Ending Corporate Stalinism

*Tyler Cowen and David Parker, **Markets In The Firm: A Market Process Approach to Management**, Institute of Economic Affairs, London, 1997*

Reviewed by ***Ken Phillips***

WITH *Markets In The Firm*, Tyler Cowen (George Mason University, USA) and David Parker (Aston University, UK) have, in a succinct 80 pages, provided a snapshot of the philosophies and approaches which have been driving business management since the start of the industrial revolution. They revisit the question that Ronald Coase asked in 1937: why do firms exist?

The conclusion of their study is summarised in the book's title. Until recently, the internal operations of firms have been dominated by command-and-control socialist principles. Markets in free-enterprise economies have operated between firms but not within firms. But in developed economies market principles and practices are now penetrating the internal operations of firms: and so they should, according to Cowen and Parker.

The authors first consider the latter days of craft production, then move on to the Taylorist or 'scientific' approaches to mass production which superseded craft production and which have dominated practice since the industrial revolution. 'Scientific management ... endorsed the separation of thinkers (management) from doers (labour)' (p. 23). Under the scientific principles of command and control, 'The senior managers would plan and control their businesses in a fashion similar to the way Soviet commissars from the 1920s planned and controlled their empires'. This continued until the 1970s, 'when US and European businesses dominated world markets aided by cartels, oligopolistic market structures, tariffs and a relative paucity of global competition' (p. 10). But in the more competitive world of today, firms are obliged to rely more on market based mechanisms, and especially on price triggers, as the most efficient way of processing and transmitting information and providing focused direction through the firm.

The authors draw on the writings of numerous modern business commentators. They associate the success of modern Japan with that country's rejection of Taylorist methods. They cite the works of Charles Handy, Peter Drucker, Edwards Deming, Tom Peters and many others to illustrate their points. In companies such as Rank Xerox, Du Pont, General Electric, ABB, AT&T, Johnson and Johnson, Siemens, Hewlett Packard and Chrysler, to name but a few, 'Employee commitment, "multi-tasking" and organisation in self-motivating teams are replacing Taylorist alienation, specialisation and top-down management' (p. 32). 'Workers must now be thinkers rather than simply doers ...' (p. 28).

But what can the firm be if it is not a system of command and control? What other mechanisms do or can hold firms together and give them strategic direction? How do the CEO and the company board ensure that their business plan prevails when they don't even have 'control' over the top layer of management? Cowen

and Parker look to market principles for the answers, arguing that just as price signals drive the commercial relations between entities in the market place, so price signals should, can and do drive the relationships between entities inside firms. Can the firm then be conceptualised as an organisational series of internal price signals tied to the ultimate price signal of the firm, namely, operational profit? Cowen and Parker appear to believe so. They respond to the problem identified by Coase (1937) — that the transaction costs associated with price mechanisms are too high for such mechanisms to operate inside firms — by insisting that contract management, as opposed to command and control management, resolves the issue: 'A "contract view" of the firm, in contrast to the "command" view, emphasises similarities rather than differences between resource allocation in firms and in markets' (p. 45). This view of the firm has parallels with Coase's (1988:9) own claim that 'Markets are institutions that exist to facilitate exchange'. Cohen and Parker have identified management developments that create market-based institutions that operate inside the firm.

For managers, this penetration of market principles into the workings of firms creates major practical problems. How do managers manage when apparently the invisible hand of the market is in control? How does the contract view of the firm translate into practice? Cowen and Parker do not seek to provide a sweeping 'one method fits all' model: no single organisational model will suit all businesses, just as the specific dynamics of any two markets are not identical.

Markets In The Firm is at its strongest on this point. Cowen and Parker address the practical problems through case studies. They examine the US petroleum wholesaling company Koch Industries Inc., McDonald's, and the retail giant Nordstrom as examples of firms that utilise internal price mechanisms. Nordstrom has bonuses 'tied directly to the sales performances of the individual. Furthermore, sales people who do not meet specified targets are either fired or transferred ... Sales people have a maximum incentive to apply their individualised knowledge' (p. 69). Koch Industries, meanwhile, has upper- and middle-management incentive compensation systems which 'emphasises the discovery of knowledge' (p. 51). But CEOs need to look to the particular circumstances of their firms in seeking suitable market mechanisms. As the authors stress, 'The firm and markets face the same economic problem of efficient resource allocation' (p. 72).

Despite my enthusiasm for this book, I believe Cowen and Parker have overlooked a significant issue. An important ingredient of Coase's analysis of the firm is his linkage of the firm to the law. In *The Firm, the Market and the Law,* Coase (1988) claimed that the existence of the firm was dependent on the entrepreneur-owner having the legal right to control the entities (people) in the firm, in the legally defined master-servant, employer-employee relationship. It is this 'right to control' of the employer over the employee which continues to be the key ingredient of the legal employment relationship. But to what extent can markets operate inside the firm while this remains the case? For contracts to flourish in the firm, the legal employment relationship must be replaced by independent contractor arrange-

ments. I suggest this is the central issue in promoting the play of market forces within firms.

Not that this comment detracts from the importance of Cowen and Parker's pioneering study. A fate similar to that of the Soviet Union awaits firms that continue to apply socialist command-and-control management practices in a market-dominated world.

References

Coase, R. (1937), 'The Nature of the Firm', *Economica* 4: 386-405.

—— (1988), *The Firm, the Market and the Law*, University of Chicago Press, Chicago.

Ken Phillips is a Melbourne-based workplace reform practitioner.