THE INCOMPLETE SEPARATION OF OWNERSHIP AND CONTROL: WHERE ARE THE MANAGERS IN LAW?

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ABSTRACT

Shareholders are in law excluded from management, unless they are appointed as directors or employed as managers. But, at the same time they keep control rights. The separation is therefore incomplete and this is an issue when managerial autonomy is considered as a condition for stakeholder management and corporate social responsibility. Past research on the separation between ownership and control has extensively studied the distinction between shareowners and directors, but less the distinction between directors and managers. In this article, we investigate why management has emerged as a distinctive function, and how the law receives it. Our study shows that it only has accommodated it but overlooked the rationales behind the historical emergence of management. The lack of conceptualization of the management in law allowed reforms in the second half of the twentieth century that have weakened managerial discretion, and the separation of ownership *and control. Our article thus calls for further research in law and management to reappraise the status of managers.*

Keywords: Ownership control, management, company law, corporate governance, management history, director.

INTRODUCTION

Since the seminal book of Berle & Means (Berle & Means, 1932), the separation between ownership and control has continuously been a matter of lively debates. Beyond the discussions on when and how this separation took place in the different countries (Cheffins, 2001, 2008; Coffee, 2001), the foundations and reality of the separation are critical both for management and corporate governance. They delineate the sphere of intervention of shareholders in the management of the corporations. The separation of ownership and control thus shapes the conditions for managerial discretion (Finkelstein & Hambrick, 1990; Hambrick & Finkelstein, 1987; Phillips, Berman, Elms & Johnson-Cramer, 2010; Wangrow, Schepker & Barker, 2015). Different perspectives have been put forward. On the one hand, the economic literature has focused on the agency relationship between shareholders who bear the risks and those in the position of running the companies. It suggested that there is a need for more accountability of "principals" to their "agents", either through supervision by the principals or through other mechanisms that align their interests. On the other hand, accounts from law emphasize that directors, on the contrary, are not agents of the shareholders, and that the separation between shareholders and directors is legally grounded and economically sound because it supports specific investments of the different constituencies (Blair, 1995; Blair & Kruse, 1999). Besides, the separation between ownership and control is seen as a condition for stakeholder management (Johnson & Millon, 2005; Lipton & Rowe, 2007). As noted by Dai & Helfrich (Dai & Helfrich, 2016):

"Despite the necessary tensions intrinsic in this relationship, there are substantial benefits to this separation as well, namely creating a more efficient capital market system in which investors are able to use their time to invest rather than govern, but more significantly, allowing corporations to be more than pure profit maximizers and simultaneously prioritize stakeholder interests and corporate social responsibility."

Yet, many authors have observed that in practice, shareholders have great influence on management (Zeitlin, 1974). This influence is all the more important with the rise of institutional investors in the past decades. And it is obviously not prevented by law: in law, directors are removed by shareholders, with the latter given an exclusive and ultimate right of control (Kaufman & Englander, 2005; Millon, 2013; Yosifon, 2014).

In these debates on the legitimacy and reality of the separation between ownership and control, past research has extensively documented the respective positions shareholders and directors. But the position of managers and the separation between the board and management have been less studied. Historically and practically, the function of management however clearly separated from that of directors (Wilson & Thomson, 2006). The emergence of management as a distinctive "social stratum" (Child, 1969: 14) around the turn of the 20th century is recognized as a major breakthrough for industrial relationships and organizations. But paradoxically, the role and duties of managers are hardly distinct in law from those of directors. Corporate law seems to suggest "as patently is not the case – that the institutional function and legal roles within the corporation [of officers and directors] are the same" (Johnson et al., 2005: 1601).

The aim of our article is to shed light on the separation of ownership and control by documenting the historical emergence of the function of management and its reception by the law: what were the fundamental roots of the separation between directors and managers? And how did the law deal with the emergence of this distinctive management function?

Methodologically, our study confronts then management history and legal history. It is important to note a clear limitation of our paper: As legislation varies between countries, and in order to have consistent data, we examine the evolution of law in a single country, even though we anticipate that the general movements we observed are probably also followed in the other Western European countries (some evidences are available from France, Belgium, Germany and Italy but would need further investigation). We chose to examine the UK because the UK showed itself to be among the most willing to make radical changes to the relationship between shareholders and directors, and has exercised a significant influence on global corporate governance through its practice of issuing soft law codes that increase accountability of managers to shareholders. Similarly, we do not study all the factors, sociological, political or financial, that drove the emergence of management. Rather, we specifically focus on the role of innovation. At the end of the 19^{th} century, as technological and scientific progress sped up, the rise of science-based industry urged new roles for management. Management's role was not (only) to rationalize production and to reduce costs but it was also to devise innovative strategies and develop new organizational capabilities. Although limited, this focus on innovation allows us to identify some fundamental reasons of the distinction between the role of directors and that of managers.

Our paper makes several contributions. First, our paper is the first, to our knowledge, to examine the law's historical approach to management. Second, building on the literature on management history, we identify different rationales of the separation of manager and director: i) in the new business model, the source of wealth shifted from the ownership to the administrative capability; ii) it necessitated new managerial techniques and competencies and finally, iii) managerial authority went with new social responsibility to advance the interests not solely of shareholders but of the different constituencies. Third, we show that the law ignored the fundamental rationales behind the distinction between directors and managers. And, the absence of any legal conceptualization of management allowed a series of reforms after WWII that pave the way for an increased role of shareholders in corporate strategy and management. Our paper thus invites for further research at the crossroads in law and management to reappraise the status of managers and the separation of ownership and control.

The paper proceeds as follows: section 1 reviews the debates on the separation of ownership and control and shows how the sphere of intervention of shareholders has been mainly discussed in relation to directors, but not to managers. Section 2 returns to the emergence of management as a separate authority from the board of directors. We build on management and history literature to identify some fundamental reasons to distinguish manager and director. Section 3 examines how this new management function was apprehended in company law through the later reforms to company law in the UK. It shows that the three fundamental rationales discussed above were significantly absent from the debates. This absence allowed reforms that limited managerial discretion and its function in developing specific competences and serving the collective interest. Section 4 concludes.

Separation of Ownership and Control: Economic and Legal Views

The divorce between ownership and control is perhaps the most famous issue of corporate governance. It was historically coined by Berle and Means (1932). At the end of the 1920's, the authors observed the rise of "modern corporations" which were giant and powerful business organizations, and where the traditional structure of powers were puzzling. At that time, most Western countries had adopted limited liability and consolidated the law for public corporations (Companies Act 1862 in UK consolidating earlier Acts giving limited liability and separate legal personality to joint stock companies). The new legal setting allowed massive fundraising and led to the well-known dispersion of ownership (Berle et al., 1932). Capital providers were not necessarily in control of the business, whilst the new professional managers had considerable power. But the concept of the divorce between ownership and control encapsulates different issue.

The arm's length model of control and agency theory

The Anglo-Saxon system is often characterized as "outsider/arm's-length" model: outsider because share ownership is dispersed rather than being concentrated *"in the hands of family owners, banks or affiliated firms"; and 'arm's-length' signifies that investors in the US and the UK are rarely poised to intervene in running a business. Instead, they tend to maintain their distance and give executives a free hand to manage"* (Cheffins, 2001).

In this system, the dominant theoretical framing views shareholders as mandating executives to run companies on their behalf, and this "delegation allows agents to opportunistically build their own utility at the expense of the principals' utility (wealth)" (Donaldson & Davis, 1991). Agency theory then justifies empowering shareholders to supervise executives. First, as "residual claimants", shareholders get returns only when the profit of the firm is positive, i.e. when the 'contractually prescribed amounts' are paid to the other stakeholders. Shareholders then have then the best incentives to monitor the executives, which would be a condition of efficiency. Second, shareholders should be given exclusive control rights (Jensen, 2001) in order to ensure optimal control and to avoid contradictory expectations (Tirole, 2001). And some authors even go as far as suggesting that shareholders should be allowed to have more direct influence over business decisions, especially when these decisions frame the "rules of the game" (e.g. closing the game, scaling down, distribution of profit…) (Bebchuk, 2005). Thus, in the agency perspective, the more management is separated from ownership, the more supervision and control is needed from shareholders.

The view from law: autonomy of the board of directors

While agency theory sees managers as agents of shareholders, this interpretation has been deeply challenged by "a view from law" (Lan & Heracleous, 2010).

Team Production Theory. The most important challenge to date to the "grand design principal-agent model" of the corporation has come from Margaret Blair and Lynn Stout (Blair & Stout, 1999). They argue that corporate law in the US separates the board of directors from share ownership, but does not view directors as agents. On the contrary, business corporations are the locus of team production, intended to produce 'collective output', which is 'qualitatively different and vastly larger than the sum of what each individual could produce separately' (p. 264). Team production requires various parties to make contractually-unprotected firm-specific investment. It necessarily requires some mechanisms that reassure the parties that they will be protected against opportunism and rent-seeking by other team members. (p. 251-2)

This, in Blair and Stout's view, is precisely what the law provides by separating shareholders and directors. Protection of firm-specific investments comes in the form of a neutral mediating hierarchy, 'whose job is to coordinate the activities of the team members, allocate the resulting production and mediate disputes among team members over that allocation'. The board of directors is the apex of the hierarchy, with legally-protected independence from the various team members, and 'an extraordinary degree of discretion to pursue other agendas and to favour other constituencies, especially management, at shareholders' expense.'

This approach runs counter to current agency theoretical accounts of the board, giving it the broader function of protecting the 'enterprise-specific investments of all the members of the corporate "team", including shareholders, managers, rank and file employees, and possibly other groups, such as creditors'. (p.253) This vision of team production recognises that a number of different groups make investments in the enterprise and bear risk, and therefore that a fair allocation of the results of collective production is required. The Team Production Theory also accords, unlike the economic theory of the firm, an important place to the corporate legal entity as a means of committing resources to the enterprise. It is more accurate from a legal perspective as, in law, the distinction between shareholder and director, is clearly recognized.

Shareholders do not run the business: the distinction between directors and shareholders. Simply being a shareholder does not establish the right to intervene in the management. The relationship between shareholders and managers is not one of principal – agent, as underlined in a recent report from the New York Bar Association (ABA, 2009), given that the managers have sole responsibility for their decisions (Lipton et al., 2007). More generally, "shareholders do not necessarily have the power to order the directors to follow any particular course of action. Rather, the powers of shareholders are limited to what corporate statutes specify and, to the extent permitted by these statutes, to the company's constitutional documents" (Bebchuk, 2005).

If we take the case of UK, ever since the Companies Act 1848, UK company law separated shareholders and directors (Ireland, 2010). At first, the directors were given a statutory power to 'conduct and manage the Affairs of the Company', whilst the shareholders were explicitly excluded from management unless appointed as directors (Section 27 Joint Stock Companies Act 1844), and were later given limited liability, making them analogous to creditors.

Several legal elements further solidified the separation. Whilst it remained normal practice to require directors to hold significant quantities of shares, which ensured that they were not unresponsive to shareholder interests, the directors were insulated from shareholder demands by a number of rules (Campbell and Turner, 2011). First, the early companies acts gave the shareholders little or no power to remove the directors, and few means of obtaining redress if they were dissatisfied, other than to sell their shares. In the UK, the 1844 Act gave the shareholders no power to remove the directors outside of a three-yearly retirement cycle, whilst from 1862, the default rule was that directors could only be removed by special resolution or extraordinary resolution, both types of resolution requiring the support of 75 per cent of those voting in person or by proxy. As the shareholders became increasingly dispersed, it became very difficult to achieve the necessary majority[1].

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[1] Directors in the US have even more autonomy from the demands of shareholders than their counterparts in the UK, where shareholders have a mandatory right to remove the directors by simple majority, and defensive measures against hostile takeovers are impossible. The right of the shareholders to change the directors is commonly attenuated in large US corporations, through classified board structures (Cremers and Sepe, 2016) and constitutional provisions allowing removal only 'for cause'.

Second, between 1906 and 1935, the courts consistently prevented shareholder interference with decisions of the directors, offering a number of different justifications for this, ranging from protection of minority shareholders to the status of the company as a separate legal entity.

Third, by relying on a strong presumption (known in the US as the ‘business judgement rule’) that the directors were acting in good faith and for proper purposes, the courts gave the directors a broad discretion to determine whether particular actions were for ‘the benefit of the company’, and made it very difficult for shareholders to use litigation to challenge directors’ decisions. The business judgment rule gives directors discretion in deciding how to pursue a corporate objective (Bainbridge, 2004).

The result of these rules was that directors were answerable to, and subject to the residual control of, the board of directors rather than the shareholders.

Is the separation of ownership and control a reality?

Yet, as has been pointed out by critics such as Zeitlin, the influence of shareholders on management has always be important (Zeitlin, 1974). Legally, as shareholders are still in position of voting for directors, the mediating hierarchy role of the board has been compromised (Millon, 2000).

Despite some legal mechanisms of insulation, the real pressure for shareholder wealth maximisation that undermines the prospects of the board acting as a mediating hierarchy comes from market rather than legal forces. Diversified shareholders can make exit threats which are far more credible than those made by employees who have made investments in firm-specific human capital (Millon 2000: 1028), threatening a decline in the share price, and with it, the threat of reduced bonuses for executive directors and senior managers. Alternatively, they can accept an offer to transfer their proxies from the board to a shareholder who will install a new board.

More generally, the board of directors is not sufficiently “insulated” from direct shareholder pressure (Gelter, 2009), and this has been exacerbated by the growth of activist institutional and alternative investors (such as hedge funds) who demand short-term shareholder value maximisation (Coffee & Palia, 2015). While team members can form a corporation to pursue various objectives, the structure of the corporation often fails to protect such objectives (Marens & Wicks, 1999; Yosifon, 2011), as directors are ultimately accountable only to the firm’s shareholders (Kaufman et al., 2005). In particular, the law gives the latter great power of influence over directors (Greenfield, 2008; Greenwood, 2005; Mayer, 2013). Managers can sometimes even be forced or incentivized to give up social purposes to favor more profitable strategies (Haigh & Hoffman, 2014) or to pursue shareholder interests at the expense of the firm's long-term welfare (Lazonick, 2014), especially in case of takeovers or other changes of control (Page & Katz, 2010). Once these factors are taken into account, the prospects of mediating hierarchy under the current US system look much weaker, and the absence of an explicit legal mandate to act as a mediating hierarchy becomes crucial.

THE RISE OF MANAGEMENT: NEW RATIONALES FOR SEPARATING DIRECTORS AND MANAGERS

While past research has extensively discussed the legal insulation of the board of directors and the possibility of shareholders’ influence on management, the separation of ownership and control has been little analyzed from a managerial perspective. In Blair & Stout’s analysis, teams make decisions ‘collegially’, but there is little or no emphasis on the distinctive role of managers. Managers barely figure in this account, appearing, like employees, merely as functional team members (“*bona fide* team members” (Lan et al., 2010). This heavily contrasts with what we know from management sciences and this has important implications. For instance, the impacts of managerial decisions are not discussed. For instance, in Blair and Stout's account, risks come only from opportunistic behaviour from other team members, such as shirking and rent-seeking. Yet, management has profound, transformative effects on those it employed, who, under the guidance of management, developed the capabilities necessary to achieve the goals of the enterprise (Conner & Prahalad, 1996; Eisenstat, Beer, Foote, Fredberg & Norrgren, 2008). As a result, workers come to bear risk as the failure of the innovative project will profoundly affect both their current situation and future prospects.

For these reasons, it is worth trying to reappraise the need to separate ownership and control with a view from management. What are the foundations and the conditions for managerial discretion? In this section, we now turn to examine more thoroughly the historical roots of the distinctive management function.

The rise of managerial authority is often associated with the emergence, at the end of the nineteenth century, of mass production, (Hounsell, 1984), the increasing size and administrative complexity of industrial organization, as well as intensive capital requirements. Yet, in what follows, we focus on another factor: the increased pace of technological and scientific progress, and the rise of a science-based industry. In a few decades, innovation concerns radically changed the nature, forms and purpose of the corporations. And it provides new strong rationales to separate ownership and control.

The rise of a new managerial authority: the role of innovation

The new function of labour management. Around the turn of the twentieth century, labour law recognised that employees were subordinated to employers within the enterprise. This was a drastic change: some mentioned in France a "*coup de force dogmatique*" (Cottereau, 2002) and Deakin speaks about a "conceptual shift" (Deakin, 2009). The trend in the nineteenth Century was indeed to conceptualise work relationships in contractual and commercial terms. In the UK, master & servant law was definitively abolished in 1875 (in France, it came much earlier with the Revolution at the end of the 18^{th} century proscribing contracts that were not between juridical equals, like those of guilds). Workers were more or less independent contractors or suppliers, with their own methods, and often their own tools. They were usually paid in accordance with a piece-rate system, and therefore assumed the risks of poor quality or other production failures. The supervisory or managerial staff was very limited in number (Lefebvre, 1999). To the extent they existed, the role of hierarchies or intermediate managers was mainly to find and hire labour, and bargain over prices.

The new employment contract had distinct features: it is distinguished from self-employment with an "open-ended duty of obedience" on the part of employee (Deakin, 2009). It also gives rise to a set of mutual obligations: labour law began to attribute increased responsibility to managers. For instance, at the end of the nineteenth century, employment relationships entailed the employer absorbing social risks. Legislation towards the end of the nineteenth century made employers responsible for all workplace accidents (Workmen's Compensation Act 1897 in the UK). How to explain this conceptual shift?

This shift was made possible and necessary because of the emergence of a new conception of labour. Labour was seen earlier as a commodity and the wage was that of the competitive market. Yet, in the end of the 19^{th} century, early labour management policies rejected the "laissez faire" doctrine and adopted the "industrial betterment" principle to improve working conditions and standards of rewards (Child, 1966, p. 35). It becomes clear, at least in a few pioneering companies, that the wage could be designed and serve a lever both to productive efficiency and to human weelbeing (Cadbury, 1912). More importantly, labour management started to be formalized (with early manual such as Cadbury's one in 1912): labour was no more a commodity but a factor which could be consciously 'managed'.

The notion of "scientific management" made in the beginning of the 20th century visible how labour management has developed a series of technique (organizational control, executive recruitment and training, incentive wave payments…). In Uk, industrialists such as Cadbury, Rowntree or Renold were both very receptive to scientific management and critical. They were reluctant to considering workers as "living tools", but at the same time, they were convinced by the necessary to develop new expertise to rationalize working processes and to train workers.

With the progress of mechanization, it became clear that the more complex or innovative were the products, the less the classical labour market could work: the workers were no longer able to produce the pieces with the know-how and tools they had. Frederic Taylor was among the first to conceptualize the need for business organizations to specialize experts in the development of new knowledge and the design of innovative working processes (Hatchuel, 1996).

In a context of high-precision metal industry, Taylor observed that workers generally did not have the know-how to optimize the flow of production. Not only workers, but in fact every one ignored the factors of productivity: to develop an efficient working protocol for the cutting of new pieces of metal, one has to investigate deeply the behaviour of the metal in various conditions, the impact of new tools and new methods of cutting, etc. In these conditions of innovative production regimes, *the old rule-of-thumb method of* management by "incentives and initiatives" was a (highly conflictual) dead-end. Management received this role of organizing scientifically the production of new working methods. In his view, the scientific management's tasks were to 1) "*develop a science for each element of a man's works, which replaces the old rule-of-thumb method*" and 2) to "*scientifically select and then train, teach, and develop the workman, whereas in the past he chose his own work and trained himself as best he could*" (Taylor, 1911).

Although the shift was not fully apprehended at that time, it is worth noticing the profound changes to the employment relationships introduced by the emergence of this labour management. Until then, workers had been independent and organized their work in their own ways. Subsequently, their know-how was substituted by managerial prescriptions. The consequence was that workers no longer simply exchanged their labour for a salary. Instead, they saw their *capabilities transformed* as they were integrated into complex production systems. While Taylorism is often denigrated as de-skilling workers, the management was first and foremost a function to renew and develop workers' capabilities. Progressive thinkers such as Commons, grasped this shift from a theory of the man "as a commodity" to a theory of the man as "*a mechanism of unknown possibilities*" (Commons, 1919).

The transfer of control from directors to "executives". This developmental role of management was echoed across all western countries (Child, 1969; Le Chatelier, 1935; Urwick & Brech, 1949). But the influence of management was not only felt at the workshop and in the rationalization of production. It also emerged as a specialized function and capability to steer the whole firm. The role of "chief executives" or "general management" was rather indistinct before 1900 but it became progressively more critical when salaried managers, outsiders to the company, were progressively appointed to run the businesses.

While owner families often kept control of their companies (via their control of the board), they progressively but massively recruited managers to run their companies (or sent their sons to the high schools that would make them knowledgeable themselves) (Joly, 2013). In the UK, the founding families maintained their representatives on the board of directors for an exceptionally long time (Keeble, 1992), but the same handover of "control" of the business to professional managers, with the appointment of professional managers, started from the 1870s (Wilson et al., 2006). Whilst this was a slow process (Lewis, Lloyd-Jones, Maltby & Matthews, 2011), from the 1930s, the numbers of managers employed in British businesses began to grow rapidly. And by the middle of the twentieth century, professional managers were increasingly being appointed to boards (e.g. up to three quarters in the steel industry in 1947 (Erickson, 1986)).

This transfer of control from directors to executives illustrates the need for new competencies. Instead of relying on their directors, companies tended to recruit men from the field from "outside" the company, because the context and the nature of the activities have deeply changed. Beside the growing corpus of techniques to manage labour, planning and accounting, the context of intensive scientific discovery and technological progress brought the rise of managerial authority forward.

The beginning of the twentieth century was marked by integration of science and industry. Innovations had been, until then, often left to individual inventors or entrepreneurs (e.g. Watt & Boulton in 1795 in UK; Caro at BASF before 1877 in Germany, H. Le Chatelier at Pavin de Lafarge). As technologies became more complex, the development of new technologies required further fundamental research work (Letté, 2004). The need for scientific investigation became a pressing matter in a number of industries. From the chemical industry to telecommunications, via glass and electricity, historians have well described the rise of industrial research laboratories at the end of the nineteenth century. According to Reich, the number of American companies engaged in scientific research grew from 500 in 1921 to 1000 in 1927, and exceeded 2200 in 1940 (Reich, 1985). A new "science-based" industry was beginning to emerge, transforming the enterprise from a productive to an innovative organisation. The value of science appeared critical for many industries:

> *It is chiefly in the manufacturer's appreciation of the scientific branches of his establishment, and of research work that the need lies. We require more employers with Captain Cuttle's admiration of the man of chock full of science (Burton, 1899).*

But introducing science in industry was not imposing a definite scheme of production or product solutions: quite on the contrary, science drove business organizations into the unknown, and so created a demand for radically new competencies to devise innovative but sustainable strategies. Hence the new role of executives and the need for managerial discretion. As Mowery comments: 'Industrial research was not only an effect, but also a cause, of the development of the modern US manufacturing firm.' (Mowery, 1986).

New rationales for separating management and directorship

Understanding the nature of the new management function sheds light on some grounds of the separation between ownership and control. We identify three *managemement-based* rationales of this separation: a business model based on innovation, the need for new competencies and new social responsibilities.

Innovation-based economy: management as the source of wealth. With the rise of science-based industry, the economy has moved from a traditional capital-based economy to an innovation-oriented one. The shift of control from director to management basically means that the source of wealth was altered: as analysed by Berle and Means, the capital became a "passive ownership" and the shareholders only suppliers of finance (Berle et al., 1932). The value of an enterprise is "for the most part composed of the organized relationship of tangible properties, the existence of a functioning organization of workers and the existence of a functioning body of consumers" (Berles & Means, 1932: 306). In other words, the value of the enterprise doesn't derive so much from the ownership of production means or finance than from the capacity to organize collective endeavors, i.e. from the management.

The classical economic theory was based on production and consumption functions, with state of interests held in check. But this theory was unable to account for the development of new scientific knowledge and new technological know-how and for the innovative power of modern companies (Rathenau, 1921; Segrestin, 2017). Contrary to the conventional economic view of the firm in which where the role of management is to reduce transaction costs, management appeared to design previously unseen strategies and to produce *new* goods and to *renew* the means of production (Goyder, 1987; Segrestin & Hatchuel, 2011).

Managerial authority based on new competencies. Managerial authority is inseparable from scientific approaches. As Taylor himself noted, scientific management "*substitutes joint obedience to fact and laws for obedience to personal authority"* (Taylor, 1920, quoted by Child, 1969: 54). The authority of managers didn't derive neither from their ownership, nor from their inventive or entrepreneurial talents: *"Rather, in many of its activities, it operates through the application of a capacity trained in the investigation and solution of problems"* *(*Sheldon, 1923, quoted by Child 1969: 84).

In this line, new curricula of "administrative science" were introduced. In the US, long after the creation of Wharton School of Business in 1881, Harvard launched the Master of Business Administration in 1908, the number of business schools grew continuously (Hambrick & Ming-Jer, 2008; Khurana, 2007; O'Connor, 2011), 'a manifestation of the modern conception of business' (Brandeis, 1914). In UK, the Manchester technical college began teaching industrial administration, while Oxford management conferences was organized by Rowntree. A school on management was run at Cambridge in 1919. Numbers of institutes were also created and manifest the growing management movement: the Industrial Welfare Society was founded in 1918, the National Institute of Industrial Psychology in 1921, and the Institute of Industrial Administration in 1920.

The institutionalization of new academic corpus and educational curricula backed the transfer of control to management. And the development of the business schools participated to the legitimacy of managers (Khurana, 2007). But, more fundamentally it reveals a radical renewal of scientific corpus. Traditional accounting methods and schools, and traditional economy were no more sufficient to address the new industrial challenges. Management was called upon "to develop a steadily increasing technique and a more and more specialized vocational training of its own" (Webb, 1918: 6). There was therefore considerable effort to conceptualize the new function of "business administration". A whole body of literature which emerged from practitioners (such as Burton, Renold, Lee in UK; Fayol in France…): they not only tried to synthesize their experience and careers as general managers, but also to theorize the new role of administration of modern companies, which went far beyond the role of costs reduction or monitoring conceptualized by economists. All these authors felt that management required methods and doctrines which departed fundamentally from classical accounting, engineering and political economy.

New social responsibilities. Whilst the rise of management overwhelmed the traditional economic and industrial relationships, it didn't go without frictions and conflicts. But globally, it happened, and the support of the public authorities also contributed to it. This role of innovation management was positively correlated to public interests at least for two main reasons.

First, the scientific "rationalization" of work was likely to both stimulate the production of useful goods (Rehfeldt, 1988) and increase wages, in addition to potentially reducing working hours (Brandeis, 1914: 41). Besides, the promise of scientific progress was enormous: electricity, automobiles, telecommunications, polymers, etc. were expected to deliver goods of great social utility for the people. Managers were often putting forward their social responsibilities and the public or quasi-public services they were delivering with their businesses (Marens, 2008): Perkins for instance considered managers as “quasi-public servants” (Perkins, 1908). This notion of “service” was also repeated by many industrialists in UK among them W. L. Hichens (chairman of Cammell), Lord Leverhulme or S. Rowntree, who claim they regarded industry as a “national service”.

Second, the rise of management was also likely to alleviate the social conflicts between capitalists and workers: scientific managers played also the role of a “neutral technocracy” (Berle & Means, 1932), likely to pacify the relationships between owners and workers (Savino, 2009). This role had a broader purpose than the economic profit of the company: the aim was to develop workers’ and organizational capabilities. As Child analysed, many authors and businessmen considered that “the new management’s ‘wider outlook and deeper sensitiveness’ made possible the fulfilment of social functions for employees over and above the pursuit of production” (Child, 1969). This clearly went with the responsibility to define a “common purpose” capable of mobilizing the different stakeholders (Barnard, 1938). Indeed, in a number of texts from the period, from different disciplines, we find repeated the notion that the manager is a professional, a trustee, an impartial judge or arbitrator (Brookings, 1925; Dodd, 1932; Perkins, 1908).

Modern management had wider responsibility and this also calls for a separation of ownership and control.

MANAGEMENT AS A BLIND SPOT FOR COMPANY LAW AND ITS REFORMERS: THE UK CASE

The reception of the rise of management in law: an ambiguous turn

The rise of modern management was broad-based and significant, and despite national disparities and specificities, it clearly impacted all western countries. But how did the law apprehend this phenomenon?

In labour law, a power to manage was recognized. But the status of managers was not clarified as formally the company, and not the manager, is the employer: managers are basically viewed as representing the employer (Davies & Freedland, 2006). To grasp managers' status, we need to go to company law.

As a separation of the directors and the management began to develop in practice, this was belatedly recognised by the law, which had always by default allowed the directors to delegate their management function to one or more of their number (Art 68 Table A 1862), but from 1908 by default allowed the directors to appoint a *managing director* or a *manager* 'for such term, and at such remuneration (whether by way of salary, or commission, or participation in profits, or partly in one way, and partly in another), as they may think fit…' (Art 72 Table A 1906).

The effect was that the managers below board level, whilst treated as representatives of the employer in labour law, were simply viewed as employees from the perspective of company law, capable of being dismissed and restrained from divulging trade secrets, but not viewed as being subject to fiduciary duties (at least until recently) or having any other special status.

'A sharp line was drawn between the directors (seen as partial owners' representative of the owners as a whole) and managers (seen as employees). Firms were viewed as sets of operations

carried out by employees but initiated and supervised by directors in a manner analogous to the separate roles of politicians and civil servants.' (Quail, 2002).

The role of managing director thus appears as a strange hybrid. The managing director had to also be a director, and so a connection was maintained between the board and the management through the person of the managing director or manager. As the practice evolved of the directors appointing one or more of their number as managing directors to act as the head of management, the courts recognised the validity of their contractual arrangements. Faced with these changes in practice, the courts had to identify the legal implications of appointing a managing director. The view taken that a managing director is both a manager and a director. However, beyond stating that the role was 'of a managerial and not of a subordinate character', the law did not prescribe the functions of the managing director, which were determined by the contract between the director and the company.[2] A company law textbook of 1920 explained that 'The duties of the managing director are to attend to the commercial part of the business of the company, and not to things which concern the company itself but not its business' (Stiebel, 1920:43). Hence there was a separation of the management function, which could be delegated by the board, and the control function, which could not. In effect, the management function was a residual category, consisting of all those functions which the directors were allowed to delegate.

It is also worth noticing that the board could not delegate to a manager on terms that he would be free from their supervision. In the case of *Horn v Henry Faulder & Co*,[3] the company – acting through the two governing directors named in the articles – had appointed the plaintiff as sole manager of its confectionary department with full power to conduct the business of the department without interference from the directors except as regards expenditure of capital on new branches, erection of buildings and machinery and conduct of

[2] Per Lord Reid in *Harold Holdsworth & Co (Wakefield) Ltd v Caddies* [1955] 1 All ER 725 at 738.
[3] (1908) 99 LT 524.

legal matters. Neville J ruled that the agreement was ultra vires the company (that is, it was an infringement of the articles), and therefore the plaintiff could not rely on it to prevent interference. Since power to manage the business had been delegated by the company under its articles to the two governing directors, the company had no power to appoint someone who would have a share in the management 'independently of the control of the governing directors'.

Likewise, where management was delegated to a general manager, the courts took the view that the scope of permissible delegation was determined by the articles, so that 'the only duties which [the board] could delegate to the general manager are those which belong to the management of the ordinary commercial business of such a company.'[4]

To conclude, the historical emergence of management was accommodated within existing legal structures, rather than supported by a positive legal regime. Managers were viewed as employees, and were never endowed with any special authority. Their function was never separated conceptually and clear from that of the directors. As their status was never clearly defined in law, their innovative function, their distinct competencies and their responsibilities were never defined or protected in law, which restricted its focus to the relationship between directors, shareholders and the corporate entity. As we will see in the next section, this legal ambivalence opened the door for these developments to go into reverse soon after WWII.

Management as a blind spot for company law and its reformers

We now review more thoroughly the main changes to company law and corporate governance after WWII, which affected the status of management specifically in UK. We do

[4] *County Palatine Loan and Discount Company. Cartmell's Case* (1874) L.R. 9 Ch.A 691 per Sir G. Mellish, L.J

not purport to offer here a comprehensive account of company law reforms. Rather, we show how the changes introduced in company law overlooked the managerial authority and that they left the door open to principles of corporate governance which weakened the management function, putting non-executive directors and shareholders in charge of strategy and the allocation of corporate assets. More precisely, our analysis shows that the absence of clear managerial status allows reforms that "reverse the managerial revolution" (Fourcade & Khurana, 2013; Styhre, 2015) we have outline in the first part: the reforms basically 1) reduced the managerial authority toward shareholders and restored ownership as the source of legitimate power; 2) suppressed the reference to special competencies to run the companies, and 3) alleviated the reference to social responsibility and to the role of business companies for society and collective interest.

The 1948 Company Law Reforms – the way back to ownership-based economy? A Company Law Amendment Committee, known as the Cohen Committee, was appointed in 1943 and reported in 1945. This review took place against a background of recognition of the growing separation of 'ownership' and control, concerns about the quality and reliability of company accounts, and a wider debate about the role of companies in society (Bircher, 1988; Clift, 1999). The Committee was given the mandate 'to consider and report what major amendments are desirable in the Companies Act, 1929, and, in particular, to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest.' But considering shareholders as 'owners' and 'those on whom the first loss falls', the Committee focused its attention almost exclusively on strengthening the position of shareholders in relation to directors. There was no discussion whatsoever of the emergent role of management during the first half of the twentieth century during the reported proceedings of the Committee.

After reviewing the evidence on the growing separation of ownership and control, the Committee concluded that it was "desirable to give shareholders greater powers to remove directors" (Cohen, 1945). To make it easier for shareholders to exercise control over the management, it recommended a number of changes, including the introduction of mandatory minimum notice periods for general meetings to make it easier for shareholders to attend, facilitating shareholder resolutions and making it harder for directors to solicit proxies.

However, the most important change was the Committee's recommendation that "any director (…) should be removable by an ordinary resolution, without prejudice to any contractual right for compensation." (Cohen Committee, para 130) This mandatory power was introduced by section 148 of the Companies Act 1948, and overrode the provisions in the articles relating to the removal of directors, which, by default, required at least a 75 per cent majority on the part of the shareholders.

The importance of this change has been almost entirely overlooked by commentators, both at the time (see for example (Dodd, 1945; Kahn - freund, 1946)) and in the years that followed (Wedderburn, 1965), and it was not explicitly mentioned in the minutes of the evidence given to the committee. Yet this rule fundamentally changed the balance of power within companies.

In particular, it allowed hostile takeovers to emerge as a means of dislodging managers. Before 1948, hostile takeovers were virtually unheard of, but a wave of hostile takeovers began in 1952. Section 148 opened up many companies to takeover, because incumbent directors knew that, even if a bidder only acquired majority control of the general meeting, it could remove them from the board, leaving them virtually locked in as mere minority shareholders (for an example of this in 1953 (Bull & Vice, 1961)). In essence, it amounted to a statutory 'breakthrough' rule which allowed any shareholder who acquired a majority of the shares to take control of the composition of the board, leaving the board and the management vulnerable to change at short notice.

This rule was set up despite the background of the separation of director and management we discussed in part one. It restores the view that the wealth is due to ownership of capital providers rather than to the collective innovation processes, organized by management. And it basically allows to see managers as agents of shareholders, rather than "technocrats" or stewards of the enterprise, and with real managerial discretion (Veldman & Willmott, 2016).

Non executive Directors – a transfer of control back from managers to directors. A second fundamental change began during the 1970s, as policy-makers began to call for greater numbers of non-executive directors (NEDs) on boards. Whilst NEDs had always been on the boards of listed companies as a way of reassuring shareholders, they were widely disparaged as 'guinea pigs' (Samuel, 1933). Their rehabilitation as a means of 'countering the 'vicious practice of having the board controlled or dominated by the managers' began in the United States in the 1930s (Douglas, 1934). In the 1940s, the SEC began to recommend that publicly-held companies should have audit committees consisting of 'non-officer board members' as a 'means of strengthening auditor independence' (Earle, 1979). The SEC became more active during the 1970s, with successive chairmen arguing for more outside directors, until in March 1977 the NYSE imposed a listing requirement that companies have audit committees consisting at least predominantly of outside directors, a requirement which took effect from June 1978 (Sommer, 1977).

As the takeover boom of the 1960s faded, these US developments influenced the United Kingdom. In 1973, the Confederation of British Industry (CBI) published a report entitled 'A New Look at the Responsibilities of the British Company', also known as the Watkinson Report, with the support of the Governor of the Bank of England. The Report concluded that ‘inclusion on the board of non-executive directors was highly desirable’. The CBI was strongly opposed to the introduction of two tier boards with employee representation, which was proposed by the EEC in its Fifth Company Law Directive, and this recommendation sought to head off the threat by increasing the monitoring role of the one tier board. Although the government supported an expanded role for NEDs, it declined to legislate. However, the CBI’s recommendations had considerable influence, and ultimately acted as a starting point for the work of the Cadbury Committee. From 1978, the Bank of England began to push for more NEDs, culminating in the establishment in 1982 of an agency for the Promotion of Non-Executive Directors (known as PRO NED) (Bank of England 1983), chaired by Sir Adrian Cadbury from 1984, before the Cadbury Report formalised these developments in 1992.

These efforts bore fruit. By 1976, boards in the UK still tended to be dominated by management, with around 25 per cent of the largest 1000 companies having no non-executive directors, but the majority having between one and five. However, they were rarely in a majority on the board, with larger companies tending to have boards of ten or more directors, but few having more than five NEDs (Bullock, 1977). However, by 1979, the Bank of England estimated that 88 per cent of the largest 1000 companies had at least one non-executive director, while 53 per cent had three or more, with higher numbers in the largest companies (Bank of England 1979). And by 1988, 75 per cent of directors were independent in the sense of having no previous or present relationship with the company (Bank of England 1988).

With the rise of NEDs, we observe a movement that reverses the earlier transfer of control from “directors” to executive managers. In practice, the increasing role of NEDs had significant implications for management. Although we have little evidence as to the information on which NEDs base their decisions (see for example Higgs Report 2003), it has been shown that that NEDs' control over management is based mainly on financial metrics (Baysinger & Hoskisson, 1990). Since the role of management and the related competencies was never recognized, this reform pushed corporate governance back to the pre-managerial period.

Institutional Investor Engagement: from common purpose back to private control. One last change is worth mentioning to illustrate how the rationale behind the distinction of management was eclipsed in the second half of the twentieth century: the rise of institutional shareholder engagement and, later, activism, was strongly encouraged by policy makers, with little regard to the need of separating ownership and control in modern businesses.

From the mid-1950s onwards, institutional investors began to increase their shareholdings, so that by 1963, they owned 21 per cent of listed company shares (King & Fullerton, 2010). Their shareholdings continued to increase steadily, from 37.8 per cent of listed companies' shares in 1969 to 58.9 per cent in 1985 (Cosh, Hughes, Lee & Singh, 1989).

Policy makers saw engagement by these new institutional investors as a complement or alternative to the market for corporate control in terms of ensuring accountability of management to shareholders. In 1972, against the backdrop of a downturn in the takeover market, the Bank of England set up a working party to discuss the creation of a 'central organisation through which institutional investors, in collaboration with those concerned, would stimulate action to improve efficiency in industrial and commercial companies where this is judged necessary.' (Bank of England Annual Report 1972 at 25-6) The result was the establishment of the Institutional Shareholders' Committee (ISC), with the support of the Bank of England. With the Bank of England alarmed by the fact that the law had made shareholders 'technically supreme', but that they had 'all but abdicated', deciding only on the success or failure of takeover bids (Charkham, 1989), new efforts were made by the ISC to address the perceived problem of communication failures between institutional shareholders and corporate management. In 1991, the ISC issued a statement on the 'Responsibilities of Institutional Shareholders in the UK', and the 1992 Cadbury Report on the Financial Aspects of Corporate Governance endorsed this, encouraging 'regular systematic contact at senior executive level to exchange views and information on strategy, performance, board membership and quality of management' (Cadbury, 1992). It also noted the importance of shareholders exercising their voting rights, and paying particular attention to questions of board structure (which was the primary concern of the Report). From this point on, institutional investor activism became a progressively more important part of corporate governance policy, culminating in the adoption of the Stewardship Code after the 2008 financial crisis, which built on the activities of the ISC and termed institutional investors 'stewards', a role which Cadbury had originally given to NEDs.

This phase of corporate governance policy represents another sidelining of managerial discretion, with institutional investors now having authority over managers to offer views on strategy. The separation of ownership and control was a required condition to take into account the various interests of the firms' stakeholders. And, as we outlined in the first part, managers had to assume historically wider responsibility, especially to employees who had begun to bear risks as their capabilities were transformed by the innovative industrial regime. Yet, these social responsibilities of managers were not explicitly recognized by law. Company law allowed institutional investors to have significant influence on strategy and without bearing responsibilities to employees or to the wider society and environment.

CONCLUSION AND FURTHER RESEARCH: TOWARDS A NEW STATUS FOR MANAGERS?

In this article, we have contrasted the historical rise of professional managers with the law's silence on their function. Focusing on the increased role of science and technological innovation in business, we have highlighted how the rise of a distinctive management function engrained some important foundations for separating ownership and control. We identify three basic rationales: the shift of the source of wealth from ownership to management, the need for specific skill-set, and the rise of new social responsibilities. While corporate law clearly distinguished between directors and shareholders, the manager remained either an employee (with no autonomy) or a director. And progressively, reform – overlooking the historical emergence and justifications of management - gave back control to shareholders and limited the scope of managerial discretion.

Taken together, these changes were crucial because the overall mission of management to develop new capabilities and to organize innovation processes has progressively become secondary to the purpose of maximizing shareholder value. Yet, more and more authors consider today that the innovative strategies are essential for the creation of value in the long term, for a balanced stakeholder management and for a sustainable economic development.

Our analysis adds then to the body of research on the separation of ownership and control by adding new light on the historical status of managers. It also suggests that the law has overlooked some fundamental changes in business organizations. While the law has been primarily concerned by the relationship between the board and the shareholders, the management has been practically absent of legal reflections and reforms. Yet, a conceptualization of management could have provided alternative foundations for a separation of ownership and control. Our article further opens new avenue for research: If we consider, as many authors do, that managerial discretion is a key condition both for collective innovative endeavours and for stakeholder's management, then, could the law today integrate a conceptualization of management? There have been many many proposals of reforms of corporate governance have been suggested throughout the 20th century: with alternative business forms (such as cooperatives, hybrid organizations…); broadening fiduciary duties (Orts, 1992); broadening participation by allowing groups other than shareholders to appoint, influence or sit on the board (Asher, Mahoney & Mahoney, 2005); changes to takeover regulation; enterprise contracts; and so on (see (Wells, 2002) for a review). More recently, it has been suggested to extend the fiduciary duties of managers to controlling shareholders, who have practically a considerable great influence on management decision (Anabtawi, Stout, 2008). But would such reforms resolve the confusion between management and directors and controlling shareholders?

In our view, very few proposals really aim at recognizing the role of management in law. Our analysis calls therefore for further research to make the distinctive role of management more visible in law. The historical grounds of management can inform new proposals of reform and a better conceptualization of management in law could probably fuel a new law of the enterprise. Shouldn't the law recognise the role of management in ensuring companies' survival and prosperity?

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