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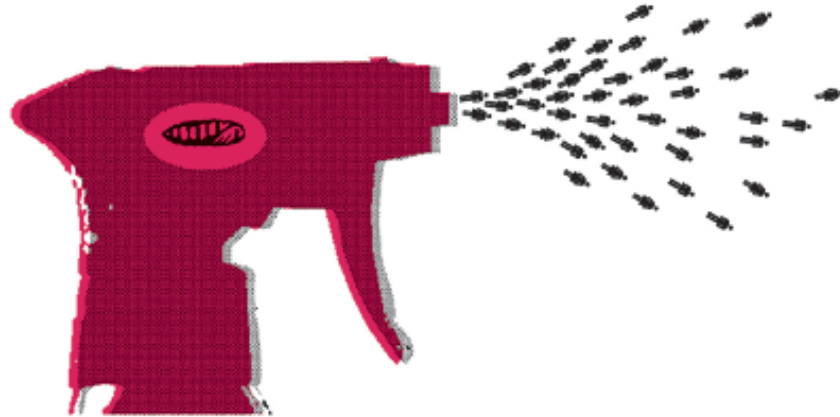
**SHOP****SURVEY: THE NEAR FUTURE****Will the corporation survive?**

Nov 1st 2001

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**Yes, but not as we know it**

FOR most of the time since the corporation was invented around 1870, the following five basic points have been assumed to apply:

- The corporation is the “master”, the employee is the “servant”. Because the corporation owns the means of production without which the employee could not make a living, the employee needs the corporation more than vice versa.
- The great majority of employees work full-time for the corporation. The pay they get for the job is their only income and provides their livelihood.
- The most efficient way to produce anything is to bring together under one management as many as possible of the activities needed to turn out the product.

The theory underlying this was not developed until after the second world war, by Ronald Coase, an Anglo-American economist, who argued that bringing together activities into one company lowers “transactional costs”, and especially the cost of communications (for which theory he received the 1991 Nobel prize in economics). But the concept itself was discovered and put into practice 70 or 80 years earlier by John D. Rockefeller. He saw that to put exploration, production, transport, refining and selling into one corporate structure resulted in the most efficient and lowest-cost petroleum operation. On this insight he built the Standard Oil Trust, probably the most profitable large enterprise in business history. The concept was carried to an extreme by Henry Ford in the early 1920s. The Ford Motor Company not only produced all parts of the automobile and assembled it, but it also made its own steel, its

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own glass and its own tyres. It owned the plantations in the Amazon that grew the rubber trees, owned and ran the railroad that carried supplies to the plant and carried the finished cars from it, and planned eventually to sell and service Ford cars too (though it never did).

- Suppliers and especially manufacturers have market power because they have information about a product or a service that the customer does not and cannot have, and does not need if he can trust the brand. This explains the profitability of brands.

- To any one particular technology pertains one and only one industry, and conversely, to any one particular industry pertains one and only one technology. This means that all technology needed to make steel is peculiar to the steel industry; and conversely, that whatever technology is being used to make steel comes out of the steel industry itself. The same applies to the paper industry, to agriculture or to banking and commerce.

On this assumption were founded the industrial research labs, beginning with Siemens's, started in Germany in 1869, and ending with IBM's, the last of the great traditional labs, founded in America in 1952. Each of them concentrated on the technology needed for a single industry, and each assumed that its discoveries would be applied only in that industry.

## **Everything in its place**

Similarly, everybody took it for granted that every product or service had a specific application, and that for every application there was a specific product or material. So beer and milk were sold only in glass bottles; car bodies were made only from steel; working capital for a business was supplied by a commercial bank through a commercial loan; and so on. Competition therefore took place mainly within an industry. By and large, it was obvious what the business of a given company was and what its markets were.

Every one of these assumptions remained valid for a whole century, but from 1970 onwards every one of them has been turned upside down. The list now reads as follows:

- The means of production is knowledge, which is owned by knowledge workers and is highly portable. This applies equally to high-knowledge workers such as research scientists and to knowledge technologists such as physiotherapists, computer technicians and paralegals. Knowledge workers provide "capital" just as much as does the provider of money. The two are dependent on each other. This makes the knowledge worker an equal—an associate or a partner.

- Many employees, perhaps a majority, will still have full-time jobs with a salary that provides their only or main income. But a growing number of people who work for an organisation will not be full-time employees but part-timers, temporaries, consultants or contractors. Even of those who do have a full-time job, a large and growing number may not be employees of the organisation for which they work, but employees of, eg, an outsourcing contractor.

- There always were limits to the importance of transactional costs. Henry Ford's all-inclusive Ford Motor Company proved unmanageable and became a disaster. But now the traditional axiom that an enterprise should aim for maximum integration has become almost entirely invalidated. One reason is that the knowledge needed for any activity has

become highly specialised. It is therefore increasingly expensive, and also increasingly difficult, to maintain enough critical mass for every major task within an enterprise. And because knowledge rapidly deteriorates unless it is used constantly, maintaining within an organisation an activity that is used only intermittently guarantees incompetence.

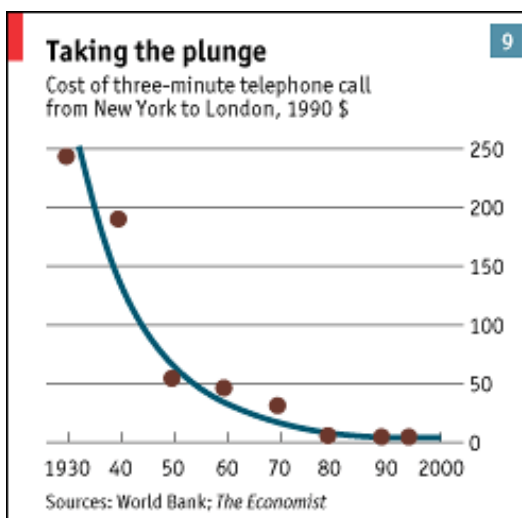
The second reason why maximum integration is no longer needed is that communications costs have come down so fast as to become insignificant. This decline began well before the information revolution. Perhaps its biggest cause has been the growth and spread of business literacy. When Rockefeller built his Standard Oil Trust, he had great difficulty finding people who knew even the most elementary book-keeping or had heard of the most common business terms. At the time there were no business textbooks or business courses, so the transactional costs of making oneself understood were extremely high. Sixty years later, by 1950 or 1960, the large oil companies that succeeded the Standard Oil Trust could confidently assume that their more senior employees were business literate.

By now the new information technology—Internet and e-mail—have practically eliminated the physical costs of communications. This has meant that the most productive and most profitable way to organise is to disintegrate. This is being extended to more and more activities. Outsourcing the management of an institution's information technology, data processing and computer system has become routine. In the early 1990s most American computer firms, eg, Apple, even outsourced the

production of their hardware to manufacturers in Japan or Singapore. In the late 1990s practically every Japanese consumer-electronics company repaid the compliment by outsourcing the manufacturing of its products for the American market to American contract manufacturers.

In the past few years the entire human-resources management of more than 2m American workers—hiring, firing, training, benefits and so on—has been outsourced to professional employee organisations. This sector, which ten years ago barely existed, is now growing at a rate of 30% a year. It originally concentrated on small and medium-sized companies, but the biggest of the firms, Exult, founded only in 1998, now manages employment issues for a number of *Fortune* 500 companies, including BP, a British-American oil giant, and Unisys, a computer maker. According to a study by McKinsey, a consultancy, outsourcing human-relations management in this way can save up to 30% of the cost, and increase employee satisfaction as well.

•The customer now has the information. As yet, the Internet lacks the equivalent of a telephone book that would make it easy for users to find what they are looking for. It still requires pecking and hunting. But the information is somewhere on a website, and search firms to find it for a fee are rapidly developing. Whoever has the information has the power. Power is thus shifting to the customer, be it another business or the ultimate consumer. Specifically, that means the supplier, eg, the



manufacturer, will cease to be a seller and instead become a buyer for the customer. This is already happening.

General Motors (GM), still the world's largest manufacturer and for many years its most successful selling organisation, last year announced the creation of a major business that will buy for the ultimate car consumer. Although wholly owned by GM, the business will be autonomous, and will buy not only General Motors cars, but whatever car and model most closely fits the individual customer's preferences, values and wallet.

•Lastly, there are few unique technologies any more. Increasingly, the knowledge needed in a given industry comes out of some totally different technology with which, very often, the people in the industry are unfamiliar. No one in the telephone industry knew anything about fibreglass cables. They were developed by a glass company, Corning. Conversely, more than half the important inventions developed since the second world war by the most productive of the great research labs, the Bell Laboratory, have been applied mainly outside the telephone industry.

The Bell Lab's most significant invention of the past 50 years was the transistor, which created the modern electronics industry. But the telephone company saw so little use for this revolutionary new device that it practically gave it away to anybody who asked for it—which is what put Sony, and with it the Japanese, into the consumer-electronics business.

### **Who needs a research lab?**

Research directors, as well as high-tech industrialists, now tend to believe that the company-owned research lab, that proud 19th-century invention, has become obsolete. This explains why, increasingly, development and growth of a business is taking place not inside the corporation itself but through partnerships, joint ventures, alliances, minority participation and know-how agreements with institutions in different industries and with a different technology. Something that only 50 years ago would have been unthinkable is becoming common: alliances between institutions of a totally different character, say a profit-making company and a university department, or a city or state government and a business that contracts for a specific service such as cleaning the streets or running prisons.

Practically no product or service any longer has either a single specific end-use or application, or its own market. Commercial paper competes with the banks' commercial loans. Cardboard, plastic and aluminium compete with glass for the bottle market. Glass is replacing copper in cables. Steel is competing with wood and plastic in providing the studs around which the American one-family home is constructed. The deferred annuity is pushing aside traditional life insurance—but, in turn, insurance companies rather than financial-service institutions are becoming the managers of commercial risks.

A "glass company" may therefore have to redefine itself by what it is good at doing rather than by the material in which it has specialised in the past. One of the world's largest glass makers, Corning, sold its profitable business making traditional glass products to become the number one producer and supplier of high-tech materials. Merck, America's largest pharmaceutical company, diversified from making drugs into wholesaling every kind of pharmacy product, most of them not even made by Merck, and a good many by competitors.

The same sort of thing is happening in the non-business sectors of the economy. One example is the free-standing “birthing centre” run by a group of obstetricians that competes with the American hospital’s maternity ward. And Britain, long before the Internet, created the “Open University”, which allowed people to get a university education and obtain a degree without ever setting foot in a classroom or attending a lecture.

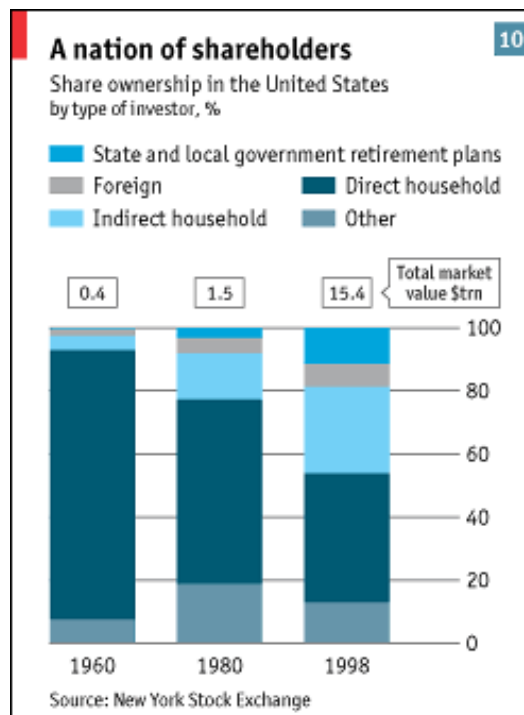
## The next company

One thing is almost certain: in future there will be not one kind of corporation but several different ones. The modern company was invented simultaneously but independently in three countries: America, Germany and Japan. It was a complete novelty and bore no resemblance to the economic organisation that had been the “economic enterprise” for millennia: the small, privately owned and personally run firm. As late as 1832, England’s McLane Report—the first statistical survey of business—found that nearly all firms were privately owned and had fewer than ten employees. The only exceptions were quasi-governmental organisations such as the Bank of England or the East India Company. Forty years later a new kind of organisation with thousands of employees had appeared on the scene, eg, the American railroads, built with federal and state support, and Germany’s Deutsche Bank.

Wherever the corporation went, it acquired some national characteristics and adapted to different legal rules in each country. Moreover, very large corporations everywhere are being run quite differently from the small owner-managed kind. And there are substantial internal differences in culture, values and rhetoric between corporations in different industries. Banks everywhere are very much alike, and so are retailers or manufacturers. But banks everywhere are different from retailers or manufacturers. Otherwise, however, the differences between corporations everywhere are more of style than of substance. The same is true of all other organisations in modern society: government agencies, armed forces, hospitals, universities and so on.

The tide turned around 1970, first with the emergence of new institutional investors such as pension funds and mutual trusts as the new owners, then—more decisively—with the emergence of knowledge workers as the economy’s big new resource and the society’s representative class. The result has been a fundamental change in the corporation.

A bank in the next society will still not look like a hospital, nor be run like one. But different banks may be quite different from one another, depending on how each of them responds to the changes in its workforce, technology and markets. A number of different models is likely to emerge, especially of organisation and structure, but perhaps also of recognitions and rewards.



The same legal entity—eg, a business, a government agency or a large not-for-profit organisation—may well contain several different human organisations that interlock, but are managed separately and differently. One of these is likely to be a traditional organisation of full-time employees. Yet there may also be a closely linked but separately managed human organisation made up mainly of older people who are not employees but associates or affiliates. And there are likely to be “perimeter” groups such as the people who work for the organisation, even full-time, but as employees of an outsourcing contractor or of a contract manufacturer. These people have no contractual relationship with the business they work for, which in turn has no control over them. They may not have to be “managed”, but they have to be made productive. They will therefore have to be deployed where their specialised knowledge can make the greatest contribution. Despite all the present talk of “knowledge management”, no one yet really knows how to do it.

Just as important, the people in every one of these organisational categories will have to be satisfied. Attracting them and holding them will become the central task of people management. We already know what does not work: bribery. In the past ten or 15 years many businesses in America have used bonuses or stock options to attract and keep knowledge workers. It always fails.

According to an old saying, you cannot hire a hand: the whole man always comes with it. But you cannot hire a man either; the spouse almost always comes with it. And the spouse has already spent the money when falling profits eliminate the bonus or falling stock prices make the option worthless. Then both the employee and the spouse feel bitter and betrayed.

Of course knowledge workers need to be satisfied with their pay, because dissatisfaction with income and benefits is a powerful disincentive. The incentives, however, are different. The management of knowledge workers should be based on the assumption that the corporation needs them more than they need the corporation. They know they can leave. They have both mobility and self-confidence. This means they have to be treated and managed as volunteers, in the same way as volunteers who work for not-for-profit organisations. The first thing such people want to know is what the company is trying to do and where it is going. Next, they are interested in personal achievement and personal responsibility—which means they have to be put in the right job. Knowledge workers expect continuous learning and continuous training. Above all, they want respect, not so much for themselves but for their area of knowledge. In that regard, they have moved several steps beyond traditional workers, who used to expect to be told what to do, although later they were increasingly expected to “participate”. Knowledge workers, by contrast, expect to make the decisions in their own area.

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### **From corporation to confederation**

Eighty years ago, GM first developed both the organisational concepts and the organisational structure on which today's large corporations everywhere are based. It also invented the idea of a distinct top management. Now it is experimenting with a range of new organisational

models. It has been changing itself from a unitary corporation held together by control through ownership into a group held together by management control, with GM often holding only a minority stake. GM now controls but does not own Fiat, itself one of the oldest and largest car makers. It also controls Saab in Sweden and two smaller Japanese car makers, Suzuki and Isuzu.

At the same time GM has divested itself of much of its manufacturing by spinning off into a separate company, called Delphi, the making of parts and accessories that together account for 60-70% of the cost of producing a car. Instead of owning—or at least controlling—the suppliers of parts and accessories, GM will in future buy them at auction and on the Internet. It has joined up with its American competitors, Ford and DaimlerChrysler, to create an independent purchasing co-operative that will buy for its members from whatever source offers the best deal. All the other car makers have been invited to join.

GM will still design its cars, it will still make engines, and it will still assemble. It will also still sell its cars through its dealer network. But in addition to selling its own cars, GM intends to become a car merchant and a buyer for the ultimate consumer, finding the right car for the buyer no matter who makes it.

### **The Toyota way**

GM is still the world's largest car manufacturer, but for the past 20 years Toyota has been the most successful one. Like GM, Toyota is building a worldwide group, but unlike GM, Toyota has organised its group round its core competence in manufacturing. The company is moving away from having multiple suppliers of parts and accessories, ultimately aiming for no more than two suppliers for any one part. These suppliers will be separate and independent companies, owned locally, but Toyota will in effect run their manufacturing operation for them. They will get the Toyota business only if they agree to being inspected and "advised" by a special Toyota manufacturing consulting organisation. And Toyota will also do most of the design work for the suppliers.

This is not a new idea. Sears Roebuck did the same for its suppliers in the 1920s and 1930s. Britain's Marks & Spencer, although in deep trouble now, was the world's most successful retailer for 50 years, maintaining its pre-eminence largely by keeping an iron grip on its suppliers. It is rumoured in Japan that Toyota intends ultimately to market its manufacturing consultancy to non-car companies, turning its manufacturing core competence into a separate big business.

Yet another approach is being explored by a large manufacturer of branded and packaged consumer goods. Some 60% of the company's products are sold in the developed countries through some 150 retail chains. The company plans to create a worldwide website that will take orders direct from customers in all countries, either to be picked up in the retail store nearest to them or to be delivered by that store to their home. But—and this is the true innovation—the website will also take orders for non-competing packaged and branded consumer products made by other, and especially smaller, firms. Such firms have great difficulty in getting their wares on to increasingly crowded supermarket shelves. The multinational's website could offer them direct access to customers and delivery through an established large retailer. The pay-off for the multinational and the retailer would be that both get a decent commission without having to invest any money of their own, without risk and without sacrificing shelf space to slow-moving items.

There are already a good many variations on this theme: the American contract manufacturers, already mentioned, who now make the products for half a dozen competing Japanese consumer-electronics firms; a few independent specialists who design software for competing information-hardware makers; the independent specialists who design credit cards for competing American banks and also often market and clear the cards for the bank. All the bank does is the financing.

These approaches, however different, still all take the traditional corporation as their point of departure. But there are also some new ideas that do away with the corporate model altogether. One example is a "syndicate" being tested by several non-competing manufacturers in the European Union. Each of the constituent companies is medium-sized, family-owned and owner-managed. Each is a leader in a narrow, highly engineered product line. Each is heavily export-dependent. The individual companies intend to remain independent, and to continue to design their products separately. They will also continue to make them in their own plants for their main markets, and to sell them in these markets. But for other markets, and especially for emerging or less developed countries, the syndicate will arrange for the making of the products, either in syndicate-owned plants producing for several of the members or by local contract manufacturers. The syndicate will handle the delivery of all members' products and service them in all markets. Each member will own a share of the syndicate, and the syndicate, in turn, will own a small share of each member's capital. If this sounds familiar, it is because the model is the 19th century farmers' co-operative.

As the corporation moves towards a confederation or a syndicate, it will increasingly need a top management that is separate, powerful and accountable. This top management's responsibilities will cover the entire organisation's direction, planning, strategy, values and principles; its structure and its relationship between its various members; its alliances, partnerships and joint ventures; and its research, design and innovation. It will have to take charge of the management of the two resources common to all units of the organisation: key people and money. It will represent the corporation to the outside world and maintain relationships with governments, the public, the media and organised labour.

### **Life at the top**

An equally important task for top management in the next society's corporation will be to balance the three dimensions of the corporation: as an economic organisation, as a human organisation and as an increasingly important social organisation. Each of the three models of the corporation developed in the past half-century stressed one of these dimensions and subordinated the other two. The German model of the "social market economy" put the emphasis on the social dimension, the Japanese one on the human dimension and the American one ("shareholder sovereignty") on the economic dimension.

None of the three is adequate on its own. The German model achieved both economic success and social stability, but at the price of high unemployment and dangerous labour-market rigidity. The Japanese model was strikingly successful for 20 years, but faltered at the first serious challenge; indeed it has become a major obstacle to recovery from Japan's present recession. Shareholder sovereignty is also bound to flounder. It is a fair-weather model that works well only in times of prosperity. Obviously the enterprise can fulfill its human and social functions only if it prospers as a business. But now that knowledge workers are becoming the key employees, a company also needs to be a desirable employer to be successful.



Crucially, the claim to the absolute primacy of business gains that made shareholder sovereignty possible has also highlighted the importance of the corporation's social function. The new shareholders whose emergence since 1960 or 1970 produced shareholder sovereignty are not "capitalists". They are employees who own a stake in the business through their retirement and pension funds. By 2000, pension funds and mutual funds had come to own the majority of the share capital of America's large companies. This has given shareholders the power to demand short-term rewards. But the need for a secure retirement income will increasingly focus people's minds on the future value of the investment. Corporations, therefore, will have to pay attention both to their short-term business results and to their long-term performance as providers of retirement benefits. The two are not irreconcilable, but they are different, and they will have to be balanced.

**Corporations, therefore, will have to pay attention both to their short-term business results and to their long-term performance as providers of retirement benefits**

Over the past decade or two, managing a large corporation has changed out of all recognition. That explains the emergence of the "CEO superman", such as Jack Welch of GE, Andy Grove of Intel or Sanford Weill of Citigroup. But organisations cannot rely on finding supermen to run them; the supply is both unpredictable and far too limited. Organisations survive only if they can be run by competent people who take their job seriously. That it takes genius today to be the boss of a big organisation clearly indicates that top management is in crisis.

### **Impossible jobs**

The recent failure rate of chief executives in big American companies points in the same direction. A large proportion of CEOs of such companies appointed in the past ten years were fired as failures within a year or two. But each of these people had been picked for his proven competence, and each had been highly successful in his previous jobs. This suggests that the jobs they took on had become undoable. The American record suggests not human failure but systems failure. Top management in big organisations needs a new concept.

Some elements of such a concept are beginning to emerge. For instance, Jack Welch at GE has built a top-management team in which the company's chief financial officer and its chief human-resources officer are near-equals to the chief executive, and are both excluded from the succession to the top job. He has also given himself and his team a clear and publicly announced priority task on which to concentrate. During his 20 years in the top job, Mr Welch has had three such priorities, each occupying him for five years or more. Each time he has delegated everything else to the top managements of the operating businesses within the GE confederation.

A different approach has been taken by Asea Brown Boveri (ABB), a huge Swedish-Swiss engineering multinational. Goran Lindahl, who retired as chief executive earlier this year, went even further than GE in making the individual units within the company into separate worldwide businesses and building up a strong top management team of a few non-operating people. But he also defined for himself a new role as a one-man information system for the company, travelling incessantly to get to know all the senior managers personally, listening to them and telling them what went on within the organisation.

A largish financial-services company tried another idea: appointing not one CEO but six. The head of each of the five operating businesses is also CEO for the whole company in one top management area, such as corporate planning and strategy or human resources. The company's chairman represents the company to the outside world and is also directly concerned with obtaining, allocating and managing capital. All six people meet twice a week as the top management committee. This seems to work well, but only because none of the five operating CEOs wants the chairman's job; each prefers to stay in operations. Even the man who designed the system, and then himself took the chairman's job, doubts that the system will survive once he is gone.

In their different ways, the top people at all of these companies were trying to do the same thing: to establish their organisation's unique personality. And that may well be the most important task for top management in the next society's big organisations. In the half-century after the second world war, the business corporation has brilliantly proved itself as an economic organisation, ie, a creator of wealth and jobs. In the next society, the biggest challenge for the large company—especially for the multinational—may be its social legitimacy: its values, its mission, its vision. Increasingly, in the next society's corporation, top management will, in fact, be the company. Everything else can be outsourced.

Will the corporation survive? Yes, after a fashion. Something akin to a corporation will have to co-ordinate the next society's economic resources. Legally and perhaps financially, it may even look much the same as today's corporation. But instead of there being a single model adopted by everyone, there will be a range of models to choose from.

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**In the next society,  
the biggest  
challenge for the  
large company may  
be its social  
legitimacy: its  
values, its mission,  
its vision**

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