The Struggle for Control of the Modern Corporation: Organizational Change at General Motors, 1924-1958

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The decentralized or multidivisional structure (M-form) identified by Chandler [1] is widely acknowledged as perhaps the "most significant organizational innovation of the twentieth century" [5, p. 279]. Characterized by a number of distinct operating divisions run as separate profit centers and overseen by a hierarchy of professional managers, the M-form is said to have arisen and succeeded by reducing the costs of governing large firms operating in multiple markets. Central to the M-form's efficiency is the separation between strategic and tactical planning that leaves top executives free to carry out strategic planning, investment allocation, and performance allocation, while division management oversees daily operations.

Transaction cost economics (TCE) [4, 5] attributes the efficiency of the M-form to two factors: 1) the exclusion of divisional management from strategic planning makes it difficult for managers to divert resources to their own units, reducing the potential for self-interested policy making, and 2) giving the divisions authority over operations helps to prevent top executives from making low-level decisions for which they lack information. Additionally, the creation of financial controls provides information that allows headquarters to reward high-performing divisions and punish low performers. TCE explicitly warns that conflation of strategic and tactical planning is sub-optimal [4, pp. 148-54]. If divisions gain representation in planning, they will pursue self-interested policies; if the general office becomes involved in operations, long-term planning will be neglected as top officers focus on issues better resolved in the divisions.

A re-examination of decentralization at General Motors raises crucial questions concerning this image of the M-form. Although GM was one of Chandler's original case studies, historical documents show that the strong distinction between strategic and tactical planning existed there only briefly. For

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most of the period prior to 1958, GM had an M-form in which division managers were represented directly in strategic planning. During the decade of the 1930s, top executives pursued the opposite strategy, creating a structure in which the general office made strategic, financial, and operating decisions. Throughout the period between 1924 and 1958, owners urged a return to the textbook M-form, with its strong distinction between strategic and tactical planning. Ironically, when this change was finally implemented in 1958, GM's performance declined.

The GM case thus seems to violate the predictions of efficiency theory. Rather than leading to sub-optimal performance, conflation of strategic and tactical planning corresponded to GM's reign as one of the most profitable firms in the world. Even more surprising, after planning was made the exclusive province of top executives, performance deteriorated. In the remainder of this paper, I provide a brief summary of decentralization at General Motors and outline the factors underlying the changes. I then discuss the implications of the GM case for existing theories of corporate governance.

Decentralization at General Motors

The drive to include the divisions in planning was undertaken primarily by Alfred P. Sloan, Jr., who took over as GM's president in May 1923. Between 1923 and 1934, owner opposition to such participative decentralization forced Sloan to pursue divisional participation in planning through informal practices rather than through changes to the formal organization. The formal body in charge of planning was the Executive Committee (EC), comprised primarily of general executives. Policies involving capital expenditures above a specified amount had to be ratified by the owner-controlled Finance Committee (FC). In 1923, Sloan attempted to include divisions in planning by creating an Operations Committee (OC) composed of division managers. Although the OC held no power to make policy, Sloan's intent was to merge the OC and EC, creating a planning body comprising of both division managers and general office executives. When owners opposed this plan, he turned to a less formal strategy: the EC and OC would meet together to discuss policy, giving division managers a voice in the planning process. Once an agreement was reached, EC members would ratify the decision.

There are not sufficient data to determine whether this arrangement gave the divisions real power over planning. What is clear is that Sloan favored such participation as a means of ensuring divisional acceptance of corporate policies. Concerned that exclusive reliance on financial sanctions and fiat would create resistance from below, Sloan believed that allowing managers to participate in planning would create greater "understanding and zeal" in enacting policies [3, p. 194] than would the use of reward and punishment mechanisms. This became especially clear after 1929, when Lammot du Pont took over as GM's chairman of the board and eliminated divisional representation on the OC. Sloan repeatedly argued that this move would disrupt motivation and lead to divisional resistance. Lammot eventually relented, allowing Sloan to put division managers back on the OC.

Between 1934 and 1941, GM reversed course, giving the general office control of both operating and financial decisions. The first steps toward administrative centralization occurred between September and December 1933, when a new set of managers took over at the five car divisions, the OC was dissolved, and divisional representation on the EC was eliminated. Concomitantly, GM's competitive strategy was revised. Because the depression had created a severe decline in demand for medium- and high-priced cars, GM could no longer afford to have five car divisions operating in separate price classes. The EC thus decided that four of GM's divisions would compete with one another in the low-priced market. To cut costs, the divisions would share chassis, frames, and other parts; designing and producing cars would thus entail increased coordination among divisions. To achieve coordination, technical staff took over what had once been division prerogatives, making decisions about design, manufacturing, and production.

This centralization culminated in a 1937 reorganization that gave the general office formal control over financial and operating decisions. Complaining that owner control of the FC led to a financial dictatorship, Sloan argued that financial decisions required greater assessment of prospective policies. For this to occur, general executives with a better knowledge of such policies needed to be included in financial decision making. Sloan thus proposed replacing the FC and EC with two new committees, the Policy (PC) and Administration (AC) Committees. The former, comprised primarily of general office rather than owner representatives, would be given complete authority over financial and operating decisions. The AC, comprised exclusively of general executives, would oversee operating policy. Because the PC held all legal power, AC decisions would be reviewed and modified from above. While owners opposed this plan, they acceded, recognizing Sloan's successful track record, and fearing that intervention might be problematic in the climate of the New Deal. The 1937 reorganization created a structure in which top executives made virtually all important operating and financial decisions.

GM's conversion to defense production in January 1942 produced a rapid return to participative decentralization. This time, however, divisional participation was formal in nature. In May 1942, the AC took over most facets of running the corporation. For the duration of the war, the PC did little more than rubber stamp decisions made by the AC. Concomitant with these changes, division managers were added to the AC. Initially only a few were included, but by 1945, managers from all the car and truck producing units, as well as the head of Fisher body, sat on the AC. Yet this arrangement did not give the divisions uncontested control over policy. Prospective policies were formulated in functionally defined policy groups, composed exclusively of general office men. These groups forwarded proposed policies to the AC for debate, modification, and ratification. This arrangement allowed general executives to control the broad parameters of planning, but it gave the divisions substantial power to revise, amend, and veto policies.

Owners again opposed these changes, but acquiesced due to the need for rapid action. By 1945, however, they charged that divisional men on the AC were engaged in self-interested policy making rather than in an objective evaluation of alternatives. They pushed for a return to the pre-1937 organization, in which owners controlled finances and the general office carried out planning. Sloan opposed this idea, leading to a protracted struggle over the form the postwar organization would take. By June, 1946 a compromise was reached. A Financial Policy Committee (FPC) of owners and general executives would have authority over financial policies, while an Operating Policy Committee (OPC) comprised of general office men would oversee strategic planning. The AC would continue to include division managers, but it held no legal authority, being charged only with making policy recommendations to the OPC.

In theory the 1946 organization excluded the divisions from strategic planning by giving the OPC final authority over operating policy. Yet in practice the president, who chaired both the AC and the OPC, carried out substantive discussions of policy with division managers in the AC; once approved by that body, he would ram policies through the OPC with little input from general executives. The OPC thus did little more than rubber stamp decisions made by the AC. Moreover, in the new organization the president rather than the chairman served as CEO, giving him authority over the financial staff. Increasingly, the president and the divisions acted in concert to approve expansion plans against the entreaties of financial staff. Initially the FPC was able to curb such expenditures, but over time, they found themselves unable to judge the merits of proposed policies. Moreover, the U.S. government antitrust suit against DuPont made owners hesitant to interfere in GM's affairs. Between 1946 and 1958, the most profitable period in GM's history, the financial and operating sides of the corporation were engaged in an increasingly bitter political struggle.

When return on investment began to decline after 1956, owners and Sloan finally agreed to reorganize GM again. Ironically, after decades of debate, owners finally convinced Sloan to implement a textbook M-form. The organization put into effect in August 1958 resurrected the Finance and Executive Committees, giving the latter complete control of operating policy. The AC continued to exist, but it no longer considered policy proposals, which now went straight to the EC, removing divisions from the planning process. Finally, the new chairman of the board was named CEO, giving him line authority over the president and operations.

Ironically, while the new organization put the general office in charge of planning, it also destroyed the mechanisms for creating divisional consent. The new chairman did little to solicit input from the divisions, which in turn resisted policy directives from above. The new administration attempted to force the divisions to obey, but this only exacerbated resistance, leading to an extensive breakdown of cooperation. The implementation of a textbook M-form marked the beginning of GM's long decline.

Governing the Modern Corporation

The changes at GM were the result of two factors: owners' ability to insist on adherence to a textbook M-form, and the need to create divisional consent to corporate policies. The ability of GM's general office to engender divisional participation in planning was constrained by owners. The du Ponts' preference for the traditional M-form was predicated on their interests as shareholders. The M-form was initially created in the wake of divisional opportunism that dissipated shareholder value, and the du Ponts saw any attempt to include the divisions in planning as a step in this direction. Even more important, E.I. du Pont de Nemours itself was governed via a textbook M-form. When owners questioned Sloan's emphasis on consent, he suggested that DuPont's smaller size and the fact that both operating and general executives were together in Wilmington meant that consent could be produced informally there. In the much larger GM, with general executives in New York and operating men in Detroit, agreement had to be created through more formal means.

Although owners possessed legal authority to insist on a textbook M-form, their willingness to utilize this power was shaped by the perceived legitimacy of such intervention. Legitimacy rested on two factors. First, owners' control over finances was predicated on the assumption that capital was a scarce commodity. When GM's success led to excess profits that could be reinvested, owners could not claim that funds for expansion were unavailable. Under these conditions, evaluation of prospective policies turned more on an assessment of the substance of policies. Lacking knowledge of the automobile business, owners found it difficult to engage in such an assessment. Second, increasing state regulation – both New Deal legislation and the antitrust suit against DuPont – made owners increasingly wary of interfering in GM's affairs, particularly when the company was performing well.

Divisional participation in planning was used to create consent to policies. Sloan believed that managers who took part in formulating policies were more likely to accept them and work towards their implementation. The need for consent, in turn, rested on the degree to which divisions served separate markets. When each division served a different price class, managers were included in planning; when divisions competed in the same market, GM centralized. Contrary to the assertions of economic theory, Sloan believed that consent to policies could not be created by situational sanctions. Instead, extensive reliance on such mechanisms would lead to resistance rather than acceptance. He thus pursued a compromise between radical decentralization that ceded control of policy to the divisions, and a structure that allowed the general office to control planning.

Sloan saw consent as crucial for rapid adaptation to changing conditions, and he believed that a narrow focus on costs would impede the ability to adapt. It thus may be that an emphasis on low-cost governance is more appropriate in stable markets requiring little innovation, while consent is crucial in dynamic markets [2]. Moreover, although Sloan went to great lengths to devise a structure

that allowed for divisional input while giving the general office ultimate authority over policy, he was loathe to use this power to overrule the divisions. Even when he knew that managers were pursuing self-interested policies, Sloan often preferred to pay the costs of opportunism rather than invoking fiat. This approach proves problematic for a framework that sees cost minimization as the primary imperative facing governance mechanisms. The GM case thus suggests that the focus on costs advocated by efficiency theories must be broadened to take account of the social construction of order and cooperation within the firm.

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