

Lecture of
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before
BUREAU OF INDUSTRIAL RELATIONS
UNIVERSITY OF MICHIGAN
RACKHAM MEMORIAL BUILDING, DETROIT
APRIL 9 1962 5:00 PM

A NEW LOOK AT MANAGEMENT RESPONSIBILITY

A corporation lawyer (which I am) has professional competence only in a specialized field of political economy. He does, however, have a splendid stance to observe and participate in the day to day working of a predominant part of the American economic system. That system has become primarily industrial. Its work is done by managements of corporations--chiefly big ones. This is the basis for the observations in this essay.

I here suggest that big business, in the American system, exists and derives its right to exist under, and only under, a tacit social contract. This social contract requires management of big business (let us say, arbitrarily, the 1500 largest corporations in the United States) to assume certain responsibilities. Assumption and fulfillment of them entitles big business to the privileges it receives from the State, and to acquiescence in their existence by the economic community they affect and serve.

Under this arrangement responsibilities have devolved on corporate management. I here deal only with two of them.

One is their responsibility for the timing and results of allocation of their capital resources. The second is their responsibility for the administration of price and quality of product. They are expected and entitled to come up with profits as a result of this administration. But they also are required, while seeking profit, to assure that their work in both these fields shall

contribute to economic stability, to maintaining continuous and adequate supply, to providing continuity and stability of employment, and to providing technical advance in their industry.

Four results, all in the public interest, must be sought and if possible attained, namely,

- (1) a reasonably stable and growing economic situation;
- (2) a supply of desired goods sufficient to meet predictable demand;
- (3) maintenance of continuous employment; and
- (4) technical advance.

Seeking these results modifies, pro tanto, the old theory that the whole duty of management was satisfied by maximizing profits. Put differently, the right to make and retain profits is conditioned on working toward and, let us hope, attaining these ends.

These are the terms of the “social contract” upon which big business has the right to exist. This essay does not purport to give a complete review of that contract. But these are major heads in it.

Allocation of capital

It is now generally understood that the large, modern corporation is a capital-gathering and capital-creating machine, as well as an organization for the production and sale of goods and services. I have made that point elsewhere, notably in my recent volume, “Power without Property.” More recent figures verify the contention. The monthly “Business Review” of the Federal Reserve Bank of Cleveland for February, 1962, summarized the data for the decade 1950-1960 inclusive. In that eleven-year period, according to the figures of the Federal Trade Commission and the Securities & Exchange Commission, manufacturing corporations in the United States acquired \$229 billion of new capital. For most of this they did not go into the “capital markets,” by selling bonds or stock to the public. They accumulated “internally,” by

piling up out of their gross receipts allowances for depreciation, and earnings which they did not distribute to stockholders.

Depreciation allowance under current law are not considered “profits,” and as a rule are not considered available for distribution (there are, of course, exceptions). Earnings, over and above costs and depreciation, may or may not be distributed. The custom has been to distribute about half of “earnings” (after depreciation) as dividends, and to retain the other half for corporate purposes. 60% or more of the \$229 billion of total capital (say, roughly, \$138 billion for the 1950-1960 period) was accumulated by depreciation charges plus retained earnings. Another 20% -- say, \$45 billion--was brought in through bank loans for capital purposes, some of which were loans in anticipation of predictable capital accumulation from internal sources. The remainder was raised through the capital markets--about half through private placement of bonds. The predictable internal accumulation really lays the credit base entitling these corporations to ask long term capital from the public or the financial institutions by selling bonds or stock--the 20% of the \$229 billion of capital collected from outside.

Now the right to accumulate earnings is a right given by corporation law. It is a rare and singularly valuable privilege. You will find, if you consult your counsel, that a trust for perpetual accumulation is outlawed. No individual has a right to set up a trust or other arrangement which does not end after a generation or so (customarily, a lifetime or lifetimes and twenty-one years thereafter) nor to arrange that that trust shall perpetually accumulate profits. So far as I know, this privilege of perpetual accumulation of all or part of earnings is allowed only to corporations and to certain forms of pension funds and similar arrangements.

The companion privilege of deducting depreciation allowances from income, so that this amount pays no federal tax, is also a singularly valuable privilege, given by law. Without this,

52% of these allowances would have to be paid to the federal government as corporate income tax. Businessmen take it for granted. Yet, in fact, the right to accumulate is an immensely profitable right. It is given for a purpose. The purpose is to assure that new capital will continue to be gathered to replace old, and that it will continue to be applied to renew the tools and plant for production needed or wanted by the population of the United States. There is no objection to this arrangement. Renewal of old capital and the gathering of new is an absolute essential to the industrial economic process here or anywhere else. In point of fact, if these two methods of capital gathering were ended, some substitute for them would have to be found at once. An industrial economic system slows up or breaks down when capital is not continuously renewed and added to and continuously and usefully applied. Corporations though not required are expected to do this. Unless, of course, they are about to liquidate. That is why they have the accumulation privileges.

Yet if our reasoning is sound, the obligation goes with the privilege. There is a clear responsibility to see to it that the capital is regularly applied--put to work, if you will--and that this application shall be done usefully. "Usefully" here means in such fashion that the results of this capital investment shall contribute to assure the adequacy, continuity and progress of the American system of supply and distribution. Ideas and standards of adequacy economic health and progress will, of course, change with passing years through growth of awareness of economic functioning through rising expectations of what can be derived from our industrial system, and with greater knowledge as to how they can be fulfilled.

But here we have a forceful qualification on a supposedly absolute management power. Let us see how it works.

We have become persuaded by the patient records and research of economists and by our own direct experience that economic cycles (“booms and busts”) are unhealthy and undesirable. We have also learnt that one of the more powerful stabilizers consists of continuous, steady and predictable investment of capital funds. When recession comes, one of the standard remedies now is to arrange greater application of capital. We use government funds and government credit if need be. But the first resource is not to seek government funds, but to stimulate and assure what is called “private” investment--meaning, in economic fact, the application of capital whose accumulation by corporations is authorized and encouraged by our law and tax system, and perhaps of additional capital based on the credit this accumulation engenders. It is no secret that in 1958 (recession then being in progress) a group of businessmen under the stimulus of Mr. Nelson Rockefeller and others met to check it in part by voluntary (that is non-governmental) action. Specifically that meeting did two things. It discouraged corporations from cancelling planned investment in capital plant (meanwhile holding cash or short-term securities and waiting to see how the cat would jump.) Such hoarding would have meant less expenditure for capital goods, a continued decline in business and especially in heavy industry, and almost certainly greater depth of recession. Second, the meeting encouraged increased capital expenditures by these corporations wherever possible because it was realized that this stimulus to the economy (coupled with government measures) would lead to more rapid recovery--as, in fact, it did.

And now to our responsibility--duty, if you like--under the social contract. In timing their expenditure of capital, managements of corporations accumulating and gathering capital must take account of the total effect on the economic health of the country. They ought not to hoard when expenditure is needed; perhaps they ought to slow down under some conditions.

There will be protests from some quarters. Does not the industry have too great productive capacity? Would it not be better to wait and see? May there not be opportunities to invest later, as distress drives prices down? Rightly, businessmen ask these questions. Yet the cold reply comes: if the economic system is to remain healthy, the capital must continuously go to work and management must solve the problem of finding a useful job for it.

A companion responsibility lies in this area. Plainly if capacity to supply any predictable demand already exists with adequate margin for probable increase, allocation of capital in that kind of capacity is not presently needed. Then search must be made for other areas in which capital facilities are or will be needed. Application of capital in that field ought promptly to be made. In any business the first criterion in investing capital obviously is to assure productive capacity to meet predictable demand for those products which the corporation is expected to supply. If that has already been provided for, the second obligation is to build or increase capacity in some other line where adequate productive capacity is not yet developed.

What can not be done is simply to sit down and wait, where the corporation is able to act. To do that means interrupting employment, wage-flow, demand, and business generally.

At this pint, our fourth responsibility--technical advance--comes into play. A well-run corporation ought not to have to start looking around for something to do. Presumably it has a research and development department whose precise business is to discover new needs, or better ways of satisfying old needs, or development of new and useful products, or better ways of producing old ones. If the department has been well run, possibilities will already have been discovered. Laboratory and engineering work will already have been done, and projects will have been developed. Governments, knowing (as now they do) that they may have to support the economy in case of slowdown, try to have a shelf full of public works plans ready for

immediate activation in case of need. A private corporation should have a shelf full of new projects ready to go. The more of these ready-to-go projects, accompanied by willingness to put them in action, the less the government will need to draw on its work-project shelf, and on its taxes or credit to pay the bill.

This, to be sure, implies that the concern has long interested itself in technical advance in its own field of business and in allied or related fields and (possibly) in new fields which will diversify its operations. The obligation of corporate managements to interest themselves in technical advance, to foster and not impede that advance, rests on something more than merely "good business" in the profit-making sense. It is a definite responsibility to the community and the economy. The corporate privilege of accumulating capital was granted and has been permitted to continue in part at least on the premise that the concern fulfills that responsibility.

I note that in the pending revision of the tax laws provision is made for greater or at least more rapid, depreciation allowances. In effect, these provisions exempt for a period of time an added slice of gross profit from the 52% federal tax by permitting a larger deduction from taxable profit. This is an increase in the privilege of accumulating capital. And it is proposed, supported and probably will be passed on precisely the grounds stated above. It is offered on the assumption that the corporations benefitting from it--that is, accumulating more capital than before--will promptly put that capital to work and thereby support an increase in the productivity, the employment, and the general economic health of the country. The hoped for effect is that total product will be increased, that men otherwise unemployed will be kept at work and put to work, that greater and newer product development will occur--because managements do put this capital to work.

More can be said on this subject. Today I am only scratching the surface of this section of the social contract--the public franchise, if you will--which entitles big business to accumulate capital and remain in private hands.

Administration of price

A second, less well understood, responsibility is that resulting from the power of big business to “administer” prices.

The economic fact appears to be that, in most of the basic lines of production, the price of the product is “administered”--that is, set by management rather than by competition, over substantial periods of time. A book just published by Harper Brothers, “Pricing Power and the Public Interest,” written by my former colleague, Dr. Gardiner C. Means, makes an unanswerable case study of the facts in respect of steel prices. I am clear that in many, perhaps most, other basic lines equally powerful demonstration can be made.

This I know hurts the feelings of some who like to believe prices are still made by a sort of continuous auction and chaffer in public markets. Nevertheless the facts are there. True, competition has not been entirely eliminated in determining price. True, monopoly not being allowed, no management has absolute pricing power. True, products compete with one another just as aluminum can often be substituted for steel, and as prices of chemical fibres are more or less modified by the prices of animal and vegetable fibres. But allowing for all that, it still is true that under our system, big plants, big producers, big corporations and big business set the general range of prices in many products and that prices so set rise and fall very slowly. Competition still does set top limits, does interrupt the pricing process, does qualify absolute power. But the usual result is a stabilized level of prices reached by a sort of management consensus,

conditioned by more or less uniform costs (including the uniform cost of labor) and by a rough consensus on acceptable profit margin.

I am not able to join those who condemn this system. The passing of the sensitive, rapidly fluctuating, intensely cut-throat “free market”--so dear to classical economists--is not, I think, cause for tears. That kind of market indeed did from time to time lower prices. It also produced sweat-shops, bankruptcies, fiercely fluctuating employment, financial instability and all sorts of human distress. If you reckon the costs of that distress--always paid for by the community in the form of relief, or by losses of individuals and of small business and consequent human suffering, you probably would find that any price advantage consumers may have derived was more than off-set by general losses all along the line. A reasonably stable society, in which a community can expect to go on working and living, and in which men having jobs can expect they will continue, is a value in itself. The “administered price” in my judgment has contributed to that value, which we have learnt to appreciate in this generation.

Large corporations are allowed to exist, under our social system, because, among other things, they assist a healthy economy in the community. Because of their size, they have acquired the power to administer prices--thereby they can and do give a measure of stability to economic life as well as to achieve it for themselves. This factor makes the American system and now the Western European system preferable to the bazaar-and sweat-shop price systems familiar in the nineteenth century, and still found in less mature economies. My impression is that nobody--but nobody--really wants the old, unlimited, day-to-day, minute-to-minute, dog-eat-dog fluctuating prices, wages and employment and the resulting conditions back again. Where these conditions do exist, as for instance in some of the garment trade industries, and in some branches of coal mining, every kind of device is worked out to overcome or mitigate the damage.

In more industries than you think, indeed, these conditions have been more or less eliminated by national stabilization plans. Some of these have been in force for a generation. This, for example, is true in the oil business, as it is also true in the sugar business--with which last I am very familiar. As you know, in the transport and public utility fields, the system has been abandoned altogether: in them, prices are set by public authorities.

So the emergence of administered prices does not seem to me either uneconomic, or anti-social, or contrary to the American dream. It strikes me as merely intelligent.

But it does involve a responsibility--and that responsibility primarily falls on management. Power to administer prices does give a measure of power over the private incomes--or, more accurately, the private expenses--of 185 million Americans. Any group of corporations holding that power have to remember that it was not given them at all--it has grown from their size--and cannot be used merely to maximize profits. Obviously corporations have to make profits--else they would be out of business. But their profit must be in the nature of fair compensation for the job they do--and not a premium for exploiting the consuming public. The measure of competition coming into play only when that limit is over-passed, does exist as one check or balance on the pricing power. But a management is irresponsible if it merely feels for the top price limit available without explosion. It is as irresponsible to do that as it would be for an individual businessman to push his advertising policy just short of the point of a criminal indictment for fraud.

In this area we are not to be sure dealing with clear-cut, defined legal tests. We do not have--and I hope we will not have--commissions trying to figure out what prices can be charged or exactly what is a "reasonable" return on capital--as they do in the case of rates for gas or electricity. There are too many variables. Study through the next few years will probably

develop crisper, clearer standards in this singularly fuzzy field. And yet. Every businessman knows when he is getting a decent or a fair price--as medieval priests used to say, a "just" price--and when he is getting away with economic murder. He and his colleagues ought to understand the wages of the sin of abusing pricing power sooner or later will be justifiable State intervention--and quite likely their own exit from the scene.

This means, in practice, that where prices are "administered," a management must take the responsibility of being willing and able to "justify" that price when asked to do so. A subcommittee on antitrust and monopoly of the Senate Judiciary Committee whose Chairman is Estes Kefauver, is asking such questions now. Specifically it is considering alternative public policies in dealing with the problems of administered prices. In particular it is asking the drug companies to "justify" their prices on some of their new products. A similar committee may ask at any time that "expenses", for example, advertising, be likewise "justified."

These are legitimate questions. After all the 185 million American consumers pay the shot. Presumably in most cases of administered prices, there is "justification." But a modern corporate management must consider its justification and be prepared to make it--and make it honestly--not with mirror statistics or appeals to by-gone enterprise absolutism or "what the traffic will bear" theories of nineteenth century doctrine.

For it is also a part of the social contract permitting big business that it shall supply the public with the goods and services needed and wanted by it at a justifiable price. Managements have accountants who can state or at least approximate the facts of investment, costs of research and development, costs of market entry, costs of production, depreciation and of profit. They can calculate the necessity of accumulating further capital. They can, more or less, relate these costs, this accumulation, and this profit to each product they sell. They can include the high-risk

expenditure of venture capital in pure research, applied research, development and distribution. They can calculate whether the price as administered is designed to cover these items--or merely to represent everything the traffic will bear, irrespective of consequences to the consumers on whose pay and spending all business ultimately depends.

Let me here insert a final angry paragraph. Because angry, let it be brief. Administration of price goes hand in hand with administration of quality. Big business needs better ethics than those of bunco-steerers outside a country fair. To rig quality against the consumer is as evil as to enforce an extortionate price. And doubly evil when surreptitiously done. To "build in" obsolescence comes perilously close to being crooked--unless, of course, the seller is willing to say what he is doing. If he is prepared to advertise in large type "This machine guaranteed to break down in two years" or "In eighteen months we plan a campaign showing this model is junk and you must buy another," or "No repair service after next February," or the equivalent disclosure, it may be allowable. The sucker does not have to buy, or at any rate then knows what he is doing. But in any case the planned obsolescence game is at best organized waste, and if undisclosed it is not far from plain cheating. As you catch the idea, I shall not expand. The management responsibility is clear, personal and obvious.

CONCLUSION

In summary, my proposition is this. Business, and more especially big business, exists by virtue of a social contract. The contract expands and develops as the American community grows, as it develops new needs and standards, and as the great corporations grow greater with it. Two items of that contract were here dealt with. One is that the capital accumulation shall be continuously and conscientiously put to work to maintain stability and achieve continuing progress. The second is that the power to administer prices includes a responsibility to justify and to be able to justify an administered price.

Consciousness of both responsibilities will, I am clear, be the most powerful motive assuring their fulfillment.