

# WORKING PAPERS IN ECONOMICS

THE CONGLOMERATE AND THE FOCUSED AGGLOMERATE:  
MODERN FORMS OF THE LEADER-COMMANDED FIRM\*

By Bruce W. Ross

No. 109 July 1988

DEPARTMENT OF ECONOMICS



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#### ABSTRACT

The dominant business form of this century, the hierarchically controlled multidivisional enterprise, is typically committee-commanded. However in the last quarter-century there has been a resurgence of leader-commanded firms. Two distinct types are identified. The more common is the diversified conglomerate. The other is the focussed agglomerate. The focussed agglomerate has greater potential to eventually transform into a hierarchically controlled multidivisional enterprise.

## LEADER-COMMAND AND COMMITTEE-COMMAND

Alfred Chandler has demonstrated that in the period following the first World War the hierarchically controlled multidivisional enterprise became the dominant business form. Such an enterprise is managed by a hierarchy of top and middle level salaried managers who monitor and coordinate the work of other managers and thus the performance of the many distinct operating units.

Chandler asserts that the hierarchical structure is a source of permanence, power, and continued growth. Whereas traditional owner-managed enterprises were normally short-lived, managerial hierarchies have a permanence beyond that of the individuals who work in them. As managers die, retire, or are promoted, others are trained and ready to take their place. The institution remains even though men come and go (1977, p. 8).

At the top of the hierarchical structure is the general office where general executives and staff specialists coordinate and plan policies and allocate resources for the divisions. Although strategic plans can originate from below, their implementation, in terms of allocation of the necessary resources, is normally a function of the general office (1977, pp. 9, 11).

One of the most important outcomes of the development of the managerial hierarchy is that responsibility for taking strategic decisions has shifted from a single dominant individual to a group constituted as a board or committee.

This can be clearly seen in the organisational structure established by Alfred P. Sloan at General Motors, which provided a model for many other corporations as they developed into modern

business enterprises. Under the Sloan plan control of all executive functions was centralised in the President as chief executive officer. The President was responsible to the Directors and also to the Finance and Executive committees. The Executive Committee was to concentrate on "critical entrepreneurial and strategic decisions". Chandler specifically acknowledged the subordination of the chief executive officer to the committees: "The President's primary role would be to interpret the policies of the top committees and to see that they were carried out (1962, pp. 134, 140). Sloan himself asserted: "A group can make policy, but only individuals can administer policy" (1972, p. 114).

This, then, is the essential distinction. The chief executive administers corporation policy, but the committee or group is responsible for the strategic decisions which determine that policy. In other words, the group makes decisions while the chief executive implements them.

In order to comprehend the dynamics of a business enterprise, it is vital to know where power lies within that enterprise; in particular the power to determine the enterprise's direction, to make arbitrary decisions and to compel obedience. In short we need to know - who commands?

Adoption of this criterion enables us to highlight a crucial distinction between the traditional owner-managed enterprise and the mature modern enterprise. We can say that the former is "leader-commanded", while the latter is basically "committee-commanded".

In practice, of course, an enterprise which normally has a committee-commanded structure may for a time become effectively leader-commanded. This would be likely to occur where an individual by force of personality or superior ability achieves dominance or where a

situation of crisis causes committee members to defer to a leader. Both conditions were fulfilled when Sloan carried out his reorganisation at General Motors, although the corporation gradually adopted true committee-command. A recent instance was when the near fatal crisis at Chrysler led to leader-command being instituted under Lee Iacocca. No one at Chrysler can be in any doubt as to where the ultimate decision making power lies:

My policy has always been to be democratic all the way to the point of decision. Then I become the ruthless commander. "Okay, I've heard everybody," I say. Now here's what we're going to do." (1986, pp. 55-56).

Leader-command is no guarantee of superior performance. Everything depends on both the quality of the leadership and the appropriateness of the leader's contribution. Leader-command was responsible for the creation of both Ford and General Motors. But it was also responsible for the near destruction of both enterprises, in the first case with Henry Ford becoming increasingly eccentric in his later years, and in the second with Billy Durant being unable to manage what he had created.

#### THE LOCATION OF COMMAND AND STRATEGIC COMMITMENT

Elsewhere (1988), I have argue that the essence of entrepreneurial activity is "strategic commitment". This has two elements - firstly, strategic thought and decision and secondly, commitment based on that strategy. Strategic decision is concerned with changing the firm's relationship to its environment, while strategic thought involves a

capacity to see the overall picture - to deal with a multitude of variables simultaneously and to exploit their interactions. Successful enterprise requires a strategic campaign, i.e., the continual application of strategy.

Commitment in this context has three distinct connotations - resource commitment, psychological commitment, and organisational commitment. The first reflects the commitment of physical and human resources for a specific purpose. The decision maker senses an opportunity, makes an assessment of the situation, and then backs that judgment by committing resources.

The notion of psychological commitment reflects the realisation that the entrepreneurial act is not simply a choice between alternatives. It is usually a test of the nerve, of the will-power, of the self confidence of the decision maker, often requiring the application of all their energy and ingenuity to transform an initial decision into a successfully completed project.

Organisational commitment is a product of the other two types of commitment. It relates to the human resources committed to a project - particularly at the managerial level. It is also so closely allied to psychological commitment that it is virtually a subset of it. Where there is strong organisational commitment a team spirit or group dynamic develops which greatly increases the productivity and potential of the organisation.

Entrepreneurial responses are triggered by both opportunity and threat. In both situations the presence of leader control can provide the most appropriate response in terms of flexibility and determination, and the concept of strategic commitment helps us to understand the basis of this advantage.

Committee decisions are usually based on the formal assessment of facts. Where information is incomplete, decisions are frequently either deferred or resolved in favour of maintaining the status quo. Effective strategic decision making, however, typically has to proceed on the basis of very limited information, with the decision being guided by imagination and intuition. Such thinking is the province of the individual rather than the group, and there may be an understandable reluctance of other committee members to back a particular member's "gut feeling".

For this reason resources can be expected to be committed more readily in a leader-commanded organisation. It is also obvious that intense psychological commitment is most likely to be generated in an individual exercising undisputed leadership. This in turn may be the basis for organisational commitment, which frequently derives from the charismatic quality of the leader. Subordinates perceive the leader's total commitment to the project and the spirit of that commitment is transferred to them. Such loyalty is less likely to be inspired by an essentially faceless board of directors or a committee.

THE RESURGENCE OF LEADER-COMMAND

Some twenty years ago Galbraith asserted, with considerable justification, that in large mature corporations, group control had almost totally supplanted individual control:

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With the rise of the modern corporation, the emergence of the organization required by modern technology and planning and the divorce of the owner of the capital from control of the enterprise, the

entrepreneur no longer exists as an individual person

in the mature industrial enterprise (1972, p. 85).

He conceded, of course, that the individual entrepreneur could still be found "in smaller firms and in larger ones that have yet to reach full maturity of organization," but he obviously saw such firms playing an insignificant role compared to the giant corporations.

While it is still true that the name of the current head of General Motors is unknown to "people outside Detroit and the automobile industry" (Galbraith, 1972, p. 22), the same could not now be said, for example, about the head of Chrysler. More importantly, there is increasing recognition that the committee-commanded mature firms have become increasingly bureaucratic and lack the flexibility and initiative to respond appropriately to challenges and threats.

In the last quarter-century leader-commanded firms have again become arguably the most dynamic force in the economy. George Gilder writes of the United States as "a country of small firms and new inventions and radical breakthroughs by daring men who are leading the world economy into a new age of growth and prosperity" (1986, p. 44). While Gilder is justified in highlighting the re-emergence of the "real world" entrepreneur, the most visible manifestation of the resurgence of leader-command has been the phenomenon of firms achieving quite spectacular growth basically by exploiting imbalances in the market for corporate control. Waves of merger activity have occurred with even giant corporations being devoured by upstart newcomers who are frequently much smaller than their targets.

The main outcome of this corporate raiding has been the creation of conglomerates. However an important minority of raiders have developed into what I would term "focussed agglomerates".

## THE CONGLOMERATE

The word "conglomerate", in relation to mergers, is a comparatively recent addition to the terminology of economics. Its first reported use was in 1941 during hearings of the Temporary National Economic Committee of the United States (Steiner, 1975, p. 430). As its usage has now developed, the essential characteristic of a conglomerate organisation is the diversity of industries in which it operates.

Chandler points out that the conglomerate form differs from the hierarchically controlled, multi-division enterprise in terms of both strategy and organisational structure. The modern multi-divisional enterprise grows primarily by internal expansion, i.e., by direct investment in industries related to its original product line. Its expansion is usually directed towards markets where its managerial, technological and marketing skills and resources provide a comparative advantage. By contrast the conglomerate grows entirely by external expansion, i.e., the acquisition of existing enterprises which are often in totally unrelated fields.

Historically, the motivation for the creation of conglomerates was a realisation that there was limited potential for growth in a firm's own industries, together with an awareness of the greater security provided by a diversified product line and an investment strategy based on having a range of products at different stages of the product cycle.

The organisational structure of the conglomerates reflected their growth strategies. Because of the principal's lack of specific knowledge, the acquired operating units were given much greater

autonomy than the divisions of the hierarchically controlled, multi-industry enterprise. But the greatest difference was in the composition of their general office. Conglomerates do not have general office specialists in such areas as purchasing, sales, research and development, advertising or production. Apart from legal and financial experts, their general office staff concentrate on corporate planning, i.e., the formulation of strategy to be used in investment decisions. Thus the conglomerate could focus more single-minded on making new investments and was also much more flexible in withdrawing from existing investments.

On the other hand, Chandler asserts, conglomerates are far less effective in monitoring their divisions and in improving their performance. They have "neither the manpower nor the skills to nurse sick divisions back to health." In addition, their lack of technological expertise or research and development facilities makes them incapable of effectively introducing new processes or products. Their managers are "almost pure specialists in the long-term allocation of resources" (1977, pp. 480-82).

I believe that it is important to distinguish between committee-commanded and leader-commanded conglomerates. The former are often essentially defensive conglomerates, formed by mature enterprises faced with the problem of limited growth in their traditional areas of activity. By contrast the most aggressive and growth-oriented conglomerates have clearly been leader-commanded. The pioneer, Textron, was the creation of Royal Little. Similarly, Charles "Tex" Thornton, Charles Bludhorn and James Ling were primarily responsible for the meteoric rise - and subsequent spectacular decline - of Litton Industries, Gulf & Western, and LTV, respectively.

An important characteristic of the leader-commanded conglomerate is that, unlike either the hierarchically controlled enterprise or the committee-commanded conglomerate, there is unlikely to be any clear delegation of responsibility among the general office staff. The major function of such staff in such a conglomerate is to provide support for the entrepreneurial leader who retains ultimate decision making responsibility, and may at times intervene in any areas of the enterprise's operations.

When Harold Geneen was recruited from Raytheon to take the presidency of ITT, he negotiated a contract which assured him a free hand and sufficient power to exercise control. Some years later he was reported as saying: "If I had more arms, legs, and time, I could run the entire corporation" (Sobel, 1982, pp. 180, 193).

Significantly, ITT survived the shake-out of the 1970s much better than most of the other conglomerates (Sobel, 1982, pp. 256, 345). This was in large measure due to the quality of Geneen's management, but in particular to the diversification strategy which he adopted. ITT was never intended to be a pure conglomerate. Initially, Geneen was very discriminating in his choice of targets. For the most part ITT's large-scale takeovers were of firms "capable of becoming the core of a new division," while its smaller acquisitions were undertaken "to round out existing operations and augment existing segments of the firm" (Sobel, 1982, pp. 217-18). Some of his later acquisitions did not conform to this grand strategy, but in essence Geneen, one of whose few heroes was Alfred Sloan, was engaged in systematically constructing a cohesive multidivisional enterprise.

## THE FOCUSSED AGGLOMERATE

The use of the word "conglomerate" in economics and business apparently developed by analogy with its original geological application to a rock formed when fragments of pebbles or rocks are cemented together by clay, silica, etc. In both usages the emphasis is on the diversity of the things which are combined to form the conglomerate.

Another word, "agglomerate", derives from the same Latin root, "glomus", meaning ball. An agglomerate is a jumbled heap or mass. I propose to use agglomerate to refer to a corporation consisting of many companies which continue to operate as virtually separate businesses. Thus "agglomerate" would be the general term for the gathering together of companies, and a "conglomerate" would be a particular type of agglomerate, distinguished by the diverse nature of the activities of its constituent companies.

The term "focussed agglomerate" would be used for the situation where a large number of businesses are assembled under common ownership and continue to be run as separate businesses, but where there is a common focus to their operations, in that they are all involved in the same or related industries. The focussed agglomerate differs from the traditional holding company which "provided the legal form to maintain tighter control over a federation of small, single-unit, single-function manufacturing firms" (Chandler, 1977, p. 320). The essence of the distinction is that the focussed agglomerate is commanded by an individual with supreme authority, whereas in the holding company control was typically shared among representatives of the member firms. If the holding company can be viewed as a federation then the focussed agglomerate is best described as an empire.

When we examine the focussed agglomerate in terms of strategy and organisational structure, we find important differences from both the diversified conglomerate and the hierarchically controlled multidivisional enterprise. Like the conglomerate, the focussed agglomerate expands primarily by external expansion. However its motivation is likely to be a realisation by its leader that its specialised managerial, technological and marketing skills give it an advantage over other potential acquirers of businesses in its own industry. It is better able to make an assessment of the true worth of such targets and to improve their performance. At the same time, its reliance on external expansion enables it to grow much more rapidly than could a firm which channelled its investment through its existing plant and personnel.

In one sense the focussed agglomerate typically allows its operating units far greater autonomy than is permitted to the divisions of the hierarchically controlled enterprise. Management is much less concerned with establishing formal chains of command or with standardising operating procedures. But on the other hand, because it is leader-commanded, there may at times be quite direct, and frequently arbitrary, involvement in the operations of the subsidiaries.

One of the earliest examples of a focussed agglomerate was General Motors as it was originally created by Billy Durant. In the first two years of its existence General Motors took control of, or a substantial interest in, over thirty companies, including 10 passenger car and two truck manufacturers plus an assortment of automotive parts and electric lamp manufacturers. No attempt was made to develop systematic coordination or control of the various subsidiaries. "[T]he old companies retained their corporate and independent operating

identities in the new one, which was a holding company - that is, a central office surrounded by autonomously operating satellites" (Sloan, 1972, p. 5).

As late as 1920, twelve years after its incorporation, General Motors' central administrative organisation consisted of just seven executives plus their secretaries. Durant constantly frustrated his divisional managers by his arbitrary intervention, while his chairman, Pierre S. du Pont, became exasperated by his lack of consultation. The Finance and Executive committees were seldom convened and Board meetings were called at the shortest notice, and then on the initiative of Durant rather than du Pont.

When, as was inevitable, Durant's chaotic methods brought the corporation to the point of collapse, Alfred Sloan implemented the organisational structure which "transformed General Motors from an agglomeration of many business units, largely automotive, into a single, coordinated enterprise" (Chandler, 1962, p.130).

An example of a contemporary focussed agglomerate is the organisation built up by the expatriate Australian media proprietor, Rupert Murdoch. In 1952 he inherited a pair of struggling newspapers in the Australian city of Adelaide. Six years later, when television was introduced to Adelaide, a company controlled by him was awarded one of the two commercial channel licenses. From this provincial base he pursued a growth strategy which largely involved taking over media companies in difficulties and resuscitating them. He now controls sixty per cent of the Australian newspaper market.

In 1968 he purchased the News of the World, Britain's top-selling newspaper. Since then he has acquired a number of titles, including the prestigious Times and Sunday Times, and holds more than a third of the national newspaper market in Britain.

In the United States, in addition to his newspaper, magazine and film interests, he is endeavouring to establish the nation's fourth television network. In August 1988 his long sequence of takeovers culminated in the \$US3 billion acquisition of an American publishing house which produces a number of specialist magazines. He has also recently announced plans for satellite-delivered commercial television in Europe. With his organisation producing well in excess of three billion newspapers each year, he seems destined to create the first world-wide media network.

The Murdoch empire is indisputably a focussed agglomerate rather than a conventional multidivisional corporation, even though the formal structure of his individual businesses is elaborately hierarchical. A typical Murdoch newspaper has an editor, associate editor, deputy editor, assistant editor, then department editors who all have deputies, who all have assistants and so on (Regan, 1976, p. 181). However there is little integration or coordination of the various operations within the organisation. Power is concentrated in the leader. The role of the group executives is to support him and they have little scope for independent initiative. All of the organisation's executives are required to carry out his instructions to the letter and to keep him fully informed. "He probably makes more decisions at more levels than any other managing director of any concern of comparable size. Certainly a lot more than any other newspaper proprietor" (Regan, 1976, p. 190).

One of the characteristics of the leader-commanded firm is speed of response to opportunity or threat. This is clearly evident in a recollection by one of Murdoch's executives:

I once watched him when he heard a newspaper might come onto the market. He had two telephones

working at once. He called lawyers, bankers, the whole board, executives, family and so on. In a matter of hours he had found out the situation, confirmed the rumours, assessed his own position and set the whole thing in motion. He knew what he could spare from the Kitty, how much more he could borrow, what the price might be, who his competitors were, and when and how he should make the bid. It was an amazing sight to watch. He had heard of the chance at around eleven in the morning and by dusk that evening the whole organization was geared up to get weaving. By eleven the following morning Murdoch had made his bid (Regan, 1976, p. 16).

Even though his reputation for sacking editors is legendary, Murdoch retains the ability to inspire tremendous organisational commitment:

Murdoch offers the dream and people succumb. ...

Murdoch is able to charge them with his own brand of enthusiasm. He backs this with generous portions of flair and energy. And for a time the mixture works.

The trouble arises because few can actually keep up with Murdoch. They burn themselves out trying. At the end of around three years, they are exhausted. Then Murdoch bursts back - and not a drop of his energy is drained away. He is able to milk a man dry (Regan, 1976, p. 130).

The Murdoch organisation illustrates the enormous potential of the focussed agglomerate form in an industry which demands entrepreneurial flair coupled with specialised knowledge and

experience. But it also illustrates the essential limitation of any leader-commanded firm. In the absence of Murdoch, very formidable management problems would soon be apparent.

#### THE IMPERMANENCE OF LEADER-COMMAND

There are a number of factors which limit the time period during which the leader-commanded firm remains a healthy and growing entity.

Firstly the effect of continued growth may be to produce a scale of operations which is basically unmanageable in the hands of a single individual, no matter how capable. Alternatively the finite life-span of the leader obviously imposes a limit to the organisation's capacity to continue as an entrepreneurial firm, unless the original leader can arrange to hand over control to a younger person with similar qualities of enterprise. Usually the entrepreneurial timespan of the leader-commanded firm is limited not so much by the biological or working life-span of its leader, but rather by the timespan of their psychological commitment to the enterprise.

Because of their impermanence, both the focussed agglomerate and the leader-commanded conglomerate are transitional forms. However their evolution is likely to be different. Because the focussed agglomerate is essentially a viable entity, it is quite probable that it will eventually transform into a mature, hierarchically controlled organisation. By contrast, the conglomerate, lacking economic and industrial logic, is more likely to contract or disintegrate over time.

Leader-commanded organisations inevitably face the problem of leadership succession. However it is unlikely that a suitably endowed successor can be found within the organisation. An individual who

possesses similar drive and dynamism to the incumbent leader is likely to find the atmosphere of working in their shadow unbearably constricting. Also, because the organisation is essentially the expression of one person's personality, it is improbable that control can be smoothly transferred to a successor.

In any event, after a long period of leader-command, the organisation may be better served by a period of consolidation rather than an endeavour to maintain its historic pattern of growth. For this type of challenge a committee-commanded structure would probably be most effective. However the type of sycophantic executives who have survived until the passing of their leader are unlikely to possess the necessary attributes to determine a new direction for the organisation.

#### CONCLUSION

This paper recognises that the organisational structure of business enterprises is continually evolving. The hierarchically controlled multidivisional enterprise became dominant because it was the most effective vehicle to cope with mass production, distribution and marketing. However, being committee-commanded, such corporations as they mature tend to develop organisational rigidity. Their decision making becomes increasingly bureaucratic and unenterprising.

Postwar developments, particularly in the market for corporate control, have presented opportunities for a new generation of business leaders. Two distinct types of leader-commanded organisations have eventuated. The most common and widely recognised has been the diversified conglomerate. The other, not previously identified as a separate type, is the focussed agglomerate. Although it is less

common, the focussed agglomerate form is of particular importance because of its greater potential to eventually transform into a hierarchically controlled multidivisional enterprise.

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