

**THE CORPORATION WITHIN THE COMMUNITY**

**An Address By**

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Detroit, like my town - Washington - has had a major riot. It knows the danger of frustrations within the community which seem to coalesce around a culprit referred to as "the Establishment". The term appears to be abstract and elastic. In recent months, "the Establishment" has managed to encompass such diverse personalities as Governor Reagan and Mayor Daly, Dr. Hayakawa, officials of Dow Chemical Corporation and Cardinal O'Boyle. It is the anathema of college student and black militant. For most of us it is a difficult and worrisome puzzle -- who or what is this "Establishment" which is the cause of so much commotion?

A recent article in Fortune, intended to synthesize the views of 200 student critics, has defined the "Establishment" as "the business, governmental, and academic power structure" which guides society. The students, as do some of their elders, give "big business" the distinction of being, to put it in the most favorable terms, the most influential institution in that power structure. The students appear to be of the view that technology has taken over our society; that it demands great size and a discipline that is dehumanizing and impersonal. We need to rethink the relationship between our institutions and the community. Both have made possible, in a manner never achieved before, personal and individual participation which seems inconsistent with the discipline and the organizational structures required by our complex social, political and industrial society.

The growth of the business corporation, in size and power, over the last 30 years has been tremendous. At the same time their number has tended to diminish. In every sense of the word, they are super-organizations.

Some corporate giants have such far flung interests that no one man, or group of men, can hope to understand more than a fraction of their operations. Huge conglomerate companies have brought under one corporate umbrella many businesses in disparate industries, related only through control by multiple levels of corporate bureaucracy. Other institutions -- governments, the universities and labor organizations -- are also characterized by complex levels of organization. I suppose the concept of the "Establishment" is abstract because despite

technology we are living in an increasingly abstract society.

Indeed, as I have noted, many feel that our institutions have grown so abstract and all powerful that they are no longer responsive to the needs or aspirations of mere people, but have developed a will of their own which is fundamentally hostile to individual freedom and self-fulfillment. This feeling of alienation has overflowed all too often into violence. The turmoil at the Chicago Convention, the riots here in Detroit and in other cities and student rebellions across the land are manifestations of this struggle for the minds of men.

Of all the institutions I have mentioned, Government is the only one specifically charged with promoting the welfare of the community. It must be recognized that, like every organization invested with important powers, Government is not always free from abuse of power. Its leaders are not always men of good will, nor are they always endowed with such intellectual gifts as to see clearly the course which best promotes the public good. Individuals can, and sometimes have, used the "public good" merely as a facade to mask the misuse of power, sometimes with disastrous consequences for the community. But the important thing about our government, as an institution, is that it has built-in mechanisms to limit the misuse of power. The separation of powers and the checks and balances it makes possible, public elections and the requirements of procedural due process restrict the amount of power that any one man or group of men within government can exercise. The Constitution limits the authority of public officials to affect the private rights of individuals through governmental power.

Another check, is what I shall call "institutional criticism." Public policy decisions, for the most part, are made in the public arena. Our institutions, and our traditions, protect free analysis and criticism of public policies within the branches of government and in the press, professional journals and elsewhere. This device is bound up with the rather wholesome idea that anybody, no matter how clever, can make mistakes and can learn from the criticism of others. When that person is a public official whose actions affect others, he has a duty to listen carefully and to respond responsibly. I suppose what I am saying can be more simply put by the conviction that,

in a democracy, institutions invested with political power must be non-authoritarian.

It is still a staunchly held view of many that different rules operate in the private sector. Classical economic theory considers that competitive forces in a free market best insure an optimal allocation of resources. The idea of tens of thousands of individual producers and merchants making their own business decisions in a free market, with a minimum of government intervention, corresponded nicely with our democratic ideals of individual freedom and initiative. But, the free market, as enunciated in classical theory, has undergone a revolution in this century -- an organizational revolution, which has been accelerating rapidly since the end of World War II.

In 1932, Berle and Means published their famous treatise, "The Modern Corporation and Public Property". Its conclusions--so startling then -- are commonplace today. It noted that ownership of productive property had been divorced from control. Ownership had become diffused among surprisingly large numbers of shareholders. The power which traditionally resided in ownership had become concentrated in the hands of a relatively few corporate managers who were all but immune from effective shareholder control. The shareholder's only practical recourse, if he did not like the decisions of management, was to sell his shares.

The tremendous growth and concentration of power in corporate organization has caused some rethinking and reshaping of the responsibilities of those who wield that power. The old distinction between the public and private sectors has been reconsidered and found to be wanting. Business leaders participate increasingly in government decisions and government officials in business decisions. Administrative agencies regulate important segments of industry. Many of our largest corporations depend on government contracts for their continued viability. John Kenneth Galbraith has termed this Government-business partnership the "New Industrial State".

This fusion of Government and business power to achieve social objectives is a political and economic fact of life. Traditionally, the function of business in this partnership has been viewed as the production of goods and services, while

the function of government was deemed to be the bare minimum necessary for the regulation of these productive activities to promote the common welfare. This view maintains the neat line between the public and private sectors drawn by the classical economists. Unfortunately it does not conform with reality. For as long as I have been in Government, the government-business partnership has consisted principally in the accomodation of different interests and viewpoints. I doubt that it is realistic to single out either institution as the sole instrument of social and economic policy.

Some have seen in this government-business partnership the threat of a heavy-handed state authority dictating business decisions to private industry. I don't accept this view. As a member of one side of that partnership, I have witnessed the growth of a great industry beyond the dreams of its most optimistic members -- the Securities Industry -- under a system of cooperative regulation.

Others have warned of a threat coming from the opposite direction. President Eisenhower in his farewell message stated: "In the councils of government we must guard against the acquisition of unwarranted influence, whether sought or unsought, by the military-industrial complex. The potential for the disastrous rise of misplaced power exists and will persist".

Over 30 years ago Berle and Means made this chilling prophesy:

"The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state -- economic power versus political power, each strong in its own field. The state seeks in some aspects to regulate the corporation, while the corporation, steadily becoming more powerful, makes every effort to avoid such regulation. Where its own interests are concerned, it even attempts to dominate the state. The future may see the economic organism, now typified by the corporation, not only on an equal plane with the state, but possibly even superseding it as the dominant form of social organization."

I am not prepared to accept this view either. I believe continued efficient and vigorous regulation not just by the various branches of government -- but by industry as well -- will provide an important check on the exercise of misdirected private economic power. But we must do more than to mouth such phrases if we are to bring back to effective participation in the important tasks ahead our brightest and most sensitive young men who, increasingly, feel alienated from our society, its leaders and its institutions.

The organizational revolution I mentioned has overtaken most of our principal institutions: our schools, our governments, our business corporations and our securities markets. The securities business in recent years has experienced a dramatic trend toward the combination of individual savings into a relatively small number of "institutional investors" in which a few fiduciaries make decisions to buy or sell securities on behalf of hundreds of thousands of small investors and others. This development has placed a great strain on our traditional market mechanisms. I don't know what this development portends for our securities markets or our economy. The Commission, which I serve as Chairman, has just launched an Institutional Investment Study to find some answers. But one thing is clear. Important powers are being delegated into the hands of a few.

Concentrated economic power transferred to a relatively few fiduciaries takes on the characteristics of political power. Large corporations (unlike tens of thousands of small entrepreneurs acting in a free market) have the power to affect a great many lives. Individuals are increasingly dependent upon membership and participation in organizations such as labor unions and business corporations to practice their trades or influence their working conditions. Doesn't such power carry with it the duty to act in full recognition of the responsibility of these corporations to all of society -- to their suppliers, their employees, to the communities within which they operate, to the taxpayer and to the needs of the nation as a whole, as well as to their securityholders?

The corporation has responsibility to the communities in which it resides, or in which its products will be used,

not to pollute the air and the streams with industrial waste or to deface streets, public places and the countryside for commercial purposes.

The consumer has a right to expect that the goods he buys will be safe and reasonably well constructed. The sale of a defective automobile is not just a danger to the purchaser, it is a grave threat to every member of the community. It is surely an area in which the community has a legitimate interest. The sale of shoddy merchandise, misrepresentations and high pressure sales techniques can have a tremendous adverse impact on the community, especially on the economically disadvantaged. As is so often the case, the persons least equipped to gather, or to insist upon, relevant information, to recognize the alternatives and to make informed decisions, are the most likely victims. The Attorney General for the State of New York recently reported that 75% of all persons who complained of consumer fraud during 1968 were ghetto residents.

We have ample proof that such abuses create smoldering resentments which explode into violence, affecting the whole community. If further evidence of the responsibility of the business community is required, the past several years, a period of incomparable prosperity, have nevertheless spawned tragedy and violence on a scale that boggles the minds of those who believe that our civilization is an advanced one and that we share a common ethical and religious heritage. There can be little doubt of the political nature of the power of the business community.

It is to the credit of the business community that, in many instances, it has directed this power towards improving the lives of the disadvantaged and otherwise contributed to the attainment of accepted social goals. Job training programs for the unemployed and unskilled have created new hope. Construction of office buildings in urban ghettos has produced new job opportunities and scholarships sponsored by business have enabled many to leave the ghetto. Vast sums are made available to educational institutions serving those who do not fall into the category of the disadvantaged as well as those who do.

Professor Berle and the late Professor Merrick Dodd thirty years ago engaged in a debate -- which has raged ever since -- whether the State should have the sole responsibility for determining social policy or whether the corporation should share that responsibility. I doubt whether it is realistic to attempt any sharp distinctions between the public and private sectors. John Gardner made this point yesterday on the TV program Face The Nation.

Whether or not corporate managers are motivated to maximize profits and whether, in consequence or in addition they seek to promote the social welfare, the important point is that the corporation as an institution is, in fact, invested with political powers.

The importance of this point has not been overlooked by the students interviewed by the Fortune editors or by other critics of the "Establishment". Any totalitarian institution -- public or private or semi-private -- can be run by well-meaning men; but the overwhelming fact remains -- it is still a totalitarian institution. Our democratic ideals require that political power be limited; that countervailing power be maintained; that power be responsive to the community's needs and aspirations; and that legitimate power be non-authoritarian. Adolph Berle concluded that corporate power was legitimate because it was generally accepted in the community. I suggest that the exercise of political power (whether by Government or business) cannot be legitimate unless it is non-authoritarian -- that is, unless it is subject to free and systematic analysis and criticism -- what I have termed "institutional criticism".

If we view the corporation as an institution invested with important political powers, some difficult questions arise. Do our traditional democratic ideals require that corporate power of a political nature be limited through mechanisms such as checks and balances, and the requirements of procedural and substantive due process? Should procedural guarantees such as the right to be heard, the right to confront witnesses, to cross-examine them and to present evidence be extended to employees of corporations and others directly affected by corporate actions? Many commentators argue that they should. Does the Constitution guarantee private rights to free speech and



assembly against impairment by corporate action? The Courts have begun to answer these questions in the affirmative. It has been suggested that the coming years will see the Supreme Court's emphasis on the protection of individual rights and liberties shift to defining the constitutional restrictions on the exercise of industrial power. Such a change of direction by the Court would mean a radical alteration of conventional legal notions about the private sector. It would also mean a recognition of the realities of our economic and political life.

These developments confirm the existence and power of the industrial state to which Mr. Berle and Mr. Galbraith have referred. Much of the pressure for judicial action in the corporate sphere, I believe, stems from a feeling that corporate power is not always "legitimate" in the sense I have used that term, that is, that corporate actions have a wide-spread effect on others and must be non-authoritarian to be legitimate. They must be subject to free and systematic analysis and criticism.

To some extent, federal regulatory agencies such as the Securities and Exchange Commission, the Federal Trade Commission and the National Labor Relations Board have provided this function. The Silver Case a few years ago resulted in a decision against the NYSE. The question raised by the parties arose under the anti-trust statutes. The Supreme Court articulated its decision on the failure by the Exchange to accord to the plaintiff procedural due process. Corporate directors would be well advised to develop procedures of their own for institutional criticism of important corporate decisions, perhaps through internal review committees independent of on line corporate decision-making and, possibly, through public disclosure of proposed actions for review by segments of society and institutions outside the corporation, such as the press, community improvement organizations and organizations for the advancement of the underprivileged.

Those within industry need to hear all the competing arguments if they are to form a balanced judgment about their long-term interests, the interests of their industry and of the economy which gives them sustenance. Otherwise, they may only see a very narrow, often transient and quite possibly a self-defeating, view of self interest. An example of industry

self-regulation was the development by industry of its own safety and performance codes for certain products. While industry self-regulation of this sort is a necessary element for the "legitimate" exercise of power, it will serve its purpose only if it is rigorous, if it involves sacrifice and if it is available for meaningful analysis and criticism.

In the securities industry, with which I am most familiar, there is a well developed structure of regulation by businessmen. The stock exchanges have greatly strengthened supervision of their members, their standards of conduct and other regulatory activities in the period since their rules first became subject to SEC scrutiny. When Congress determined to establish a system of regulation for the non-exchange markets, it authorized and encouraged the members of industry to form one or more associations to undertake a similar responsibility, subject again to SEC oversight. The National Association of Securities Dealers, which was established in response to this legislation, is charged with a part of the regulation of the diffused over-the-counter securities markets to ensure that they operate in the public interest. I do not wish to suggest that self regulation has always worked well and in the best interests of the investing public and the economy as a whole. Despite my disappointments, I am satisfied that it has been, and will continue to be, useful and helpful. Of course, these organizations need the full support of their memberships, a goal which they' have not yet fully achieved. I hope they do because, although I am a regulator, I would feel more comfortable with less government regulation were I sure that the private sector would undertake the self-discipline which is not only necessary to the continued growth of our financial communities, and public confidence in them, but is also very clearly in the best interests of the industry itself. Unfortunately, the time is not yet. Perhaps, it will never be. Only a Pollyanna like me can still cherish the hope.

The individual business leader, no matter how clever or well-intentioned, does not always see all the consequences of his decisions. Like all of us in government, he is fallible, and can learn from others. He also has another very human characteristic. Like all of us, he doesn't always take kindly to criticism. That is why I stress the need for institutionalized procedures designed to protect and promote free analysis and criticism of business, as well as governmental, decisions as

they affect the community. The press can help in the realization of this goal.

It has been said that the admirable man is the man with the courage of his convictions. Among those who hold great power, the truly admirable man is the man with the courage to question his convictions or, at the least, to allow others to do so.