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Corporate Decision-Making and Social Control

As the position of corporations has changed in the past thirty years, so has the position of their legal counsel, and, specifically, of the lawyers in charge of their legal departments.

In my youth, it was customary to look down on these men as “tame lawyers.” No longer. Like all lawyers, they still have the function of passing on specific legal problems as they arise and must give their legal conclusions on the basis of their professional judgment, irrespective of whether or not their professional conclusion is pleasing to their client-employers. In addition, sitting at the right hand of the policy-making officers, they have the opportunity, if not the duty, to advise upon the possible consequences, economic, legal and social, of corporate decision-making.

For some years in our seminar at Columbia, we developed the theory that the law affecting corporations falls in two categories. The first is familiar to all of you--the explicit rules laid down by decision or statute and setting out the existing legal capacities and liabilities. The second, more important and more difficult category, we call “inchoate” law. This relates to the duties of corporations, not set out either in decision or statute, but arising from the impact on social and economic situations foreseeably resulting from a corporate course of action. When the impact point is reached, it is predictable that the hitherto undetermined liability or responsibility will suddenly emerge as explicit law. This result might come about through sudden demand for and passage of legislation--or through decisions of administrative authorities breaking new ground--or through court-decision extending judicial action beyond previous limit.

It is the business of the head of a corporate legal department to be aware of these fields of inchoate law, and to guide corporate policy so that the results will accord, rather than conflict, with these inchoate rules. In the truest sense, this is corporate statesmanship, and the duty comes to rest in the legal departments advising corporate management far more than in their outside counsel.

Transition of the large corporation from a private enterprise to a social institution has now been accomplished and is generally recognized. Their size, breadth of power and unlimited scope dominate the American economic scene. This is due primarily to two legal privileges granted corporations. Taken together, they proved to be the unintended but nevertheless greatest invasion of the so-called “free market” principle so dear to our grandfathers.

First, the private corporation was granted perpetual duration. This meant that its operations were not limited by the span of a man’s life. Property did not have to be distributed or reorganized at the end of each generation as is the case with individually-owned enterprise. It was free from the old common law rule against perpetuation, limiting the life of a trust to a “life” _____ . Corporate life can go on forever.

Second, a corporation was not required to distribute all its profits. Conventionally, successful corporations distribute from 50% to 60% of profits, and accumulate or “plough in” the balance. In result, corporations had and have power of “perpetual accumulation.” They could retain part of least of their profits forever whereupon the compound-interest principle prevailed. The huge size of American corporations is primarily due to their exercise of this privilege. Because of this accumulative power, their need of new equity capital has been minor.

By consequence, the past two generations have brought corporate enterprises to their vast size, their dominating position and their substantial market power. Through their power of

acquisition, there is occurring a gradual but steady increase in concentration of economic activity in the hands of a relatively few great enterprises. A few hundred corporations dispose of more than two-thirds of America's enormous non-governmental economic activity, and their number tends to diminish though the volume of economic activity steadily increases. Because of that fact, these few hundred managements lie in a twilight zone. They over-pass the functions of private business--but they are not parts of government. The law does not define their position; competent managements understand it. Whereas a generation ago, the law was preoccupied with assuring that managements did not victimize their shareholders, preoccupation today is with the extent of their social and political and economic responsibility for the health of the American economic machine, and for employment and welfare of its citizens. With 24 million stockholders, interested chiefly in dividends and market values, and pretty much 200 million customers dependent on their product and services for today, on where they invest their capital tomorrow, and the innovations they may introduce the day after, that ill-defined responsibility commands attention.

Some thirty years ago, I debated this possibility with the late Professor E. Merrick Dodd, of Harvard. I maintained that corporate managements were primarily trustees for stockholders. He insisted that they were trustees not only for stockholders but also for their labor, their customers and the area of business on which they had impact. Pragmatically, Professor Dodd won the debate. I was not convinced as matter of doctrine that social responsibility should not be left to government--but there was no doubt that the event conformed rather to his prediction than to mine. Accepting that fact, I have attempted to deal with it and with its legal implications. This is what we are endeavoring to do tonight.

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§2.

In earlier times, the problems we must here discuss were left to the discipline of economics. Competition, and the “free market,” it was thought, would dictate what economists like to call “the optimal allocation of resources”: labor, raw materials, investment in machines and innovation, and the type of product sold. A long line of economists from Adam Smith to Professor Friedrich Hayek and now Professor Milton Friedman maintain that economic discipline is still sufficient. Yet the majority view, which I think unanswerable, points out that competition is one thing when carried on by thousands of producers and merchants; quite another when maintained by huge combinations of the size of Standard Oil of New Jersey, General Electric, General Motors or American Telephone & Telegraph. The concentration of most industries in a few giants, whose smaller competitors must follow their lead, brings about quite different results in price, product, accumulation of capital and its future direction, than when hundreds of thousands of farmers or small producers peddle their product in a sensitive and vibrating market place. Factually, left to itself, the free market would not long exist. In industrial United States it exists only because the Federal government maintains a very vigorous section in the Department of Justice, not to mention the Federal Trade Commission, devoted to enforcing a degree of competition through the anti-trust laws--in other words, devoted to preventing the free market under the corporate system from degenerating into a string of monopolies, in which case the free market would be reduced to minor proportions.

Next to the laws creating corporations, the anti-trust Acts are the greatest governmental intervention in the operation of free markets in American economics. The “free market” is today a statist instrument, used by the Federal government to protect a small, though significant, sector of private-owner business, and to maintain a degree of economic discipline, artificially imposed

upon the artificially-created corporate system. In result we have huge and growing corporations whose operations are unlimited in direction and scope, required by law to have a certain competitive aspect, but permitted to have, in fact, a high degree of power over the development of the country's economics. Social responsibility is the result of this dichotomy.

The system in major aspects has proved remarkably successful. By almost any standard, American production has been the highest in the world; so is the American per capita income. The distribution of wealth is by no means bad when compared with other systems. America is the first large country in the world to be able to contemplate and take on the problem of abolishing involuntary poverty--which it should find ways and means to do within a decade. So far as aggregate productivity and aggregate wealth is concerned, the problem is plainly manageable, at least so far as economics is concerned.

That poverty and bad social conditions exist in perhaps 15% of the population is clear. It has become fashionable in some circles to attribute this to the structure of the American economic system--that is, in large measure to corporations. I consider that charge unsupported. The corporate system of our time can do whatever in reason is asked of it in terms of production, expenditure of capital and distribution of profit. But the corporate system cannot, should not and should not be expected to produce a society. It can and should conform to social requirements; it can and should lend help to government and to quasi-public and other institutions whose task is to develop a society both good and just. On the other hand, nothing in the structure of corporations or the training of their management entitles them to be philosophers. They can be held (as they were two generations ago) to an obligation not to resist demands for betterment. They should be required to assist the social evolution as a democracy pounds out social principles, and as growing density of population requires more rules of the road. Individuals,

including those active in the corporate world as also individuals engaged in academics, politics and government can propose standards and measures and can campaign for them. Corporations can favor and protect their personnel in doing so. They can urge that better principles shall prevail and that better road rules shall be made. They can even offer technical assistance in these processes. But there they must stop. Beyond that it seems to me they are subjects. Nothing in their present situation entitles them to govern, and if they try to take on that role, they are headed for trouble.

§3.

What, then, are their responsibilities?

The first responsibility of corporations is to the markets relying on them for supply.

Under the American system, an oligopoly of large corporations has built up expectation that they will produce certain categories of goods and services. Consumers have accepted and rely upon the implied promise that supply will be available. These, the corporate “constituencies”, have come to base their operations on the premise that all manner of products, from capital goods like heavy machinery to consumer goods like shirts and that all manner of services from automobile repair and gasoline delivery to telephone communication and news will be steadily and readily available. Failure to supply these constituencies in the volume required at an acceptable price means hardship, mild or intense; for some, it may mean disaster.

Obligation to supply already developed markets is easily said and readily accepted but is not universally met. Complaints are rapidly rising; they are now so generally familiar that I omit the usual sermon. On January 22, U.S. News & World Report (p. 60) carried an incomplete bill of particulars.

Production also ought to be carried on with a minimum of waste. It ought to avoid air and water pollution, and protect the community and its landscape from debasement. It ought to keep its employment continuous. It ought to keep highways from the eruption of advertising hideousness. Sale of goods such as household appliances and television requiring periodic attention ought not to take place unless facilities for servicing are arranged. Production and the products sold ought to keep abreast of the “state of the art.” Among other things that requires conforming to the growing capacity to make products, say automobiles, safe and drugs reliable. “Built-in obsolescence” becomes a modified form of cheating.

The grist of news in this field suggests standards have been badly slackened. My own conviction is that the directors of every substantial corporation ought at once to appoint an "internal review committee," ought to examine its operations, ought to find remedies or change policies where they are found wanting. Had such a practice been adopted by the motor car companies a few years ago, they might have been spared the embarrassment of a congressional review and the passage of a Federal safety standard Act imposing on them standards they should long since have imposed on themselves. In fact, they failed to live up to one of the standard rules of inchoate corporation law--keep up with the state of their industrial art. Violation caused the law to become explicit--this time in the form of a Federal statute.

Although this head of responsibility is primarily defensive--it merely deals with the obligation of corporations to do the job they have set for themselves honorably and well--the subject is regrettably enormous. I mention it here chiefly for reference.

§4.

The greater and more crucial problem now being forced on corporations relates to their primary and perhaps greatest decision-making power. At present a corporation may be anything, produce anything, invest its capital and accumulations anywhere, when, as and how it chooses. In performing any of these functions, current law does not require it to consider local or national needs or prospects. Honest "business decision" and action accordingly is the sole standard imposed by law on corporation directors and officers.

In a sparsely settled, largely empty country, this probably was good enough. But the United States is rapidly becoming a crowded country. Its resources are vast but not unlimited. Its economic arrangements increasingly mesh into one vast mechanism. Repeatedly the question is being asked: can unlimited business decision-making power be allowed to continue--or should it be subjected to ground rules? Again, if there were hundreds of thousands of small businesses, competitive market discipline might serve, though I am not sure. In any case, that kind of market does not exist in huge areas of American business. Now, when a few hundred corporations dispose of most industrial production, the situation is far from plain. Already probability of an impact between the results of uncontrolled business operation and the present political-economic complex is beginning to appear. Its long shadow is already reaching the corporate system and advance thinking is essential. Falling into that shadow is the problem of what a corporation is--and in future what it should be allowed to be. Not unpredictably, it appears in speculation as to possible developments in antitrust law. Let us consider a few peripheral points where the shadow-edge is visible.

Size. The Department of Justice has been developing a vigorous interest in whether mere size may not, in and of itself, constitute a violation of the Sherman Act. Let us leave out the

question of whether the Sherman Act was intended to do this. Courts and particularly the Supreme Court have achieved for themselves a considerable measure of flexibility in application. Washington speculation suggests that the General Motors Corporation may be target of a test case some months from now. Whether this is the target corporation or not, it is almost predictable that, given the corporate power of perpetual asset accumulation noted when we began, that question will come up, if not next year, at any rate within a relatively short time.

Combined with the problem of corporate size is the question of corporate function. Already the shadow begins to fall on what the stock market presently calls “conglomerates.” These are corporations whose assets and credit permit them and whose ambitions inspire them to acquire a great many businesses in a great many unrelated fields.

Economics may eventually settle the problem: management capacity does have limits. In time, it may be found that corporations had best limit themselves to a few businesses their top officers can understand, rather than spread themselves over a great many businesses, some of which they probably do not. For the moment, the “conglomerate” idea has caught the imagination of the market, just as in 1928 the rag-bag all-purpose holding company had a brief day of glory--followed by ignominious crash. Possibly the law will become explicit through interpretation of the Clayton Anti-trust Act, perhaps using the DuPont case or the Proctor and Gamble decisions. What we are beginning to see is reaction against unlimited size plus multiple function.

Production. The corporation’s power to decide what to produce and how much may well come in for some qualification. This is not mere meddlesomeness on the part of government. One remembers the triumphant boast of the motor car companies in 1956 that, though experts estimated that there was a market for 6,000,000 cars, they could produce and sell 8,000,000--as

in that year they did. But--the following year they were only able to sell 4,000,000. They had merely borrowed 2,000,000 sales from the future. The result was a recession; it lasted nearly three years with resulting disturbance to the American economy and distress to a great many people. Uncontrolled business decision was entirely logical when we had no economic measure, no methods of market forecast, no good statistical guide-lines. Admittedly the science of market forecast even today is far from complete or exact. Yet in most staple lines, forecast of future demand and probable market is surprisingly accurate--accurate enough at least to indicate the general limits of probability. Reasonable adjustment to estimated demand of the amount to be produced--with flexibility to provide for marginal error--is already the rule in the refined sugar industry and the petroleum industry. The principle could be extended and I think it predictable that in future years will be. Economic guidelines which corporations can follow are likely to influence if they do not control the present unrestricted decision-making power where it may disrupt national flow of economic life. Current statistics and estimates now available indicate where demand is oversupplied and fields of demand that are not being met. For example, it is presently predictable that in three or four years there will be housing shortage in certain areas of the United States. We know, too, that in certain geographic areas, there is severe congestion; in others, underdevelopment. Already under discussion is whether the urban complexes should be allowed to become increasingly dense, or whether development should not be steered so that population will be more evenly distributed.

Meeting these problems will probably involve guidelines or other measures governing the decisions of corporations; it seems unlikely that investment decisions now largely in the hands of great corporations will be left to their uncontrolled discretion. Briefly, in the not too distant

future the United States will have to consider whether some system of indicative economic planning may not be needed to assure orderly and continuous operation of its economic system.

This development is not immediate--I should guess it lies a decade ahead. Yet it is not so far off that it can be ignored. Consider, for example, what goes on in France. There, a corporation may decide to build a plant near Paris; it will be told politely that that region is too full, and that it had better build in Normandy where employment is slack and space plentiful. It may desire to put up a factory in an industry whose over-capacity is already clear; it will receive a suggestion that it enter a field where there is not production enough. The stresses set up by French growth required measures rationalizing its system. "Indicative planning" was devised by the French economists and the resulting "Commission du Plan" has been outstandingly successful. My impression is that stresses are being set up in America by growth of population and consumption, by her insistence on full employment, but imperatives that her ghetto areas in cities and depressed areas like Appalachia will be brought to parity with other regions. These will require measures in the United States similar to those now employed in France.

I do not labor the point. I do suggest that the decision of corporate managers as to what they will produce, when they will produce, how much they will produce in the not too distant future may be required to conform to systems of local, regional or perhaps national planning. Given the progress of American industry and American technology and the growing complexity and inter-dependence of American economic operations, I do not see that this can be avoided. Corporation management are likely to find that indicative planning in these fields, far from decreasing their effectiveness, increases their efficiency and their capacity to act as good servants of American economic life.

§5.

Aesthetics. Finally, a specialized point. The habits and culture of Americans appear to be changing due to the impact of a new gadget called "TV". Mr. Julian believes that in the tens of millions of homes in the United States five and three-quarter hours are spent watching television. Students of journalism are of opinion that television far more than newspapers now supplies the information on which Americans make up their minds about most issues. Psychologists insist that the content of TV programs powerfully affect the lawful or lawless conduct of American youth. Now it so happens that television is one medium in which the sales departments--chiefly of big corporations--determine what programs shall or shall not be shown. True, they delegate that power to big advertising agencies. Nevertheless they and their marketing men have the last word on sponsorship. Reduced to lowest terms, this gives to American corporation managers final capacity to decide the direction and impact of the most powerful existing cultural current in American life.

This is a supremely dangerous power for anyone. It is particularly perilous for corporations already accused (though I think in large measure unjustly) of being responsible for an aggressively commercial, sordid and demoralized aspect of American civilization.

Impact of this power upon the American community as a whole is not distant, if indeed it is not occurring already. It is bound to produce some new extension of explicit law. I do not attempt to predict its form. It might cause outright nationalization of television and its complete removal from private control. Less drastically it could require separation of the advertising from the program function, restricting corporations to announcements peddling their wares but denying them any voice in program content. It could bring about some variety of censorship,

though there the Supreme Court might be an obstacle. What seems certain is that the present condition of affairs will be substantially changed.

By like token, the location and form of other advertising may be controlled. Defacing roads and landscapes with unsightly and offensive billboards, converting city streets and thoroughfares into esthetic horrors, debasing neighborhoods with posters and neon lights are rapidly coming to be considered offenses against American communities. Corporations committing them will not be absolved because they make occasional corporate contributions to local art museums or community improvement funds; they will be required in some manner to stop offending.

§6.

I have said more than enough to get into trouble. I hope nevertheless the ideas expressed will not be taken lightly. In blunt fact, the economics of the United States is becoming very crowded. Corporation decisions that yesterday did not materially affect other people today powerfully impinge on their lives. The American community is beginning to react. My hope is that corporations will themselves be aware of the areas of reaction, and in that awareness will reconsider some of their policies before government intervenes.