Are managers at the mercy of external forces?

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Are managers at the mercy of external forces?

- My answer is: “only up to a point”, or, in other words, “no”.
- In my talk, I will cover:
  - What does economics say about management?
  - What are the constraints on management?
  - What are the degrees of freedom for management?
  - How should we change the concept of the company

1. What does economics say about management?

- The constrained manager:
  - Neither the manager nor the entrepreneur appears in standard economics;
  - It is assumed instead that the company possesses capital and hires labour to deliver output at prices set in the market;
  - In a competitive market, the company has to adopt profit-maximising production if it is to survive;
  - At this point, the company also makes no pure profit; and so
  - The manager is on a treadmill.

1. What does economics say about management?

- Neither imperfect competition nor oligopolistic interaction changes this in any important way:
  - Under imperfect competition, companies can survive even if they are “inefficient” and do not maximise monopoly profits; but
  - even if the outcome is not then determined, there is no room for creativity.
  - Everything is both given and known.

1. What does economics say about management?

- The limits on these models:
  - The economic model is a “heroic abstraction”;
  - The actual world is characterised by dynamic and radical uncertainty induced by, among other things, technological changes;
  - Management then is more like “crossing the river by feeling the stones”;
  - The Austrian school – appropriately so, given where are – got this best: Joseph Schumpeter talked of “creative destruction” and Friedrich Hayek of the “market process”;

2. What are the constraints on management?

- Under these concepts, managers are not on treadmills, their job is, instead, to guide companies towards a creative response to opportunities they perceive in a highly uncertain world.

- Management is constrained by:
  - Available resources, both internal to the company and available outside it;
  - History: evolution of companies is path-dependent;
  - The legal and institutional setting; and
  - The structure of the company's ownership and control.
- But the future is not a given; it is created. This is true, however constraining the environment.

2. What are the constraints on management?

- The philosophy and practices of corporate governance also constrain the company:
  - With shareholder-value maximisation and an active market in corporate control, in which the company is viewed as a tradable asset, management will be more constrained;
  - In particular, long-term implicit commitments are unlikely to be “time-consistent”;
  - People may reasonably expect the company to renege if it appears convenient; and
  - This would be even more plausible if managerial continuity could be easily broken.

3. What are the degrees of freedom for management?

- Yet, under any corporate governance system, management still possesses substantial degrees of freedom, because it has:
  - Superior knowledge; and
  - At least the immediate, if not unconditional, right of control.
- Management can – and must – shape the future of the company by using creative intelligence.
- Collectively, corporate management is entrusted to guide the use of the most important economic resources of our societies. We need it to do so well.

4. How should we change the concept of the company?

- If management is to use its position to the long-term benefit of the company and society, it needs to operate under the best possible institutional arrangements.
- This has both philosophical and a more practical implications.
- Philosophically,
  - Management should be seen as a form of trusteeship;
  - And so managers are then trustees of the permanent interests of the company;

4. How should we change the concept of the company?

- The company, in turn, should be seen as a semi-permanent institution: a web of long-term implicit contracts embedded in a hierarchical structure;
- Nobody can “own” the company, any more than somebody “owns” a country. Once founded, it has a role of its own.
- Different interests have different roles and different claims upon the company.
- The shareholders’ role is to insure the company against the risk of disruptive bankruptcy
- Shareholders need compensation for this role and some (not dominant) control rights to protect themselves.

4. How should we change the concept of the company?

- The claim the shareholders are entitled to absolute control rights because they bear the residual risk, is false.
- Since shareholders are able to diversify their portfolios far more easily than the owners of human capital, the latter bear most of the residual risks.
- This is why shareholders should not own all control rights. The interests of others – workers, localities and countries – also need to be protected.
- The “dual board” structure is superior to that of the Anglo-Saxon and particularly British company.

4. How should we change the concept of the company?

- In practice,
  - the establishment of shareholder-value maximisation has allowed looting of the company by management and private-equity owners, again and again;
  - This is one of the principal reasons for rising inequality, particularly in the English-speaking countries;
  - The looting occurs by manipulating earnings, share prices and stock-related pay;
  - There is NO evidence that the result has been an overall improvement in corporate performance;
  - But it has shifted incomes, via extraction rent in companies.

4. How should we change the concept of the company?

- Solutions should be pragmatic:
  - The permanent existence of the company and the nature of its obligations should be defined in law;
  - Changes in ownership structures should be encouraged, including dual share structures and rewards for long-term ownership;
  - The aim would be to discourage *exit* and enhance *loyalty* and *voice*, in Albert Hirschman’s justly celebrated formulation; and
  - Debt should cease to be tax-favoured (which would be beneficial for other reasons, too, including financial stability).

5. Conclusion

- Economic models abstract from the role of entrepreneurs and managers. In reality, they are central to the operation of the modern economy.
- Managers are constrained by external and internal forces. But but they are not at their mercy.
- On the contrary, it is managers' job to act creatively in exploiting the opportunities.
- We need to reform institutions both external and internal to the company to make this work better.