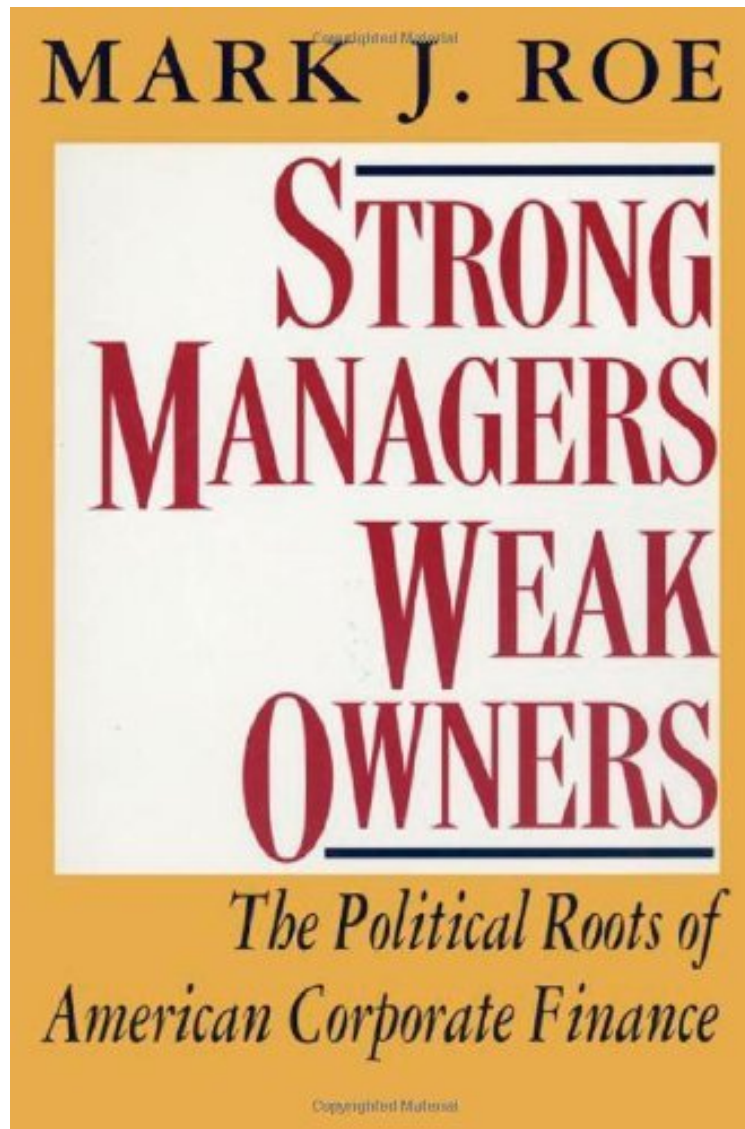


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Strong Managers, Weak Owners

Mark J. Roe

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Mark J. Roe : Strong Managers, Weak Owners before purchasing it in order to gauge whether or not it would be worth my time, and all praised Strong Managers, Weak Owners:

0 of 4 people found the following review helpful. One Star By Leonardo Netto Parentoni Used, from a public library in LA...19 of 19 people found the following review helpful. A provocative look at US corporate governance. By Stephen M. Bainbridge In their 1932 classic, THE MODERN CORPORATION AND PRIVATE PROPERTY, Berle and Means brought to popular attention the separation of ownership and control in U.S. corporations: shareholders exercised virtually no control over either day to day operations or long-term policy; instead, control was vested in the hands of professional managers. Separation of ownership and control occurred, according to Berle and Means, because

important technological changes during the 1800s, especially the development of modern mass production techniques, gave great advantages to firms large enough to achieve economics of scale, which in turn gave rise to giant industrial corporations. These firms could be financed only by aggregating many small investments. Modern corporate governance scholars refer to the consequences of separating ownership and control as agency costs, but Berle and Means had identified the basic problem over forty years before the current terminology was invented: "The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge" In *STRONG MANAGERS, WEAK OWNERS*, Mark Roe strikes out in a new direction, by attacking the origins of the agency cost problem. The question Roe poses is the foundational one of whether Berle and Means were correct in assuming that the separation of ownership and control is an inherent aspect of large public corporations. Roe contends that dispersed ownership was not the inevitable consequence of impersonal economic forces, but rather the result of a series of political decisions motivated by a fear of concentrated economic power. Investments could have been channeled to industrial enterprises through large financial intermediaries, such as banks, insurance companies, and mutual and pension funds. Put another way, while it was necessary to aggregate and tap the savings of large numbers of individual investors in order to fund major industrial corporations, such aggregation could have taken place in financial institutions specifically designed to provide savings opportunities. In turn, it would have been those institutions that invested in industrial corporations. American corporate governance did not evolve along these lines because the law created a series of obstacles to financial intermediaries. If those obstacles had not existed, ownership might not have fragmented and thus might not have separated from control. The implication of this thesis, of course, is that while economic forces shaped modern corporate governance, they did so within the parameters set by law. As such, the governance structure of U.S. public corporations may not be optimal in an absolute sense, but only relative to the set of possibilities defined by our legal system. Roe focuses on legal rules preventing institutional investors from acting as financial intermediaries between the investing public and the management of public corporations. The first third of *STRONG MANAGERS* is devoted to a historical review of the rules that preclude institutions from playing a significant role in corporate governance. In the second third, he reviews recent developments, which perpetuated the legal obstacles to governance activism by institutions. In the final part, he addresses the essential policy implication of his analysis: should the legal system encourage institutions to take a more active governance role? One can quibble with portions of Roe's historical argument. There is, for example, good evidence that ownership and control separated long before most of the rules Roe blames for the separation went on the books. At the very latest, ownership and control of large corporations had separated by the middle of the nineteenth century. In contrast, the rules with which Roe is concerned mostly came into existence only after 1900. Granted, banks fragmented in the first third of the 18th century, but a number of critical restrictions did not come into play until the New Deal. Insurers were largely unregulated until after 1906. Mutual funds, albeit long of little importance, likewise were essentially unregulated until the New Deal. Given this free market environment, why did these or other financial intermediaries not step into the economic niche opened when ownership and control separated during in the early and mid-1800s? In other words, Roe has not proven that the Berle-Means corporation would not have evolved in the absence of the constraints on financial intermediaries he describes. But, at a minimum, Roe does demonstrate that politics did nothing to impede the development of the Berle-Means corporation, perhaps facilitated its evolution, and certainly helped sustain it by preventing financial intermediaries from taking active governance roles. In and of itself, that showing is a formidable accomplishment and a valuable contribution to the literature. Although the first two sections of *STRONG MANAGERS* are notable in their own right, the book takes on importance mainly because of the significance of the policy questions to which the final section is addressed. Space does not permit one to do full justice to Roe's argument, which is nuanced and well-crafted. Suffice it to say that relatively little has changed since *STRONG MANAGERS* was published. Despite increased activism in recent years, institutions still are mostly passive. Even the most active institutional investors spend only trifling amounts on corporate governance activism. Institutions devote little effort to monitoring management, rarely conduct proxy solicitations, do not try to elect directors, and rarely coordinate their activities. And, perhaps, this is a good thing. As Roe concedes, there is good evidence that bank-dominated finance has harmed that Japanese and German economies by impeding venture capital. Moreover, institutional investors may well abuse control by self-dealing. Even if institutional investors are entirely self-less, greater control on their part would still be undesirable if the separation of ownership and control mandated by U.S. law has substantial efficiency benefits. Here is where Roe and I part company—I suspect the Berle-Means corporation has significant economic advantages over its alternatives; he is skeptical. Perhaps only time will tell, as competition in increasingly global markets puts various systems of economic organization to the test. In the meanwhile, Roe's book belongs in the library of anyone interested in corporate law or governance.

In this major reinterpretation of the evolution of the American corporation, Mark Roe convincingly demonstrates that the ownership structure of large U.S. firms owes its distinctive character as much to politics as to economics and technology. His provocative examination addresses essential issues facing American businesses today as they compete in the new international marketplace.

"Economic theory appeared to predict that the American version [of capitalism, in which firms feed on a huge and liquid stockmarket] should be the most efficient. This view stemmed from [Berle and Means] in *The Modern Corporation and Private Property* ... [and] held sway for the next fifty years.... Roe ... takes this debate a giant step forward. Far from being the inevitable winner of a Darwinian struggle, argues Roe, the Berle-Means corporation owes its existence to American politics, and in particular to a deeply ingrained popular mistrust of concentrated financial power."--*The Economist*"Roe ... argues persuasively that old-fashioned politics ... play[s] the key role in building a structure of corporate finance.... *Strong Managers, Weak Owners* does for corporate governance what Alfred Chandler's *The Visible Hand* did for the corporation: makes history essential to understanding current practice and policy."--Robert Teitelman, *Institutional Investor*From the Back Cover"No one before has ever written a comprehensive political history of the fragmentation of stock ownership nor demonstrated the critical role that this fragmentation has played in shaping the power of managers in the American business system. Roe has provided a powerful and original explanation of the emergence and persistence of managerial autonomy in the United States."--David Vogel, University of California, Berkeley"A seminal work that should become [a] mainstay for years to come."--Peter H. Aranson, Emory UniversityAbout the AuthorMark J. Roe is a professor at Columbia Law School.