The Forces of Change in British Business:  
A New Paradigm  

By  

Steven Toms* and John Wilson**  

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University of Nottingham Business School  
Jubilee Campus  
Wollaton Rd  
Nottingham NG8 1HR  

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This paper is circulated for discussion purposes only and its contents should be considered to be preliminary.
The Forces of Change in British Business:

Abstract

The purpose of this paper is to synthesise the main strands of the organisational

Although derivative from neo-classical political economy, the paper also explains how other paradigms of political economy might be accommodated within what aims to be an synthesis is to establish a model that can explain why diverse organisational forms emerge, alongside the business strategies that accompany these changes and the historical

of the main propositions are also offered. This allows conclusions to be drawn on the limitations imposed by systems of corporate governance, the development of ‘efficient’ capital markets and the impact of globalisation on multinationals and business networks.
The Forces of Change in British Business:
A New Paradigm

For almost forty years, most business historians have relied on Alfred Chandler’s claim that the success and failure of different types of *capitalisms* – from *personal* through to *entrepreneurial* and on to *managerial* - can be explained in terms of the scale and scope economies available to entrepreneurs.¹ Clearly, though, given the enormous increase in work on how business systems have evolved, at both conceptual and empirical levels, not to mention the passage of time, one might argue that a reassessment of these views is long overdue. In effect, the Chandler view offers a teleological approach that belies the history of international business history, in which the rise and fall of national and industry specific systems of corporate governance features prominently. As Whittington and Mayer argue, though, the Chandlerian model lacks universal appeal because of its failure to accommodate both ‘territory – national cultures and national institutions’, as well as ‘the constant ebb and flow of power or fashion’ in our understanding of business evolution.² Furthermore, Pettigrew and Fenton note that firms embark on ‘change journeys and continuous processes involved in moving towards and sustaining such strategic positions and forms’.³ At the same time, as Djelic illustrates, radical discontinuities like a world war can significantly affect strategy and structure, leading to major changes in approach.⁴

This recent literature re-emphasises the need to revise older, more deterministic and static models that ignore the dynamics associated with business evolution. As a
consequence, we would like to propose a radical reassessment of the traditional view, by incorporating conceptual work into a paradigm that can be illustrated by reference to empirical vignettes. Two specific points of contention are explored: firstly, that the implied view of corporate governance and accountability to external stakeholders is restricted; and secondly, that more weight needs to be accorded to external economies of scale. Crucially, by using a revised theoretical framework, this paper extends the use of corporate governance and internal and external economies of scale and scope, which is then used to re-assess British business history incorporating more recent developments. Above all, we would like to claim that rather than sustain the current preoccupation with deterministic evolutionary models, it is far more useful to assess the dynamics associated with the reasons why firms change their strategy and structure. While the analysis might have evolutionary implications for the industries or firms involved, the basic model is aimed more at explaining cross-sectional heterogeneity and the dynamics of business change.

The paper starts by presenting a theoretical framework that extends the scale and scope view of business history by incorporating a more accurate and specific view of corporate governance and accountability into our understanding of the reasons why businesses change strategy and/or structure. While detailed definitions of accountability and scale economies are derived from relevant theory, emphasis is also placed on the processes of change affecting them through the historical long run. The possible nature of their inter-relationship is then explored, leading to the construction of an analytical matrix that could be used to complement traditional paradigms. This matrix is based on the notion that business is always in transition, strategically and structurally, governed by
interaction of scale and scope economy exploitation and accountability to external stakeholders. These processes are then analysed using some empirical examples from different periods in British business history. The examples are based on a synthesis composed of a traditional mapping of the relationship between scale, scope and organisational form, but with a superimposition of the battles for control between different interests and groups that have striven to govern British business. The story is told in three empirical sections: 1) The struggle for control of British Business, 1850-1950, 2) managerial capitalism, 1950-1980, 3) Institutional investors, restructuring and the ‘new economy’, 1980-2000. Each period is illustrated with reference to specific examples of businesses and industrial sectors. A final section emphasises the validity of the proposed framework, indicating the need to pursue alternative research agendas that could well provide more useful insights into the nature of British business evolution.

II

Although the basic parameters of Alfred Chandler’s business history model are generally well known, it would be helpful to outline aspects of his views that significantly inform the ensuing discussion. With specific regard to the British case, he has argued that the relatively small domestic market and limited opportunities to obtain the benefits of scale economies meant that the entrepreneur became locked into the constraints of personal capitalism. This system was based on the preservation of ownership and control in the hands of family cliques, limiting the opportunities for both professional managers and investors to determine strategy and structure. Furthermore, while this worked successfully up to the mid-nineteenth century, Chandler notes that thereafter problems
arose as a result of the emergence of economies employing more sophisticated organisational structures. Chandler, like many other American commentators, also seems to be persuaded by the ‘cultural’ argument, that personal capitalism is somehow inherent in the British psyche. Of course, it is clear from a wide range of empirical studies that both of these points are open to question. In particular, Wardley has demonstrated that prior to the First World War a significant number of British firms had achieved an impressive scale. Similarly, Wilson has also emphasised how the nature of British business organisation and ownership proved entirely appropriate to the contemporary market-cum-technological, legal and financial scenes, markedly diminishing any critical analysis. Moreover, and crucially in the context of this paper, after the 1940s the business scene changed radically as a result of City intervention, making British entrepreneurs and managers accountable to new external stakeholders. Detailed analysis of British corporate governance changes, especially after 1950, is hence absent from most American analyses. Nonetheless, the Chandlerian thesis remains a widely accepted view of British business history.

Chandler offers a three-stage model to explain business evolution. In the model most firms pass from the personal stage (where family ownership and management dominates) through to an entrepreneurial form (where some delegation of responsibility to professional managers is permitted by the family owner-managers), culminating in a managerial stage (characterised by the complete divorce of ownership and control). While this might be useful for some firms, it ignores the reality that most are prone to multiple evolutionary paths, whatever their size. Above all, while sufficient credence is given to securing scale and scope economies as a motivation behind business change,
explicit use of transaction-cost theory is lacking in the Chandlerian model, providing yet another strong *raison d’etre* for this paper.

Having highlighted the weaknesses in the Chandlerian approach to business change, we would claim that it is essential to consider in much greater detail two aspects of theory, accountability and economies of scale and scope. In pursuing this point, we shall now conduct a survey of the more relevant issues. We will then add a synthesis that leads to the fabrication of an analytical matrix capable of explaining how and why British business has evolved over the course of the last 150 years.

Accountability refers to the processes whereby the stewards of the business are held accountable to its owners and other external stakeholders through the processes of corporate governance. The term corporate governance has been poorly understood in the business history literature. To date, employing descriptors like *managerial capitalism* or *personal capitalism*, it has been used to illustrate either the typical ownership groups or where the locus of power lay within business organisations. For example, according to Chandler, in the system of British *personal capitalism* powerful families used businesses as estates to be nurtured for their wealth-creation properties. In turn, he claims that this damaged performance, given the alleged propensity to pay out a substantial proportion of annual profits in dividends.\(^9\) One might add that Chandler failed to substantiate these claims with adequate supporting evidence, casting doubt on the universality of such claims. Moreover, given the market-cum-technological, financial and legal environment in which British business operated up to the 1940s, it is not obvious whether *managerial capitalism* was particularly relevant to those circumstances.\(^10\) Crucially, despite the
apparent importance of dividends and capital accumulation to his critique of personal capitalism, Chandler has little to say about capital markets and governance.

In view of the enormous literature now available on such issues, it is consequently clear that his analysis must be taken further. At the theoretical level, in particular, it must incorporate the literature on choice of organisational form, notably principal-agent theory and the transaction cost literature.\textsuperscript{11} While Chandler implicitly linked his work to the seminal writing of Oliver Williamson and other authorities in this field, there is no explicit use of the transaction-cost models available by the 1980s. Spanning these two elements is the theory of capital markets, efficient or otherwise, from the perspective of economic resource allocation, in which buyers and sellers of financial assets are matched through the transmission of information.\textsuperscript{12} From a business history perspective, capital markets refer specifically to the markets for corporate debt and equity capital, because they have the most direct bearing on ownership, control and business policy.\textsuperscript{13} Capital markets might also comprise commodity markets, foreign exchange markets, bond markets and derivative (both spot and futures) markets. Imperfections in capital markets force capitalists to perform an entrepreneurial role, whilst in more developed capital markets, financiers shed their entrepreneurial role and entrepreneurs ignore their financing function.\textsuperscript{14} Hence, the state of development of the capital market is likely to mediate the observed organisational form. According to one recent influential shareholder value view, the most productive firms (in terms of technical innovation, as well as shareholder wealth creation) are the ones that are most responsive to the dictates of global capital markets. As well as being more productive, these firms also create more value for their shareholders, especially in economies dominated by stock market
movements, for example the United States. Conversely, in economies (Japan, Korea and Germany) where corporate managers remain accountable to multiple and often interlocking stakeholders, the stock market is much less influential.\textsuperscript{15} While we accept that there have been many criticisms of such neo-classical theorising, our most important claims are that on the one hand much of the debate has neglected historical evidence, while on the other hand few historians have incorporated corporate governance theory into their analyses.

The transaction cost approach (and implicitly the contract-based theories of governance referred to earlier) has been criticised as static, in that comparison tends to be restricted to two contrasting states of equilibrium.\textsuperscript{16} In this context, it is important to remember that an essential part of the Chandlerian analysis, albeit one lacking a conceptual framework, centred on how organisational structures follow from opportunities to exploit economies of scale and scope. However, this ignores the traditional distinction between internal and external economies.\textsuperscript{17} To exploit internal economies, a firm must achieve high market share and hence high output in order to transform high fixed costs into low unit costs. On the other hand, where economies are external an industry spreads the fixed costs already invested in the economy as a whole over a larger output. As Lazonick points out, external economies derive from cheaper inputs that can be purchased on the market.\textsuperscript{18} These might arise from access to agglomeration based knowledge economies such as pools of skilled labour, research and development and other spill-overs.\textsuperscript{19} Small and medium-sized enterprises (SME’s) are more important when scale and scope economies are external (for example, where internal economies are limited by the size of the market). Conversely, internal economies
promote the large firm. At the same time, small firms might benefit from externalities created by prior investments in internal economies by large firms, for example infrastructure and other projects with public good characteristics, such as railway and telephone networks. Hence the availability of internal or external economies mediates the firm's opportunities and the type of capitalism that evolves: personal capitalism could well be more appropriate to a system based on exploiting externalities, while managerial capitalism flourishes where internal economies become more significant.

However, there are also several problems with the ‘stages’ approach offered by Chandler. Firstly, many business historians have applied it in a rather atheoretical fashion. Thus, it can be an exercise in pure empiricism where historians attempt to find suitable adjectives to describe different types of ‘capitalisms’. As a result, most of this type of history fails to make a contribution to theory because it neglects what is potentially interesting in the approach, namely, the processes generating the transition from one stage to the next (or causality). The Marxist view is an exception to this, providing a theoretical framework for the empirical analysis of economic transition. This has been applied to business by examining the relationship between accountability and processes of capital accumulation. A second problem is the overly Darwinian nature of the stages approach, whereby businesses seem capable merely of adapting to changes in their environment. In the USA, for example, the large-scale business evolved because there was a large domestic market that guaranteed economies of scale at sustainable levels of high output. As far as Britain was concerned, the need to export sustained the smaller firm in a more disaggregated economy. Whilst these general tendencies are obviously true, however, an overwhelming lesson of history and modern politics is that
businesses (especially large-scale business) have successfully fashioned their own environments. In addition, the general tendency to rely on the dynamic advantages of clustering and working within an intricately-connected industrial district model provided many British industries with significant external economies of scale and scope that underpinned their competitiveness well into the twentieth century.

Having noted the crucial significance of industrial districts to the performance of British business, it is vitally important to emphasise that Chandler ignores the role played by external arrangements like networks and clustering. After all, networks have recently managed to reassert their role in many economies, moving them back to the centre of recent theoretical contributions in business history. At the same time, it also important to bear in mind the criticism of interlocks and networks levelled by the shareholder value school referred to earlier, especially from the point of view of an economic rationality perspective.

In the light of the omissions and contradictions inherent within the Chandlerian perspective, it is clear that a fresh synthesis is required. We note that this is not the first paper to offer this kind of approach. For example, Casson has synthesised transaction cost theory, entrepreneurship and evolutionary theory to explain the organisation of networks. Nevertheless, bearing in mind the discussion conducted in the last two sections, we would like to suggest the continua shown in Figure 1.
Figure 1: Important Continua in Business History

Accountability Continuum

<table>
<thead>
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<th>High</th>
<th>Low</th>
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Scale and Scope Economies Continuum

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<th>External</th>
<th>Internal</th>
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Accountability in figure 1 is described as high or low and refers to the ability of stewards or managers to perform their function with or without effective scrutiny. In a transaction cost framework such effectiveness is a function of monitoring cost. Hirschman's taxonomy of voice and exit explain the processes of accountability enforcement. These mechanisms may be substitutes, for example in the Japanese governance system, or complements, for example in the Anglo American system. In general, therefore, the presence of one or both will underpin strong accountability and the absence of both will weaken accountability. Voice-based accountability may be strong where there is a dominant shareholder or conversely weak where shareholdings are widely dispersed. Exit-based accountability depends partly on the efficiency of capital markets, although like voice, the effectiveness of exit also depends on the relative power distribution amongst stakeholders. On the left, capital market transparency and the threat of stock market investors to sell their holdings might discipline managers. Alternatively, in the case of family capitalism owner-managers might be concerned by active and direct monitoring by advisors or bankers. Conversely, on the right hand side managers might be poorly disciplined either if a stock market fails to provide investors with timely and relevant information, or if ownership groups lack the voting power to dismiss them. On the other continuum, scale and scope economies might be thought of as predominantly internal or external, allowing for differing degrees between scale and scope economies.
By altering the alignment of these continua, Figure 2 combines them vertically and horizontally to produce an analytical matrix of business history. There are several potential advantages to this matrix approach. At the simple level, it could be used to describe a ‘stages’ view of history, with a logical progression from one quadrant to another. *It is not our claim that all businesses pass along an evolutionary track; rather, we would like to offer a series of theoretically sound hypotheses for explaining the process of change.* Furthermore, it could establish parameters for future debates. Thus, the rows and columns can accommodate different philosophical perspectives, from neo-classical political economy (agency and transaction cost theory) through Marxism and on to post-modernism.32

Although Figure 2 can potentially accommodate variants of the ‘stages’ approach, it does not have to adopt the teleological perspective that implies everything moves inevitably towards what we observe today (the ‘whig’ interpretation of business history).33 Rather, if an industry or firm finds itself in one quadrant, the matrix provides a

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**Figure 2: A Business History Analytical Matrix**

<table>
<thead>
<tr>
<th>ACCOUNTABILITY</th>
<th>High</th>
<th>Low</th>
</tr>
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<tbody>
<tr>
<td><strong>ECONOMIES OF SCALE AND SCOPE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal</td>
<td>Quadrant 3</td>
<td>Quadrant 2</td>
</tr>
<tr>
<td>External</td>
<td>Quadrant 4</td>
<td>Quadrant 1</td>
</tr>
</tbody>
</table>
starting point for investigating the sufficient and necessary conditions for transformation of generic organisation type. From this it also follows that the model is predictive and not necessarily confined merely to historical analysis, given that one can determine how a firm/industry has coped with various challenges and opportunities. Each quadrant for each historical period provides three alternative strategic directions for a firm or industry. Another way of considering these transitions is to consider the relative political and institutional strength of the forces set out in figure 3.
Figure 3: Forces of Transition in Business History

Accountability

High

Proprietorial Cliques

Professional Managers

Alliance and network participants

The Firm

External stakeholders

Low

Internal

External
On the vertical axis, availability of internal scale economies promotes investment in and empowerment of managerial hierarchies whilst availability of external economies promotes internalisation of public good assets through alliances and networks. Technological innovation determines the availability of scale economies, but are accommodated into the model via assumptions about the acquisition and use of knowledge. Where professional managers possess tacit knowledge through organisational learning, they can pursue diversification by exploiting internal managerial economies of scope. Conversely, where knowledge is routed in agglomeration-based external economies with public good properties, network liaison is promoted. In other words, entrepreneurship has the appearance of managerialism in the former case and networking in the latter. On the horizontal axis, control by proprietorial cliques attenuates accountability whilst the involvement of external stakeholders promotes it. Proprietorial cliques may include families, whilst external stakeholders may include institutional investors, banks, regulators etc. The arrows indicate the direction of transition through technical discovery, entrepreneurial action and transaction cost changes. Diagonal movement occurs when the basis of internal or external economies of scale alters but accountability remains constant, or vice versa. Horizontal or vertical movement occurs when the scale and scope economies and accountability structures alter simultaneously. These forces determine transition or lack of transition from one quadrant to another in figure 2.

This leads us to claim that several advantages follow from these assumed relationships. Firstly, firms and industries of different types of capitalism can co-exist within the same economy and in the same historical period, operating in one of the
quadrants. Secondly, because it supports a cross-sectional comparative analysis, the model can be applied to present-day management and economic theory. Thirdly, economies can be predominantly internal for some industries and external for others in the same period. For example, compare aircraft and electric motors with textiles in the period 1945-90. Finally, and crucially, there does not have to be an inevitable progression from inefficient to efficient capital markets or from low accountability to high. In the analysis that follows, market efficiency and accountability are treated as empirical questions.35

III
Having provided the theoretical justification for our model, it would now be useful to illustrate its validity by drawing on examples from British business history. To do so completely would involve considering all transitional permutations from each quadrant to the other three. In each case, where appropriate, there would need to be detailed analyses of continuity and change, depending upon the systems of governance and accountability, as well as the available economics of scale and scope. The cases chosen are not intended to be comprehensive as a test of the model, but they at least provide some illustrations of how the model reflects reality. In each case, we concentrate on empirical evidence indicating the predominance of internal or external economies and the processes of accountability.
The struggle for control of British Business: 1850-1950

This period was based on the exploitation of internal economies of scale in railways and other transport infrastructure, supporting a limited number of large companies. Railways, and parallel developments in newspapers, banking, telegraphy and the postal service, helped reduce costs in other sectors. Hence, other industries, especially manufacturing sectors, where output was limited by the size of the market, exploited these investments as external economies. The industrial districts of Lancashire, the Potteries and the West Midlands were based on access to cheap coal, transport and distribution networks as well as the shared knowledge that built up through technical education and knowledge based economies. In Lancashire, the cotton textile industry was dependent upon inter-linking railway transport, regional commodity futures markets and networks of overseas agents. There were consequently few pressures on individual ownership and the entrepreneurial span of control.

However, the Lancashire textile industry also provides an example of a historical transition based on reduced accountability. In Oldham, about one in four of the town's population participated democratically in the ownership of local mills using a 'one shareholder one vote' mechanism and extensive financial disclosure to hold relatively powerless directors to account. For around two decades in the 1870s and 1880s transparent governance structures and a relatively efficient stock market promoted managerial accountability. Like the rest of Lancashire, scale economies in Oldham were and remained external, but in 1890s and early 1900s social change dramatically undermined the accountability of earlier years. From the late 1880s onwards, capital ownership centralised around cliques of directors. Reflecting no change in underlying
economies of scale, but reduced accountability, this section of the industry, representing most of the coarse spinning firms, moved from quadrant 4 to quadrant 1 (see Figure 2) in the period 1870-1914.

In general, the lack of strong governance mechanisms and accountability structures prevented savings being channelled into industry via institutional investments and instead encouraged institutional investment overseas. Similarly, many examples of how the prevailing system of corporate governance lacked any effective external discipline can be found in the investment ‘manias’ of the nineteenth century. Indeed, earlier events like the 1720 ‘South Sea Bubble’ had retarded the development of limited liability.\(^{42}\) Even when most of these restrictions had been lifted, events such as the ‘railway swindle’ of 1845-7 demonstrated the opaqueness of British financial markets. Meanwhile, southern investors lamented their lack of investment opportunities in the profitable companies created in the industrial revolution.\(^{43}\) An observer in 1886 condemned the system of public ownership of shares prevalent in the cotton mills of Oldham because of the financial instability caused by mill promotions.\(^{44}\) The ‘Brush Bubble’ of 1882 provides an insight into how unscrupulous company promoters were able to mislead investors into buying £7 million of shares in electrical engineering firms that were lauded as part of a new ‘Electrical Age’. Of course, electric lighting and power had hardly left the laboratory at that time, while powerful vested interests like the gas supply industry and steam engineering still dominated the energy markets. As a result, within a year much of the investors’ money was lost, having been diverted into the promoters’ bank accounts, rather than into real assets.\(^{45}\) Similarly, the ‘bicycle-and-motors’ boom of 1896-7 reflected exactly the same problems, with investors blindly
following the lead offered by company promoters eager to sell shares in firms that realistically offered little investment potential.\textsuperscript{46} In 1919-20, there was a similar boom that resulted in a disastrous over-valuation of assets. This overvaluation was so serious that it thwarted all attempts to engineer recovery and made amalgamation schemes difficult.\textsuperscript{47} These and other promotions occurred in a legal environment where prospectuses, audit and the release of accounting information were virtually unregulated.\textsuperscript{48} Consequently, investors possessed a woeful lack of knowledge relating to domestic investment opportunities, reflecting the limited impact of external financial interests on business strategy and structure.

Predominance of external scale and scope economies and clique-based control explains why managerial hierarchies did not emerge in British industry before 1950. Corporate growth occurred within and was limited by these constraints. Even in industries where internal scale economies were present, British firms did not necessarily adopt managerial hierarchies. Leaving aside the issue of external economies and industrial districts, at the centre of Chandler's thesis is the failure of British firms to move from east to north in figure 3, from clique based control to professional managers. Far from pursuing a \textit{rentier} strategy as Chandler suggests, British family firms were actually consistently reinvesting the bulk of their profits back into the business.\textsuperscript{49} Another crucial point is the emerging difference between the kind of \textit{personal capitalism} identified by Chandler and the \textit{proprietorial} stage discussed by Quail.\textsuperscript{50} By the early-twentieth century, the ownership of especially large-scale British firms was being concentrated into the hands of syndicates of businessmen and financiers, giving rise to a variation on the family-based firm, but no accompanying move towards hierarchies of professional
managers. In the cotton industry, where amalgamations did occur, they were essentially defensive associations based on loose federal structures aimed at exploiting external scope economies, involving little expansion of scale at plant level or integration of production systems. As Hannah emphasises, because of the power vested in boards of directors at that time, financial interests rarely challenged their hegemony. This meant that where businesses did increase in size, they generally did so without diluting control to outside stakeholders. In other words, corporate governance mechanisms were similar to those prevailing in a more personal era, reflecting little accountability to external stakeholders.

Defensive mergers dominated the inter-war history of British business. Rationalisation combined grudging recognition of changes in market conditions with a stubborn reluctance to surrender control. While this sparked the emergence of complex capital structures and different classes of voting shares, thereby reducing accountability to capital markets and external stakeholders. In the absence of a legal requirement to produce consolidated accounts, the acquisition of subsidiaries gave proprietorial cliques the ideal mechanism for hiding losses and liabilities off balance sheet. The famous Royal Mail fraud case was perhaps the best example. These trends explain the extensive employment of a holding company form of organisation amongst large-scale firms, because rarely was there much effort invested in more integrated management structures capable of achieving substantial synergistic benefits. Even though the advocates of ‘Rationalisation’ urged the formation of large-scale enterprises that would be better able to exploit production economies, this advice was rarely applied in practice.
In some industries, primarily as a result of a change in emphasis in the nature of scale and scope economies, rather than changes in the level of accountability, there was a move from quadrant 1 to quadrant 2, according to the scheme in Figure 2. Only firms like ICI, Unilever and English Electric provided relatively exemplary management structures capable of coping with the organisational challenges associated with scale and scope. However, in high-growth sectors like electrical and electronic engineering (apart from English Electric in the 1930s), a holding company form came to dominate. This can be explained by the nature of the home market, since the combination of protectionism with price-fixing through the British Electrical & Allied Manufacturers’ Association (BEAMA) allowed firms to flourish in a cosy trading environment devoid of intense competition. In Lancashire textiles market pressures created debate, but no transition. The specialised marketing and production structures that had created competitive advantage before 1914 were by the 1920s and 1930s the subject of increasing criticism from contemporaries. Reformers were advocating the fabrication of a more concentrated industry, as a means of driving down unit costs, whilst retaining the advantages of external economies. The Yarn Spinner’s Association (YSA) in the textile industry operated in the same fashion as BEAMA from the 1930s up to the 1950s. In the former case, especially by the 1930s, this provided association members with guaranteed latter market shares and some dominance of imperial markets. At the same time, because competition was based more on technological excellence, rather than price, manufacturers chose not to develop mass production strategies, preferring instead to invest more in R & D and high-quality production. This would help to explain why
British electrical firms failed to compete against much more efficient European and Japanese firms in mass-production sectors like domestic appliances.\textsuperscript{64}

To summarise, the domination of British business in the period to 1950 by proprietorial cliques was a function of two forces: the predominance of external economies and the absence of an institutional basis of accountability to external stakeholders. The directorial cliques won the battle for control of what remained a deeply private and relatively small-scale economy. These forces explain what appeared to be personal capitalism, and the delay in the emergence of managerial capitalism.

\textit{Managerial Capitalism, 1950-1980}

In this period, whilst there were no decisive changes in corporate accountability, internal economies of scale were more fully exploited. The tendency in British business was to move from east to north (figure 3) and from quadrant 1 to quadrant 2 (figure 2). As in the inter-war period, there were pulls towards niche markets and informal collusion via industry associations.\textsuperscript{65} Nonetheless, the outstanding feature of the period 1950-1980 was the emergence of the M-form.\textsuperscript{66} Scale economies were predominantly internal, but easily exhausted. Consequently, the major push towards managerial capitalism came from exploitation of managerial economies of scope. This rested on two factors: the development of the market for corporate control and continued opacity of accountability structures.

The market for corporate control began to emerge in Britain in the 1950s.\textsuperscript{67} As in the USA, competition policy and restriction on concentration promoted conglomerate diversification.\textsuperscript{68} The ICI bid for Courtaulds in 1961 was one of the earliest and most
prominent take-over struggles, reflecting an attempt to purchase through the open market the shares of a firm that was perceived to be under-performing and undervalued. This transaction contrasted with the gentlemanly, agreed mergers that characterised previous business combinations. ICI’s aim was to deliver managerial objectives such as control of market share, rather than those couched in terms of shareholder interests and investment value. Where shareholders were considered, for example when Courtauld’s managers promised special dividends, this only demonstrated the absence of a transparent and efficient capital market. Rather than deliver accountability, the capital market acted as a vehicle for corporate raiders, such as Charles Clore and Slater-Walker, in their pursuit of conglomerate diversification.

By the end of the 1960s, while the market for corporate control had emerged, the spread of institutional ownership was only just beginning to assert itself. In 1957, individual persons controlled 65.8% of equity in British quoted companies, compared with 8.8 per cent by Insurance Companies, the largest institutional category. Meanwhile, the 1948 Companies Act reflected a powerful directors’ lobby for reduced disclosure on the grounds of commercial secrecy. The Jenkins Report of 1962 aimed to promote greater accountability, but disclosures such as directors’ remuneration were not introduced until the 1967 Companies Act, whilst sales turnover, nominee shareholdings, directors’ private interests and other important disclosures required a further White Paper in 1973 and only became law in 1976. By this time, ownership had shifted, but not decisively away from individuals in favour of institutions. Greater accountability would have to wait for the reforms of the 1980s.
In the meantime, diversification strategies reflected managerial priorities. Variations in the availability of scale economies explain the extent of organisational change in different industries. In the 1960s, there were only a small number of industries, for example, aircraft, mainframe computers, cars and electric motors, that required more than half the British market to be able to operate at efficient scale. In other industries, for example, brewing at 3%, cotton spinning and weaving at 2% and machine tools at 0.75%, the required share was much smaller. Hence, in the period 1957-68 diversification became increasingly horizontal and in many cases conglomerate, with acquisitions of firms in unrelated industries. British business also developed into internationally diversified firms, primarily to exploit the opportunities associated with size and market attractiveness. Where scale economies were exhausted, divisionalisation facilitated the exploitation of scope economies, undermining the traditional nature of organisation embedded in the industrial district. Indeed, internal scope economies prevailed in the 1950s and explain the characteristics of diversification in that period. It is also worth noting that advocates of the M-form suggest that efficient diversification can be achieved through the use of an internal capital market.

These processes are illustrated by changes in the way British electrical-electronics firms were structured and managed. By the 1950s, most scale-based economies were exhausted, with the top five firms (AEI, GEC, English Electric, Plessey and Parsons-Peebles) already controlling 42 per cent of domestic production. With the exception of Parsons, which focused more on generating equipment, these large-scale firms were highly diversified, manufacturing and marketing a wide range of electrical goods, from bulbs and components through to large-scale capital equipment. At the same time, even
though AEI and English Electric had at times been American-owned, they were structured along holding company lines, with little integration of management and production. There were exceptions to this rule, with GEC continuing to work with the highly centralised system established by Hugo Hirst in the 1920s, while Ferranti was operating with an embryonic divisional structure. In general, though, British high-tech firms lacked the organisational competencies of their American counterparts.

Exploitation of managerial economies of scope, in the electrical and other high-growth industries, promoted new organisational forms based on professional management skills. For example, at ICI the chairman (Sir Paul Chambers) called in the American consulting firm McKinsey to institute a major overhaul of the ageing organisational structure that had been little changed since the 1930s. This affected ICI’s traditional disdain for outsiders as senior managers, allowing new managers like John Harvey-Jones (by 1973, Chairman of the Petrochemicals division and an ICI director) to sponsor the introduction of organisational development techniques. As a result of severe liquidity problems, Ferranti passed from family ownership in 1975 into the hands of professional managers and investors. This resulted in the adoption of a multidivisional form of organisation, significantly improving profitability after several years of financial struggles and leading to the strengthening of key divisions like avionics and computer systems. Moreover, especially because of the pursuit of aggressive acquisition strategies, many other large-scale firms were reorganising their management systems. As Channon has demonstrated, seventy-two of the top 100 firms could be classified as M-forms by the early-1970s, compared to only a dozen or so in 1950.
Changes in the market for corporate control referred to earlier, combined with other changes in both the legal and competitive environments, forced through a series of dramatic mergers, especially in the late-1960s. This resulted in GEC acquiring AEI and English Electric, while Parsons absorbed other power equipment manufacturers. Paralleling this concentration of production was a commensurate change to prevailing management systems, with Arnold Weinstock leading the way with his highly focused internal financial reporting system. GEC pursued a ruthless strategy of rationalising production capacity across the sprawling empires of AEI and English Electric, as well as pulling out completely from loss-making sectors like mainframe computers, electronic components and domestic appliances like TV’s and radio. On the other hand, while these policies may have been effective from a management point of view, they reflected inadequacies in governance and accountability. With a much more effective management system in place, GEC became one of the most profitable and cash-rich firms in Britain, and generated a substantial cash mountain, rather than investing in high-tech ventures in semiconductors or consumer electronics. Although GEC’s cash surplus was envied by many, its investment in bank accounts represented poor value for shareholders. In 1984, GEC was the first company to utilise the share buy-back provisions of the 1981 Companies Act, in order to start reducing the surplus cash. While Weinstock condemned his stock market mentors for their short-termism, like many corporate managers who had enjoyed the opportunities of unrestricted diversification in the 1960s, the 1980s were the beginning of a new era of transparent stock markets and increased accountability.

Institutional investors, restructuring and the new economy, 1980-2000
In this period, large-scale, stock market quoted firms fell under the tutelage of newly empowered institutional investors, forcing divestment of subsidiaries and thereby complementing the increasing population of small firms based on the exploitation of external economies. From a corporate governance perspective, there were three related reasons for this: the completed dominance of institutional ownership and control, the rise of shareholder activism and increasing stock market liquidity. Increased automation, especially developments in information technology, underpinned these tendencies, whilst promoting a resurgence in the relative importance of external economies of scale.\textsuperscript{88} Similarly, increased global competition forced managements to look much more closely at their organisational structures and competences, resulting in the pursuit of a much more adventurous approach in this respect.\textsuperscript{89} Simultaneous increases in accountability and a resurgence of external economies of scale tended to push firms leftwards according to figures 2 and 3.

Although there had been a trend towards institutional share ownership and away from family control for several decades, it was not until the 1980s that the financial institutions became dominant. As late as 1976, a dominant group or a close alliance of interests controlled half of the largest 250 firms, with a further 20\% under minority control.\textsuperscript{90} It is important to note that while institutional investors had been contributing the bulk of new money coming in to the British corporate equity markets since the 1950s, fund managers were only able to start exerting significant influence in the 1980s. Between 1975 and 1993, the proportion of shares controlled by pension funds doubled, making them the largest ownership group in British industry.\textsuperscript{91} According to the data presented by Whittington and Mayer, by 1983 non-personal investors owned 93.3 per
cent of the top one hundred British firms, reflecting the dramatic change in the nature of British corporate capitalism after the 1940s.

A more efficient and transparent system of corporate governance emerged during the 1980s, based on the deregulation of capital markets. Even though the occasional scandal weakened the credibility of market regulation, after each significant ‘wobble’ new mechanisms were introduced as a means of reinforcing the need for transparency and rigour. This included new codes of practice in the early 1990s, following the Cadbury and Greenbury recommendations. Meanwhile, the privatisation of many formerly public utilities had widened share ownership and created conditions that encouraged the re-emergence of the small entrepreneurial company. It was also during this period that both regulators and investing institutions recognised the importance of actively monitoring their investments and discouraging the perceived negative side-effects of managerial access to free cash flow.

Another important and linked trend was an automation-driven increase in stock market liquidity. The 'big bang' reforms of 1986 on the London stock market led to a fifteen-fold increase in trading volumes by 1995. An explosion in derivative trading since 1971, but especially the development of financial futures and options, was a response to the massive growth in world demand for liquid and cash-substituting contracts. The huge scale of multinational companies, whose activities involve buying in several currencies and selling in several others, have helped drive these changes. Even so, the proportion of transactions in currency-based derivatives accounted for by actual trade fell below 2% by the late 1980s, at a time when turnover in London alone on foreign exchange deals was $187 billion per day.
These developments were also associated with the rise of new sources of external economies of scale and scope. The rise of the financial services sector was particularly striking in the last two decades of the twentieth century. Deregulation of financial services and the effective privatisation of personal finance prompted a large flow of funds into pension, insurance and property-based financial products. An associated increase in the availability of financial inter-mediation, in the form of lawyers, underwriters, accountants and other professionals, has facilitated the processes of corporate restructuring. Other such economies in the form of English language-based education and training, developments in IT infrastructure, the integration of electronic media and massive state investment in logistical infrastructure, especially road networks, also became available. These latter investments were partly a result of corporate lobbying activity by powerful businesses, including many from outside the UK. In addition to arbitrage across globalised financial markets, this also reflects the ability of multinational firms to engage in taxation and environmental arbitrage.99

Meanwhile, internal scale economies were exhausted in terms of plant size, while the need for more flexible production imposed by rapid technological change and shortening product life-cycles prompted the re-emergence of network-style associations based around strategic alliances and syndicates. Larger firms faced with mature markets and slow growth were also under increased pressure to divest. This was especially the case in multidivisional companies faced with significant agency costs and poorly functioning internal capital markets. Where this was the case, there may be benefits associated with shifting from internal to external capital markets, where the control problems associated with diversified firms outweigh the benefits of maintaining
ownership.\textsuperscript{100} This accounts for a boom in the divestment of subsidiaries and the rise of the market for management buy-outs and similar re-structuring transactions.\textsuperscript{101} At the same time, there was an increasing recognition from empirical research that diversification was not necessarily a profitable strategy.\textsuperscript{102} Some firms had begun to recognise this as early as the first wave of de-mergers that took place in 1969-72, resulting in a re-concentration around core activities by some firms.\textsuperscript{103} As Whittington and Mayer reveal, however, large British firms have consistently pursued diversification strategies throughout the last fifty years, irrespective of profitability worries or evidence.\textsuperscript{104} The main impetus for refocusing came later, with the advent of more transparent and efficient markets. From a theoretical perspective, this is not surprising, since the institutional portfolio investor can diversify at much lower transaction cost than the corporation.\textsuperscript{105}

IV

This analysis of the changes in British business does not claim to be a comprehensive survey. However, the presentation leads us to offer the following potted history of British business:

1. The growth of British firms was constrained by the size of the domestic market, so
2. British firms exhausted internal scale-based economies quickly and relied on external economies linked to districts, clusters and networks, and
3. Post-Industrial Revolution Britain was dominated by proprietary capitalism based on external economies of scale, with the exception that
4. The rise of the corporate economy was limited to certain sectors (railways, banking, trading and utilities), and

5. Scope economies drove the diversification of British firms, for example in the 1950s and 1960s, but

6. Firms were only rewarded for diversification if the product/market transaction costs were lower than the diversification costs of a capital market investor.

7. The rise of the institutional investor (from the 1950s to the 1980s) created greater liquidity and lower costs in capital markets; this is reinforced by the globalisation of capital markets, so

8. Diversified company management teams were forced to refocus their businesses on the more profitable markets and the profitable aspects of the value chain, but

9. Scope economies still existed, but lower capital market transaction costs made them relatively expensive to exploit via hierarchies, so

10. Networks, strategic alliances and joint ventures become more important for some firms. Globalisation opened up new scale-based opportunities for others.

This story can also be inserted into the model depicted in Figure 4 to provide a further perspective on the changes that occurred in British business over the last 150 years. *Crucially, one must remember that Figure 4 relates only to the examples used in this paper; it does not attempt to describe the evolution of British business in general.* In this context, one should note that the many small and medium-sized firms (SME’s) usually ignored by business historians would have remained in quadrant 1 of Figure 2, while placing other large-scale firms not covered in the earlier empirical section would
provide work for a team of researchers. Above all, Figure 4 simply reflects the evolutionary course taken by a limited population of firms; it does not predict the end of business history.

Figure 4: British Business History, 1850-2000

<table>
<thead>
<tr>
<th>ACCOUNTABILITY</th>
<th>Internal</th>
<th>External</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>1850</td>
<td>1980</td>
</tr>
<tr>
<td>Low</td>
<td>1960</td>
<td>1920</td>
</tr>
</tbody>
</table>

As this analysis and Figure 4 suggest, there were several important periods of transition in British business history. These transitionary phases came first in the 1850s, when proprietors sought to erect ownership barriers around the principal sources of profit in the emergent industrial economy. In between the late-Victorian and interwar periods, entrepreneurs began to experience a sharp conflict between the demands of scale and the desire to retain control, leading to a transitional H-form and cartel-based organisational forms that began to predominate from the 1920s. By the 1950s, there had emerged a conflict between the continued search for scale and scope economies and the increasing
demands for accountability from hitherto diverse ownership interests. Finally, the process of change in the 1980s opened a new transitional period based on transparent markets and new external economies. Of course, other firms might have taken different evolutionary paths, while in the case of many family-run companies or SME’s there was probably little change in strategy and structure. But this reveals the flexibility of our matrix, in that all evolutionary paths can be accommodated.

V

Figure 3 offers a generalised view of business history. It aims to set out the principal forces that explain transition in business organisation. To the extent that the generalisations upon which the model is based are valid, Figure 3 offers a useful synthesis for applications in other business and business history contexts. Bearing in mind the caveats listed earlier, the British experience described in Figure 4 reflects some similarities to the general model. To evaluate the model fully and fairly, any omissions in the above discussion need also to be taken in account.

A crucial question is therefore the extent to which Figure 3 might be useful as a mechanism for dealing with such omissions in future research. While offering some insight into the explanation of business change, it is also important to note that we recognise how the institutions of corporate governance should themselves be treated as dependent variables. After all, these institutions have to be placed within wider sets of institutional rules or wider institutional systems, for example those provided by the state or their relationship with the economy, legal heritage and tradition, education system and even ideological context. All these dimensions frame and influence the particular features
of institutions of corporate governance in different national, regional, or even cross-
national environments. For example, inefficient capital markets allowed greater tolerance
of what Cain and Hopkins refer to as ‘gentlemanly capitalists’, \(^{106}\) as there is reduced
accountability to external stakeholders. These groups, indeed, stifled the development of
capital markets because they relied on personal contacts and inherited wealth. 'Political'
costs, especially education and regulation, clearly have to be recognised and could be
accommodated into the model via their impact on transaction costs, thus influencing
capital markets and (external and internal) scale economy availability. This embraces a
wide range of possible theoretical approaches, ranging from Marxist and post-Marxist
theories of superstructure, via Polanyi's 'Great Transformation' argument, to endogenous
growth theory. \(^{107}\) In the model presented here, investment, for example in education, fits
Marshall’s definition of external economies that reduce the input costs of all firms. \(^{108}\) For
those who maintain that this is all too general to be of use, it remains the case that
'culture' is difficult to assimilate into any general model that fails to break its own
methodological rules.

Another possible weakness is that the model is undermined by its own flexibility
and its willingness to accommodate several business typologies simultaneously. For
example, consider the case of *proprietorial capitalism*, namely, the reluctance to divorce
control and ownership. This was not unique to the UK, given that in Japan, the USA and
Germany family dynasties held on to the reins of power well into the twentieth century. \(^{109}\)
However, in the UK it seemed to have a much more debilitating impact on corporate
governance. \(^{110}\) In this context, it is clear that the model does not provide any direct
evidence about the relative efficiency of comparative governance systems. On the other
hand, one might suggest that it provides guidance on what might be more appropriate in certain circumstances. However, the brief empirical analysis has highlighted some important interactions. Hence, in Britain a reluctance to surrender control limited the size of firms through self-denying access to funds from financial institutions. Proprietors were consequently obliged to rely on networks and the availability of external economies, or alternatively sell their businesses to the highest bidder.

Finally, some might argue that technological innovation ought to feature more prominently in any model explaining business change. Interestingly, in his most recent work Chandler has argued that one of the most important benefits of the large-scale industrial corporation, on which he places so much emphasis, is its ‘essential role … to drive technological advance’. However, while this Galbraithian view might well be capable of substantiation from certain case-studies, it does not provide much of a causal interpretation of the reasons why management indulges in R & D and innovation. Furthermore, it provides little insight into the implications of these strategies for the firms and investors. Above all, it is vital to assess these implications in the light of both corporate governance strictures and transaction cost calculations that directly affect business change.

This paper has set out a theoretical framework that necessarily imposes a substantial agenda for empirical research. At the same time, while the examples provided here are inevitably limited in that respect, they offer support for the main parameters of our theoretical framework. Future research might aim to underpin the framework further. If the model has real and lasting value, a stronger challenge will be to find exceptions to its predictions. Above all, though, in advocating a move away from the old Chandlerian
perspective, our analytical matrix emphasises not only the essential fluidity of business evolution, but also the crucial links with corporate governance and transaction-cost economics.
1 A.D. Chandler jnr., *Scale and Scope. The Dynamics of Industrial Capitalism* (Harvard, 1990), p.46.


5 One of the more prominent of these is W. Lazonick, *Business Organisation and the Myth of the Market Economy* (Cambridge, 1991), where a discussion of proprietorial capitalism is linked with an attack on the alleged weaknesses inherent in British business organisation.


A related issue in this context, but one that is beyond the scope of this paper, is the comparison with other major industrial economies like the USA, Germany and Japan. It would be especially interesting to compare the links between the transfer of ownership and the roles played by stock exchanges and banks.


Austrian School)) are also applied in evolutionary, path dependent fashion. See Wu, *Production, Entrepreneurship and Profits*.


33 For the ‘whig’ interpretation of British political history, see H. Butterfield, *The Whig Interpretation of History* (New York, 1965).


41 ibid


ibid.


Maltby, ‘Was the 1947 Companies Act a Response to a National Crisis?’ p. 38.


J.M. Keynes, *The Return to Gold and Industrial Policy II*, Collected works, Vol. XIX (Cambridge, 1981), pp. 578-637. Although the emphasis was on internal economies, it is worth noting that recent research suggests external economies remained important. See Broadberry and Marrison, ‘External economies of scale in the Lancashire Cotton textile industry, 1900-1950.’

For a case study of this approach, see Wilson, *Ferranti*.


Fligstein, *The Transformation of Corporate Control*.

J. Littlewood, *The Stock Market*, (London, 1998) pp. 114 and 130. In an efficient market, the value of the firm is determined by the generation of underlying cash flows and not by the decision to distribute or reinvest them. See M.H. Miller and F. Modigliani,


72 J. Maltby, 'Was the 1947 Companies Act a Response to a National Crisis?', pp.31-60.


74 In 1975 individual persons controlled 37.5% of equity in quoted companies, insurance companies 15.9%, and pension funds 16.8%; Scott, *Corporate Businesses and Capitalist Classes*, p.86.


80 Hannah, *Rise of the Corporate Economy*, p.126


84 Wilson, *Ferranti*, pp.529-35.

85 Channon, *Strategy and Structure* pp. 64-7.

86 The other major stimuli to organisational change were a combination of increased foreign competition, especially in domestic appliances, and the successful statutory attack on trade associations like BEAMA. T.A.B. Corley, *Domestic Electrical Appliances*, (London, 1966), pp.120-30. Jones and Marriott, *Anatomy of a Merger*, chapters 14-16.

Oughton and Whittam, 'Competition and Co-operation in the Small Firm Sector'.


J.P. Scott, *Capitalist Property and Financial Power*, (Hassocks, 1986)

Scott, *Corporate Business and Capitalist Classes*, p.86.


Teece, ‘Economies of Scope and the Scope of the Enterprise’.


