclaimed as at least a

partial answer to the decline of the U.S. steel industry. (See Chapter 8 for a discussion of the role of these mills in the U.S. steel industry.) Sustaining high levels of innovation in an economy dominated by giant, globally interconnected and highly bureaucratic corporations is an important challenge facing contemporary societies.

## SUMMARY

Large corporations exert great power in relation to workers, their host communities, and smaller companies. In recent years, they have further increased their power through mergers, expansion into diverse product lines, interlocking boards of directors, and subcontracting. The ownership of a majority share of many large companies by the largest banks increases concentration of economic power still more and—perhaps most importantly—further removes investment decisions from actual production issues.

The prevalence of large, diversified corporations and the rapid pace of merger activity have many potential negative consequences for workers and communities. Workers may lose jobs without warning and on the basis of decisions in which they had no role—about which they have little or no knowledge and which may be unrelated to how productive they are. Similarly, the use of subcontracting may lessen the power of workers and

communities and increase their vulnerability to shifts in corporate strategies.

Large-scale production in huge corporations will continue to be the dominant way in which most manufactured goods are produced. However, it is also likely that the small-firm sector will continue to be reproduced in the niches between these corporate giants. Despite its limited productivity, this sector employs a significant number of workers. Whether it can produce technological and organizational innovations that will increase its relative share of production seems less certain. Its significance, however, should not be underestimated; it will continue to play an important role in providing jobs, goods, and services. The fact that a third of the labor force works for firms with fewer than one hundred employees should caution us not to assume that the experiences of workers in the largest corporations are the only or most significant type of work experience in industrially advanced nations.

## KEY CONCEPTS

corporate economic power  
corporate political power  
corporate inflexibility  
monopoly  
oligopoly  
backward linkages

forward linkage  
vertical integration  
predatory pricing  
concentration ratio  
limited liability  
management-controlled firms

mergers  
diversification  
cash cow  
corporate divisions  
lean production  
golden parachutes  
subcontracting

satellite firms  
loyal opposition firms  
free agent firms  
multiplant companies  
Fordism

## QUESTIONS FOR THOUGHT

1. Identify a large company in your community. Research this enterprise to find out as much as you can about who owns it and about the ownership and control linkages between this enterprise and other enterprises. Is this enterprise a subcontractor to some other enterprise? Does it subcontract out any of its own work or support services?
2. What factors encourage the increased size of organizations? What factors—if any—limit organizational size?
3. In what ways do large corporations exercise power over their employees? Over communities? Over competitors? Over suppliers? Over the government?
4. Draw a timeline depicting the history of corporate mergers. Note the different types of firms emerging during the different periods.
5. What purposes are served by limited liability for the owners of corporations? Write an essay either defending or criticizing limited liability.

6. How important do you think the small-firm sector will be in the future of advanced industrial society? Would you prefer to work in a small firm, a medium-sized firm, or a large firm?

## MULTIMEDIA RESOURCES

### Print

- Michael Moore. 1997. *Downsize This!* New York: Harper. A witty and disturbing look at the state of the American economy and the values guiding it.
- Paul K. Edwards and Judy Wajcman. 2005. *The Politics of Working Life*. Oxford: Oxford University Press. A wide-ranging and insightful consideration of the running battle between corporate power and employee power.
- Neil Fligstein. 2001. *The Architecture of Markets*. Princeton, NJ: Princeton University Press. A penetrating analysis of the influence of financial managers on the economy and on modern society.
- Barry Bluestone and Bennett Harrison. 2000. *Growing Prosperity: The Battle for Growth with Equity in the Twenty-First Century*. Boston: Houghton Mifflin. A critique of the economic inefficiencies caused by large corporations. Includes proposals for revitalizing the economy based on distributing control to workers and communities.
- Sanford M. Jacoby. 2004. *Employing Bureaucracy: Managers, Unions, and the Transformation of Work in the 20th Century*. Mahwah, NJ: Lawrence Erlbaum. A revealing analysis of the rise of the modern economy dominated by large corporations.

### Internet

- "High-Flying Executives." Discusses the Northwest Airlines bankruptcy and contrasts the huge bonuses

and salaries of chief executives with the salary and pension cuts faced by pilots, flight attendants, and other airline workers. [www.pbs.org/moyers/journal/blog/2007/06/preview\\_highflying\\_executives.html](http://www.pbs.org/moyers/journal/blog/2007/06/preview_highflying_executives.html).

Wal-Mart Watch. [walmartwatch.com](http://walmartwatch.com). Devoted to supporting the struggles of employees, citizens, consumers, and suppliers to deal with power to Walmart to set wages, reduce benefits, and pressure communities.

Power Structure Research. [darkwing.uoregon.edu/~vburnis/whorules](http://darkwing.uoregon.edu/~vburnis/whorules). An Internet guide to contemporary social science research on the concentration of economic power and its consequences.

Interlocking Corporate Directorates. [www.theyrule.net](http://www.theyrule.net). An interactive site that allows users to visualize the interlocks between the largest corporations.

Financial Scandals Around the World. [projects.exeter.ac.uk/RDavies/arian/scandals](http://projects.exeter.ac.uk/RDavies/arian/scandals). Extensive reports on both business and government fraud and financial scandals.

Forbes magazine. [www.forbes.com](http://www.forbes.com). A popular magazine devoted to business issues from the perspective of business owners.

Small Business Administration. [www.sbaonline.sba.gov](http://www.sbaonline.sba.gov). The key federal agency providing support for small businesses.

National Business Incubation Association. [www.nbia.org](http://www.nbia.org). An independent association devoted to helping new businesses succeed.

## RECOMMENDED FILMS

*Enron: The Smartest Guys in the Room* (2005). A highly acclaimed (and disturbing) documentary on one of the largest corporate scandals in American history in which top executives from the seventh largest company in the country plundered over a billion dollars from investors, employees, and retirees.

*Wal-Mart: The High Cost of Low Price* (2005). Tells the story of how Walmart directly pressures its suppliers to lower their prices below what they can afford, resulting in forced movement to lower-wage locations in order to survive.