

How financial markets dissolved the society of organizations

by GERALD F. DAVIS

The dominant theories of organizations in economics and sociology reflect a distinctly American genealogy. The stylized facts of the large US corporation in the mid-20th century informed theorists' views of what organizations did and why they existed, although these facts often had limited relevance outside the US. According to scholars of law and economics, systems of corporate governance had evolved to solve the problems of accountability and control created by broadly dispersed corporate ownership (Jensen and Meckling 1976) – a situation that held for exactly one major economy. Choices about whether to make inputs or buy them on the market reflected a sharp dichotomy between markets and hierarchies (Williamson 1975) – unless one lived in parts of the world in which networks and industrial districts were common, such as Italy. Power and dependence relations led organizations to merge, share directors, or create joint ventures (Pfeffer and Salancik 1978) – if they happened to operate in a regulatory environment that foreclosed the many plausible alternatives. As (mostly US-trained) researchers sought to document how these timeless theoretical truths played out in other national contexts, it became clear that many features of American organizations were highly idiosyncratic. Like the flora and fauna of the Galapagos Islands, the dynamics of American organizations seemed to be distinctive to their own place and time.

In the past generation, the American corporation has undergone a radical transformation that challenges widely-held

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conceptions of organizations in sociology. Almost every stylized fact about the corporation is no longer true when it comes to contemporary firms. Corporate ownership is no longer widely dispersed, as a handful of mutual funds and exchange traded funds have grown to be substantial shareholders in hundreds of US corporations. At the time of this writing (November 2011), BlackRock owned significant blocks of nearly half of America's public corporations and was the single largest shareholder of one in five. Vertically-integrated organizations have been displaced by reconfigurable supply chains centered around «original equipment manufacturers» (OEMs) like Nike. Long-standing industry boundaries have dissolved as manufacturers morphed into service businesses, services learned how to offshore, and everyone discovered that finance was where the real money was made. The familiar «society of organizations» had been decomposed back into its constituent elements, like Lego structures taken apart and stowed at the end of the day.

In this article, I argue that the transformation of American economy and society over the past generation reflects two intersecting trends: post-industrialism and the increasing centrality of finance to American economy and society. More specifically, I argue that while post-industrialism was inevitable, the distinctive social form it took on in the United States was critically shaped by finance and financial considerations. I first describe the post-industrial shift in the US and its effects on the nature of large firms and employment. Next, I analyze the growth in institutional investment and the dramatic rise of mutual funds, which have become the dominant owners of corporate America through their control of pension savings. I then link the rise of institutional ownership and the ideology of «shareholder value» to changes in corporate organization, and specifically the spread of the Nike model of production. This is followed by a discussion of securitization – the shift of loan debt from banks to markets – and its implications for the organization of banking and finance. Next is a discussion of how the Nike model has been adopted by states, as sovereignty increasingly gives way to a conception of states as vendors of laws. The impact on households follows, as family life has come to reflect many of the same trends seen in the corporate sector. Finally, I conclude with a discussion of what all this means for social theory, social research, and our conception of society. It is a lot to cover in a

brief space, and the arguments are meant to be suggestive rather than conclusive. But I hope that this article stirs discussion and debate as we settle in to the new millennium.

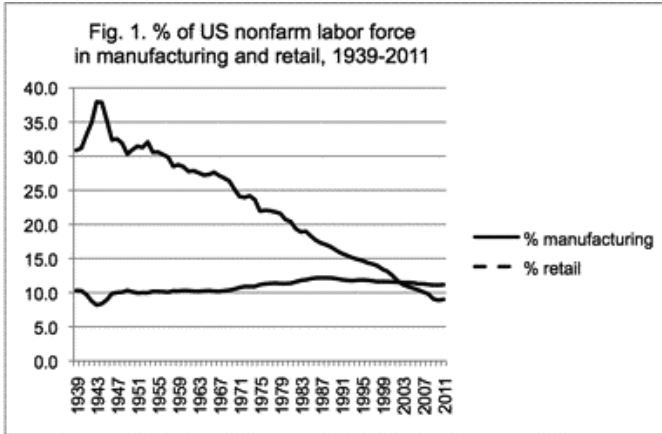
1. The arrival of post-industrial society

In 1973 the sociologist Daniel Bell published a book titled *The Coming of Post-Industrial Society: A Venture in Social Forecasting* to speculate on the implications of broad trends in economy and society, primarily in the US. One of the most visible trends – and the source of the book’s title – was «post-industrialism,» defined most simply as a situation in which «the majority of the labor force is no longer engaged in agriculture or manufacturing but in services» (Bell 1973, 15). At the time he wrote, the United States was the only «post-industrial» society by this criterion, with about 60% of its labor force in services, while the vast majority of other countries’ economies were still primarily dependent on agriculture and natural resource extraction.

Today the transition to post-industrialism is nearly complete in the United States, as agriculture and manufacturing account for less than 10% of the total labor force (and falling). Figure 1 shows the relative proportions of the non-farm labor force engaged in retail and manufacturing and documents a continuous decline in manufacturing’s share since the Second World War, and an absolute decline in manufacturing employment since the late 1970s. The 21st century has seen an acceleration in this trend: between December 2000 and July 2011, the US lost 5.4 million manufacturing jobs, or more than 31%¹.

The loss of jobs in manufacturing prior to the downturn was often attributed to offshoring – the use of foreign contractors for production. There is clearly a great deal of offshoring, as the near-disappearance of industries such as textiles (and the questionable safety of imported products from pet food to blood thinner) demonstrates. But a more fundamental source of lost manufacturing employment is expanded productivity. The US still leads the world in manufacturing value added, with a

¹ Labor statistics by industry and sector are available from the Bureau of Labor Statistics <http://data.bls.gov/PDQ/outside.jsp?survey=ce> and <http://www.bls.gov/news.release/ecopro.t01.htm>. News releases on unemployment are posted at www.bls.gov.



Source: Bureau of Labor Statistics.

FIG. 1

global share of over 18% in 2008. (China was #2 with 15%, and Japan trailed with 10%).² But the manufacturing sector's productivity is such that relatively few employees are required. This became evident during the downturn, when many American manufacturers found that it was impossible to find anyone to lay off because their remaining employees accounted for such high revenues. The «Wall Street Journal» in March 2009 quoted the CEO of Parker Hannifin, who stated that «Because of productivity gains, every one of my people carries more dollars in sales today (i.e., \$200,000 per worker compared to \$125,000 in 2000). If I need to cut back, I have to cut back fewer people to achieve the same goal»³. Like modern industrial agriculture, where a comparatively miniscule labor force can produce all the food a nation needs, IT-enabled manufacturing requires only a minimal workforce. Post-industrialism, in other words, is less about moving jobs around the globe than about the inevitable

² See *Factory employment is falling world-wide: Study of 20 big economies finds 22 million jobs lost; even China shows decline*, Jon E. Hilsenrath and Rebecca Buckman, «Wall Street Journal», 10/20/03. Time series data on manufacturing value added by country available from the World Bank at <http://data.worldbank.org/data-catalog/world-development-indicators>.

³ Quoted in *Lean factories find it hard to cut jobs even in a slump*, Timothy Aeppl and Justin Lahart, «Wall Street Journal», 3/09/09.

effects of productivity improvements in a capitalist economy (cf. Kollmeyer 2009).

One of the most visible manifestations of the new post-industrial American economy is the change in the composition of the largest corporate employers. Table 1 lists the 10 largest US employers in 1960, 1980, and 2010. In the two earlier periods, the list was dominated by a handful of large manufacturers, AT&T, and Sears (a retailer). Many of these companies dated their origin to the wave of industrialization and consolidation around the turn of the 20th century. The typical workplace of these firms was both large and interconnected. Ford's famous River Rouge plant employed 75,000 workers when it was completed in 1927, and grew from there. A visitor to the Rouge in the late 1960s could have followed a shipment of iron ore from one end of the complex, through its processing into steel, and ultimately into the body of a Ford Mustang that rolled off the assembly line at the other end.

TABLE 1. 10 largest US corporate employers, 1960-2010

1960	1980	2010
GM	AT&T	WAL-MART
AT&T	GM	TARGET
FORD	FORD	UPS
GE	GE	KROGER
US STEEL	SEARS	SEARS HOLDINGS
SEARS	IBM	AT&T
A&P	ITT	HOME DEPOT
EXXON	KMART	WALGREEN
BETHLEHEM STEEL	MOBIL	VERIZON
ITT	GTE	SUPERVALU

Source: Compustat for 1960 and 1980; Form 10-K for 2010.

Large-scale workplaces facilitated labor organization, and for decades the largest firms were in the vanguard of progressive human resource management practices, often at the behest of unions

or in an effort to forestall them. During the Second World War, many large manufacturers attempted to evade wage restrictions by offering expansive benefits packages to attract scarce labor. These «academy employers» set the standard for other employers with systems of internal labor markets, job security, health insurance, and retirement benefits, and thus had a substantial influence on the nature of the employment relation in the US (Jacoby 1997; Cappelli 1999).

Today, the largest employers are overwhelmingly in retail, where wages, benefits, and tenures are substantially lower. The shift has been stark: by 2010, Wal-Mart employed about as many Americans (1.4 million) as the 15 largest manufacturers *combined*, and nine of the twelve largest employers were retail chains. The wage and tenure differences between the old guard and the new are striking. On average, production workers in motor vehicle manufacturing earned \$25.96 per hour in May 2010, while those working in sales and related occupations in general merchandise stores earned \$9.32. The Current Population Survey for January 2004 reports that the median employee in auto manufacturing was 44 and had been with their current employer 8 years, while the median worker in electrical equipment and appliance manufacturing was 46 and had 10 years' tenure. Retail employees, in contrast, averaged three years' tenure with their current employer, even though they were 38 years old on average (see Davis 2009, 201 ff.).

In a retail economy, workplaces are both smaller and less overtly interdependent than in mass-production manufacturing. Even Wal-Mart Supercenters, perhaps the largest organisms in the retail ecology, typically employ fewer than 350 people. Yet like the auto assembly line, retailers are susceptible to a post-industrial form of Taylorism thanks to the pervasive use of information and communication technologies (ICTs) such as «workforce management» software systems. These systems automate the time-and-motion studies of Scientific Management, tracking the minute-by-minute productivity of sales associates and monitoring how many milliseconds it takes cashiers to scan each SKU in a grocery cart. Managers in remote locations can monitor, compare, and discipline every salesperson in a retail chain with the aid of real-time standardized comparison charts and discreet wireless headsets. Scheduling can be automated to reward the productive with prime hours and punish the weak

with less-desirable opening and closing times (Davis 2010). With less need for direct supervision and middle management, such retail outlets might optimistically be called a «flat» hierarchy. But the flip side of a flat hierarchy is limited room for advancement beyond the sales floor.

Large-scale employers that provided job security, career mobility through job ladders, and generous health and retirement benefits seem to have been artifacts of the corporate-industrial age in the US. Many of the so-called academy employers have explicitly renounced the former practices that had tied employees to their firms, through freezing company pensions and phasing out retiree health benefits. General Motors, for instance, notified its white collar retirees in July 2008 that in the new year they and their dependents would no longer be covered by GM-financed private health insurance because it had become too costly. Instead, they would be compensated with a \$300 increase in their monthly pension check⁴.

GM was simply following the path blazed by some of its peers. GE's former CEO Jack Welch earned the nickname «Neutron Jack» in the early 1980s by shrinking GE's payroll of 400,000 by over one-quarter. In 2001, Welch summarized the new employment compact that he had helped usher in for a group of Harvard MBA students: «If there's one thing you'll learn – and dot-coms have learned it in the last year – is no one can guarantee lifetime employment... You can give lifetime employability by training people, by making them adaptable, making them mobile to go other places to do other things. But you can't guarantee lifetime employment»⁵. And if corporate employers have abandoned the vestiges of long-term employment as anachronistic, employees would be wise to respond in kind. Contemporary workers are too sophisticated to invest in developing firm-specific skills for a company that might go from good to great to liquidation, like Circuit City or Borders Books. In a service economy, it's best to keep one's skills sufficiently generic that one is «mobile to go other places to do other things» – say, selling sweaters instead of cellphones.

⁴ Nick Bunkley, *Some GM retirees are in a health care squeeze*, «New York Times», 11/9/08.

⁵ Welch quoted at M. Lagace, *Jack Welch to HBS Grads: «Don't be a jerk»*, «Harvard Business School Working Knowledge» (accessed at <http://hbswk.hbs.edu/archive/2310.html>).

The result of the shift from manufacturing to service, in short, has been a dis-aggregation of employment in which the attachments of workers to particular firms is more tenuous, expected tenures are shorter, and workplaces themselves are often on a smaller scale. The traditional rationale for maintaining long-term employment relations was in part to encourage the development of investments in firm-specific skills. Greater employee mobility thus goes hand-in-hand with lower firms-specific investments.

2. *The rise of institutional investment*

The dis-aggregation of employment that accompanied post-industrialism has had another, less obvious effect, namely, the promotion of *greater* aggregation in corporate ownership by financial intermediaries. This happened through a change in pension financing that channeled a large portion of household savings into a very small number of mutual fund complexes, which ultimately ended up holding concentrated ownership positions in hundreds of US corporations.

Most companies that provided pensions prior to the early 1980s did so through so-called «defined benefit» plans that paid retirees benefits according to their tenure with the company. In a defined benefit plan, the employer is responsible for creating an investment pool sufficient to fund the stream of pension income promised to its employees when they retire. Defined benefit plans provided employees strong incentives to spend their careers with particular employers. With the advent of the 401(k) in the early 1980s, however, the large majority of employers that still provide pensions have shifted toward funding relatively portable plans in which employees and firms both contribute to an individually-owned pension that can be rolled over if the employee changes jobs. These «defined contribution» plans effectively transferred risk from employers to workers, who were now responsible for making sensible investment choices on their own behalf from among the options offered by their employer (see Hacker 2006; Cobb 2008). Although employers were motivated in part by cost considerations, the effect was to loosen the ties that bound employees to firms, further reinforcing the trends described in the previous section.

The growth in defined contribution pension plans helped fuel the growth of the mutual fund industry. 401(k) plans most

commonly invest in mutual funds. The mutual fund industry thus grew enormously during the 1980s and 1990s, both through 401(k)s and through retail investment, as households found mutual funds to offer better returns than other savings vehicles. The Investment Company Institute reports that there were 564 mutual funds in 1980, 3079 in 1990, and 8155 in 2000. Assets under management increased one hundred-fold, from \$135 billion in 1980 to almost \$12 trillion in 2010. And where households kept roughly 3% of their financial assets in mutual funds in 1980, by 2010 this proportion had grown to almost one-quarter. Inflows were particularly pronounced in the 1990s: Steve Fraser states that «More was invested in institutional funds between 1991 and 1994 than in all the years since 1939» (Fraser 2005, 583). By 2001, according to the Federal Reserve, 52% of households owned stock – the highest proportion in US history – and most did so directly or indirectly through mutual funds⁶.

The broad spread of stock ownership among the American populace left some commentators rapturous about the new «democratization of ownership» and its potential benefits (e.g., Hall 2000; Duca 2001). An electorate attuned to the financial markets had incentives to become more economically literate and might be more readily persuaded by fiscal arguments that appealed to their interests as shareholders. But the democratization of ownership is clearly a *representative* democracy, channeled through intermediaries. Fewer than one in five households owned shares directly in companies in 2007, about the same rate as three decades earlier. Moreover, the value of the average family's portfolio in 2009 was under \$23,000 (see Bucks *et al.* 2009, A27). Stock ownership was broad but not deep among the American populace. The real significance of this movement was in its effect on the structure of corporate ownership.

The growth in the mutual fund industry was highly uneven. Although the number of funds and their assets under management grew in the aggregate, the biggest beneficiaries of the flood of new retail investment were the half-dozen or so well-known fund complexes, which maintained a share of the industry's assets

⁶ Figures on mutual funds from 2011 Investment Company Institute Factbook, accessed at <http://www.icifactbook.org/>. Data from the Federal Reserve's triennial *Survey of Consumer Finances*, including household ownership data, and related publications are available at <http://www.federalreserve.gov/PUBS/oss/oss2/scfindex.html>.

under management of nearly 40% over the past two decades. As a result, a few fund families – Fidelity, Vanguard, and the American Funds in particular – grew to become the most prominent owners of corporate America. At any given time during the past 15 years, Fidelity was the largest shareholder of roughly one in ten US corporations (Davis 2008). More recently, exchange traded funds (ETFs) have grown to be an enormous presence in the American stock market, accounting for roughly half of all trading on any given day. BlackRock's iShares is the largest ETF sponsor and has amassed unprecedented levels of ownership. In 2011 BlackRock owned 5% or more of the shares of over 1800 US corporations and was the single largest shareholder of Exxon Mobil and Chevron (the two largest oil companies in the US), General Electric, AT&T, IBM, and several hundred others.

3. *Shareholder value, corporate restructuring, and the «OEM model»*

When corporate executives look out at their investors today, they don't see the dispersed widows and orphans of times past – they see a relative handful of financial institutions. Nearly 3/4 of the average Fortune 1000 corporation's shares were owned by institutional investors in 2005, with mutual funds making up the most concentrated block. Fidelity, one of the biggest fund families, held blocks of 10% or more in hundreds of corporations at the same time. The outcome of three decades of increased individual participation in financial markets, through mutual funds and 401(k)s, has been a re-concentration of ownership in the hands of a few financial intermediaries. This was precisely the opposite of what had happened during the first wave of individual stock market participation in the 1920s, where the quadrupling of shareholders in a few short years had broadly dispersed ownership, creating the famous «separation of ownership and control» (Cox 1963; Berle and Means 1932).

The rise of relatively concentrated institutional ownership has corresponded with an increased focus on share price as the most relevant measure of corporate performance. This is by now a familiar story, told in a number of books such as Michael Useem's *Investor Capitalism* (1996). The cultural result is all around us. By the late 1990s, the financial news media were

pervasive, financial analysts such as Mary Meeker and Henry Blodgett were household names, and firms faced high levels of scrutiny for their share price performance. It became difficult to walk through a public place, or to browse the Web, without being made aware of how the stock market was doing. Talking heads on CNN and the various financial news networks were inevitably accompanied by a stock ticker crawl at the bottom of the screen, so that CEOs (or even American presidents) were tethered to the market reactions to their every word. CEOs had personally compelling reasons to attend to their company's share price, as executive compensation came to be overwhelmingly paid in the currency of stock options during the 1990s.

By the end of the decade, any lingering doubt about the purpose of the corporation, or its commitment to various stakeholders, had been resolved. The corporation existed to create shareholder value; other commitments were means to that end. Corporate mission statements made this clear: «We exist to create value for our share owners on a long-term basis by building a business that enhances The Coca-Cola Company's trademarks.» And: «Sara Lee Corporation's mission is to build leadership brands in consumer packaged goods markets around the world. Our primary purpose is to create long-term stockholder value.»

For manufacturers in particular, the relentless focus on share price promoted the spread of the network or «OEM model» of corporate organization. OEM stands for «original equipment manufacturer», a name that ironically implies precisely the opposite of what it means in practice. Nike is a prototypical OEM: it focuses on the design and marketing of its products while leaving their production and distribution largely to others. Coca-Cola is another: although an outsider might see its business as selling sugary carbonated beverages, the Coca-Cola Company itself was primarily in the brand management business, while manufacturing and distributing the product was done by dispersed bottlers. The value added by Nike or Coca-Cola was through intellectual property – brands, patents, advertising copy, distribution know-how. Nike and Coke, like pharmaceutical companies and universities, were in the ideas business (see Sturgeon 2002 on «modular production networks» and Scott and Davis 2007 on network organizations more generally).

Share price is both a consequence and a cause of corporate structure: a consequence, because the market values firms with

different structures differently, and a cause, because executives adopt strategies and structures with an eye toward the expected market reaction. One of the best-documented regularities is the so-called «conglomerate discount», in which firms operating in more than one industry suffered lower market valuations than comparable focused firms. For a conglomerate, the stock market value of the whole was often worth much less than the sum of the parts if they were free-standing companies. Beatrice was an example: at the beginning of the 1980s, the company's portfolio of products included various branded foods (e.g., La Choy), Culligan plumbing equipment, Airstream travel trailers, Samsonite luggage, and dozens of others. Conglomerates offered a tempting target for outside raiders, who could make a quick profit by buying such chronically undervalued firms, splitting them up, and selling the parts off to buyers in related industries in the newly-relaxed antitrust environment provided by the Reagan Administration. As a result, about one-third of the 1980 Fortune 500 disappeared during the 1980s, largely due to bust-up takeovers that collectively re-drew the American industrial map (Davis *et al.* 1994).

By the 1990s, corporate executives were intensely aware of the stock market consequences of diversifying outside of their «core competence», and this helped drive their restructurings. For instance, when Ford CEO Alex Trotman announced the firm's spinoff of its financial division Associates First Capital in 1997, he said: «We believe the market value of The Associates is neither fully nor consistently reflected in Ford's stock price. Because the market views Ford as an automotive company, it has not fully recognized or rewarded us for our diversification in nonautomotive financial services businesses.» Around the same time, ITT's CEO announced a plan to split his venerable conglomerate into three free-standing parts (insurance, industrial products, and hotels and casinos): «We just think that having these three companies acting and operating and being evaluated in their own business environments will provide investors, analysts and those who deploy debt a simpler, more clear way to evaluate us.» The boundaries of the firm, in other words, were shaped less by considerations of transaction costs and asset specificity than by the cognitive capacities of Wall Street (cf. Zuckerman 1999).

Over time, share price concerns drove more radical forms of restructuring. For example, «board stuffers» in electronics –

generic manufacturers such as Flextronics and Solectron, capable of assembling and delivering virtually any electronic product from cellphones to computer servers – allowed high-tech versions of the Nike model across a wide variety of electronic products. A Hewlett-Packard vice president explained why it turned over its computer manufacturing and distribution to a board stuffer: «We own all of the intellectual property; we farm out all of the direct labor. We don't need to screw the motherboard into the metal box and attach the ribbon cable» for an HP-branded computer to be an HP⁷. The rationale for restructuring ultimately turned on the idea that the stock market values intellectual property over tangible assets. The CEO of Sara Lee, maker of consumer brands such as Champion, Hanes, and Ball Park Franks, stated it plainly when he explained why his firm was divesting most of its manufacturing capability in order to focus on its core competence of brand management: «Wall Street can wipe you out. They are the rule-setters. They do have their fads, but to a large extent there is an evolution in how they judge companies, and they have decided to give premiums to companies that harbor the most profits for the least assets.»⁸

By now, cell phones, sausages, PCs, pet food, and pharmaceuticals are routinely produced by contractors, leaving OEM firms to manage the intellectual property behind these products – patents, brand names, trademarks, and research capabilities. The consequences of the spread of the OEM model have occasionally been tragic. In 2007, thousands of dogs and cats in the US fell ill when their food turned out to be tainted with melamine, a cheap industrial filler that is chemically similar to protein. Over 100 competing brands turned out to be manufactured by the same vendor, Ontario's Menu Foods, which in turn relied on anonymous foreign suppliers for its «meat». A few months later hundreds of humans were injured, and 81 killed, when batches of Baxter Health's blood thinner Heparin were discovered to be

⁷ On vertical outsourcing: *Is this the factory of the future?*, Saul Hansell, «New York Times», 7/26/98. *Some U.S. manufacturers prosper by easing rise of «virtual» firm*, Scott Thurm, «Wall Street Journal», 8/18/98. *Ignore the label, it's Flextronics inside*, John Markoff, «New York Times», 2/15/01. *With some help from Solectron, Sony learns to love outsourcing*, Peter Landers, «Wall Street Journal», 7/14/01.

⁸ Sara Lee CEO quote: *Remember when companies actually created products?*, «Wall Street Journal», 9/18/97. *Sara Lee contracts out work, underscoring a trend in U.S.*, Robert L. Rose and Carl Quintanilla, «Wall Street Journal», 9/17/97.

toxic. The drug was manufactured by a Chinese vendor which in turn relied on small farmers for a key ingredient that appeared to be the source of the taint: pig intestines⁹.

Thanks to two decades of restructuring driven by a quest for shareholder value, the global supply chains of contemporary corporations increasingly resemble the «nexus of contracts» described by the finance-based theory of the corporation (Jensen and Meckling 1976; on global supply chains, see Rivoli 2005). One consequence of this widespread restructuring is that career ladders ain't what they used to be. Horatio Alger stories of ambitious young people from modest backgrounds working their way up from the mailroom to the CEO's office, always apocryphal, are even more unlikely now that the mailroom (and the food service, human resource department, IT department, and support staff) are all contracted out. Research suggests that young men entering the labor market in the 1980s and 1990s were much more likely to remain in «entry level» jobs 10 years later than were their predecessors in the late 1960s and early 1970s. It appears that for many, the career ladder had been replaced by the career Roach Motel as another unexpected consequence of the shareholder value movement (Berhnardt *et al.* 1999; Applebaum *et al.* 2003).

The trends I have described so far were mutually reinforcing. Changes in the largest employers corresponded to changes in pension financing toward defined contribution plans that facilitated both the decline in career attachments to particular employers and increased participation in financial markets through mutual funds. The growth in institutional investor size and influence focused firms on the share price implications of their choices of strategy and structure and, enabled by information technology, firms increasingly adopted network forms that further weakened the bonds between workers and firms.

The increasing importance of *finance*, however, did not lead to the dominance of particular *financial institutions*. Consolidation in some parts of the financial services industry, particularly

⁹ 101 brand names, one manufacturer, Ellen Byron, «Wall Street Journal» 5/9/07. Filler in animal feed is open secret in China, David Barboza and Alexei Barrionuevo, «New York Times», 4/30/07. U.S. identifies tainted Heparin in 11 countries, Gardiner Harris, «New York Times», 4/22/08. House panel criticizes F.D.A. role in drug cases, «New York Times», 4/23/08.

commercial banking, took place at the same time that banks were restructuring along lines similar to other corporations.

4. Securitization and the changing nature of banking

Finance itself has not been immune to the allure of the OEM model. In this case, it is traditional banking that has been transformed through the practice of «securitization», that is, turning assets (such as loans on the balance sheet) into securities traded on markets. The traditional model of banking is fairly simple: banks gather deposits from savers, who are paid interest, and lend it to borrowers, who pay it back at a higher rate of interest, while banks profit from the difference. In the movie *It's a Wonderful Life*, banker George Bailey explains this model to his anxious depositors, who are causing a run on the bank: «No, but you... you're thinking of this place all wrong. As if I had the money back in a safe. The money's not here. Your money's in Joe's house...right next to yours. And in the Kennedy house, and Mrs. Macklin's house, and a hundred others. Why, you're lending them the money to build, and then, they're going to pay it back to you as best they can. Now what are you going to do? Foreclose on them?».

The best-known form of securitization is mortgage-backed bonds, in which hundreds or thousands of mortgage loans are pooled together and then divided into bonds which, by the law of large numbers, have more predictable and «safer» returns. This practice allows banks to free up funds for additional lending and generally lowers the cost of taking out a mortgage. Rather than relying on a local bank and its depositors to fund their home purchase, buyers could access funds from dispersed investors around the world via mortgage-backed securities. A modern-day George Bailey might have a more difficult time explaining contemporary banking: «No, but you... you're thinking of this place all wrong. As if I held your mortgage on my balance sheet. I sold your mortgage to Countrywide 10 minutes after we closed the deal, and they sold it along with 3000 other mortgages to Merrill Lynch, which divided it into bonds that were bought by a Cayman Islands LLC, which bundled them together with other mortgage-backed bonds into a collateralized debt obligation that Citigroup sold to a Norwegian pension fund. Now what are

you going to do? Stop making your payments and force those Norwegian retirees to go back to work?».

Securitization turned expansive during the 1990s, driven by demand from institutional investors seeking outlets for their funds, supply from Wall Street banks that got paid by the transaction, and information technology that enabled the valuation of ever-more-exotic instruments. From home mortgages to auto loans to credit card receivables and corporate loans, almost anything with an income stream seemed to end up as a bond, and the bond market vastly outstripped the stock market in value. Innovations in asset-backed securities turned surprisingly postmodern. David Bowie received \$55 million in return for bonds backed by his future music royalties. Dutch financial firm JG Wentworth mounted a television ad campaign to convince those receiving insurance settlements for their personal injuries to sign over their monthly payments in return for a lump sum, with the claims to be bundled and sold as bonds. And elderly retirees in Florida were wined and dined by entrepreneurs seeking to buy their future life insurance payoffs (Quinn 2008).

The prevalence of securitization for business and other loans meant that traditional commercial banking and investment banking had become increasingly difficult to distinguish from each other. Many of the largest banks had become essentially portals to financial markets, analogous to OEM corporations. Homeowners might send their mortgage checks to Washington Mutual or Citibank, but behind the brand, the real mortgage owners turned out to be dispersed bondholders around the world. Just as corporate ownership was becoming more concentrated thanks to institutional investors, mortgage ownership was becoming more dispersed through securitization, in which thin slices of American mortgages came to be held by global institutional investors—including Norwegian pension funds. The global supply chain in finance created a situation in which American mortgages were as toxic for the portfolios of foreign investors as melamine was for the dog chow of American pet owners.

The tangled web of financial connections around the world meant that individuals' economic ties with their fellows became increasingly complex. Through my pension plan, I may own part of my neighbor's home mortgage, auto loan, credit card debt, and be a beneficiary of his life insurance. «Social capital» had come to take on a more than metaphorical meaning.

As banks and other financial institutions consolidated and merged across industry boundaries, finance became a vast meta-industry that included commercial banking, investment banking, insurance, real estate services, student loans, and others. By 2000, roughly 40% of the profits of the S&P500 came from financing, and companies as diverse as GE and Enron were effectively banks or hedge funds with some intermittent industrial operations.

Meanwhile, traditional commercial banks became far more concentrated, as a handful of national titans – in particular, Bank of America, JP Morgan Chase, and Citigroup – came to control an outsized proportion of the assets and deposits of the industry, turning a traditionally local business into an international one. Local and regional players were attractive targets for acquisitive banks. Charlotte-based North Carolina National Bank grew to become Bank of America through two decades of acquisitions that included First Republic Bank of Dallas, C&S/Sovran of Virginia, Boatmen's Bankshares of St. Louis, Barnett Banks of Florida, San Francisco-based Bank of America, and Boston's FleetBoston, along with dozens of smaller banks across the nation. In consequence of this consolidation, most major cities in the United States ended up without a major locally-based commercial bank (see Neuman *et al.* 2008).

Urban commercial banks had long served as the center of business elite networks through their recruitment of the CEOs of major local businesses and non-profits to their boards. The latent effect of this practice was that corporate elites had a regular meeting place to discuss local affairs and to coordinate their philanthropic and political activities, from pitching in to support a new symphony hall or make an Olympics bid to financing the elections of Congressional candidates (Mizruchi 1992). But a decade after the repeal of Glass-Steagall, seven of the ten largest American cities no longer hosted a major financial institution. Meanwhile, some of the biggest banks ended up as *de facto* wards of the Federal government.

5. *The changing role of the state*

The practices of outsourcing that have swept the corporate and banking world have also spread to some of the core functions of government. After several years of attempting to «rein-

vent government» and reduce Federal payrolls, President Clinton signed into law the «Federal Activities Inventory Reform Act of 1998» (the «FAIR Act»). The idea was to promote government outsourcing, which would presumably bring the efficiency of private sector organizations like General Motors to the public sector. The Act required heads of governmental agencies, including the military, to produce annual lists of functions that are eligible for outsourcing because they are not «inherently governmental», defined by the Act as «a function that is so intimately related to the public interest as to require performance by Federal Government employees.»¹⁰

During the subsequent decade, government contracting grew staggeringly large, to the point that the government ultimately employed far more contract workers than Federal employees. If the share price-driven corporation had become a «nexus of contracts», then the Federal government increasingly resembled a «nexus of contractors.» Annual spending on contractors doubled from roughly \$200 billion to over \$400 billion during the years of the Bush Administration, as tasks from running governmental databases to the armed protection of diplomats overseas were handed off to contractors. Indeed, the three largest remaining manufacturing employers in the US were military contractors: Boeing, Lockheed Martin, and Northrop Grumman. (The latter two receive 85% and 90% of their revenues respectively from the US government).

The Government's dependence on contractors was especially acute for the conduct of war, which many would regard as an «inherently governmental» task. Critics argued that employees of Blackwater and other contractors, unlike Federal employees, faced divided loyalties and limited discipline in their conduct in occupied Iraq. But a newly «rightsized» Federal workforce was evidently not up to the task of maintaining security without outside assistance. Under-Secretary of State for Management Patrick Kennedy stated in 2008 that «We cannot operate without private security firms in Iraq. If the contractors were removed, we would have to leave Iraq.»¹¹

¹⁰ The text of the FAIR Act is available at <http://www.whitehouse.gov/omb/procurement/fairact.html>.

¹¹ On growth in Federal spending on contractors: *In Washington, contractors take on biggest role ever*, Scott Shane and Ron Nixon, «New York Times», 2/4/07. Kennedy

In a world in which states have emulated the practices of the corporate sector, some governments have come to regard their status as sovereign as a core competence to be exploited in the global marketplace of laws. In a sense, sovereign nations have a capacity to sell products – incorporation, flagging ships, establishing banks – that other type of business service vendors do not. Thus, Bermuda houses dozens of «brass plate» insurance companies, and is the virtual home of hundreds of intellectual property (IP) subsidiaries, where companies park their offshore earnings for tax purposes. The Cayman Islands hosts thousands of hedge funds, which organize as limited liability companies (LLCs) in the Caymans but operate their physical presence out of Greenwich, Connecticut or London, England. Tuvalu leased its national Internet domain name (.tv) to Verisign for several million dollars per year, providing the government with a substantial part of its revenue base. And for years, Liberia has been the second-largest «flag of convenience» (behind Panama), providing the laws that govern thousands of merchant ships that transport the world's physical trade in goods. Liberia's lucrative sovereignty business, in turn, is operated out of an office park in suburban Virginia.

6. The impact on households

I have described several changes in the form and duration of the employment relation, the structure and ownership of corporations, the format of the financial services industry, and the nature of the state. In this section, I briefly examine the consequences of these changes for households. I suggest that as the ties that bound employees to firms were increasingly frayed, new ties were built that connected the well-being of households to financial markets. As both «investors» and «issuers», through mutual funds and securitized mortgages, households increasingly came to rely on financial markets for their prosperity and security. As a result, the financial crisis has done far more damage than it would have otherwise, and it therefore compels a re-thinking of our model of social organization.

The shift in employment from stable large-scale manufacturers to more ephemeral service firms changed the nature of the ties between corporations and their employees. Steve Barley and Gideon Kunda analyzed the shift to the so-called «free agent» contract worker (Barley and Kunda 2006). But the initial exuberance around the new «freedom» of independent contract work greatly subsided in the wake of the dot-com stock market collapse, when the availability of well-paid contracts disappeared and renewed the appeal of stable corporate employment that had now become so scarce.

At the same time that workers were less tied to corporate employers, households became more tied to financial markets than ever before. 401(k) pension plans and retail mutual funds connected people to the broad movements of the stock market, fueling the growth of financial media and, indirectly, the expansion and contraction of the retail sector through the so-called «wealth effect.» The securitization of mortgages and the ease of refinancing attuned a generation of homeowners to once-obscure numbers like LIBOR and riveted attention on the decisions of the Federal Reserve, which now had immediate pocketbook consequences. Alan Greenspan and James Kennedy documented that homeowners extracted about \$800 billion per year in equity during the boom times of the recent housing bubble (Greenspan and Kennedy 2008). Serial refiners and those that drew on home equity lines of credit relied on continuous increases in home prices and favorable interest rates from the Fed to make up for stagnant wages. For these households, micro-movements in the local real estate market might mean the difference between buying a new Pontiac and nursing the old car a few thousand more miles. The Web allowed individuals minute-by-minute access to numbers such as their credit rating and the (imputed) value of their house, through sites such as Zillow.com. And individuals were presented with increasingly novel ways of accessing funds from the capital markets – for instance, by selling their future life insurance payoffs to vendors who then bundled them with other insurance contracts and securitized them. Securitization thus remade the household budget just as it had reformatted the banking industry.

The increasing centrality of finance to everyday life also changed peoples' understanding of their place in society. Traditional corporate employers provided more than a job – they

provided a worldview. Economist Carl Kaysen described this in the 1950s: «The whole labor force of the modern corporation is, insofar as possible, turned into a corps of lifetime employees, with great emphasis on stability of employment.» Through its enveloping labor practices, «membership in the modern corporation becomes the single strongest social force shaping its career members...» (Kaysen 1957). Peter Drucker agreed, claiming that the corporation «determines the individual's view of his society», in some sense providing a template for understanding how society worked. The mass-production model of human organization pioneered by Henry Ford became a model for other large-scale tasks, from farming and scientific research to the D-day invasion at Normandy. Moreover, according to Drucker, employees brought this cognitive model to bear on basic tasks of living, such as child-rearing (Drucker 1949; cf. Kohn 1969). Mass production had become a worldview, a way of life.

Today, a vanishingly small part of the workforce grows food or manufactures tangible objects, and long-term careers within organizations are an anomaly rather than a norm. The «society of organizations» is no longer the enveloping force it was when Drucker and Kaysen wrote. Instead, the cognitive model that holds sway for many is that of the *investor*. Students attending college are «investing in their human capital», while people that join a bowling league or the PTA are thereby «investing in their social capital.» In a portfolio society, the organization man has been replaced by the daytrader, buying and selling various species of capital, from homes re-conceived as options on future price increases, to a college education whose estimated net present value informs the choice of school and course of study, to children whose Little League games might be an apt context to cultivate potential clients.

Like corporations, banks, and states, households have discovered the joys of outsourcing. Nannies and cleaning services have existed for generations. But the same technologies that opened offshoring possibilities for corporations have also made them more readily available for all households. Services from editing vacation videos to planning a wedding can be outsourced via the Web. With Skype and a fast Internet connection, helping the kids with homework can be contracted out to low-wage (but high-skill) professionals elsewhere in the world. And online providers offer «baby branding» services, so that children can start life with

a professionally-vetted name that will enhance their chances at elite schools and lucrative jobs. To an increasing degree, parents can leave the low-value parental tasks of naming, feeding, and educating their children to global vendors, while reserving the quality time for themselves.

But what life lessons would these parents pass on to their children during their quality time? For generations, the smart advice for making one's way in the world was to go to college and take a job with a reputable company like General Motors or US Steel or Westinghouse. Drucker summarized in 1949: «Where only twenty years ago the bright graduate of the Harvard Business School aimed at a job with a New York Stock Exchange house, he now seeks employment with a steel, oil, or automobile company. It is not only that money has become less important than industrial capacity to produce; the old financial powers have also lost control over money and credit itself, as witness the shift in financial headquarters from Wall Street to the government agencies in Washington...». The path to middle-class prosperity was clear enough for anyone willing to work hard and climb the corporate ladder.

Even as the stability of corporate jobs eroded, the young were advised to gain specialized education in order to participate in the «knowledge economy» at the high end of the value chain. Symbolic analysts such as accountants, computer programmers, and product designers were still paid well even if not protected by a corporate umbrella. But economist Alan Blinder suggests that in a Web-enabled world, any task that be sent over the Internet is open to competition from suppliers around the globe, no matter what the level of skill. From completing tax forms and designing auto parts to reading X-rays and decoding the human genome, cognitive tasks are eminently off-shoreable. The service sector, in short, is not immune to employment volatility, and Blinder estimated that perhaps 40 million jobs in the US were eligible for offshoring (Blinder 2006).

The news was not all hopeless for those who wanted to prepare for a job that might last for more than a few months. According to Blinder, one's job stability was enhanced by the level of personal touch involved. Personal fitness trainers and home health aides for retired baby boomers were not likely to be replaced by disembodied vendors on the Web. On the other hand, for those baby boomers who had the bad fortune to follow

conventional wisdom prior to the Great Recession of 2008 – buy the biggest house for which you can get a mortgage, and invest your savings in a mutual fund – retirement was going to have to wait. The pathway to prosperity for the next generation was increasingly hard to discern.

7. Moving forward

The argument of this paper has had many moving parts, but the underlying theme is that finance shaped the transition from an industrial to a post-industrial society in the United States over the past three decades. From a society of organizations in which corporations were essential building blocks that shaped the daily lives of their members, the US evolved into a portfolio society in which household welfare was increasingly tied to the vagaries of the financial markets. The economic downturn was amplified by these ties, as consumers that had relied on increasing home and portfolio values suffered setbacks that contracted consumer spending and thus economic growth. The results reverberated around the world, from investors that had purchased securities backed by American mortgage payments to producers that relied on American consumers for their sales.

The economy will come back, but the society of organizations in the United States will not, and our research needs to take this into account. Theories about organizations conceived of a world in which, as Charles Perrow put it, organizations were «the key phenomenon of our time, and thus politics, social class, economics, technology, religion, the family, and even social psychology take on the character of dependent variables» (Perrow 1991, 726). Economic mobility happened through the hiring and promotion practices of corporations, so understanding how job ladders worked could explain both class mobility and the mechanisms behind racial and gender inequality. Health care and retirement security were the province of corporate employers. Politics privileged those with access to resources, such as corporate executives, so examining the political contributions of major corporations such as GM, or Citigroup, or AIG could explain political outcomes. Urban and regional economic development was often a collective project of local corporate elites that knew each other through membership on the board of the

local bank, indicating the most fruitful place to look for elite cohesion (or its absence). And individuals' understandings of their society came from their experience at work, as long years with the same employer imprinted their worldviews.

As this article has described, the society of organizations unwound in the US after the early 1980s, although our conceptual model has not. Nostalgia is not the right response to post-industrialism. We cannot go back to a system of corporate-sponsored welfare capitalism any more than we can return to feudalism. If anything, we should be overjoyed that we have the technology to create the goods that people need with a minimal input of labor. The agenda for scholars going forward should be to help create institutions that serve the needs for economic security and health care formerly addressed by the old system while building new opportunities. But this will require a new set of conceptual tools.

In a post-industrial economy, the applicability of several of our existing theories is called into question. Some scholars have jibed that organization theory is, to a large extent, the «science of General Motors». Consider the evidence for transaction cost economics. Our understanding of asset specificity and vertical integration is largely based on the famous case of GM's acquisition of Fisher Body in the 1920s, while the value of the multidivisional structure was demonstrated by GM's M-form (e.g., Williamson 1975). Many studies of the make-or-buy decision also drew on evidence from American automakers prior to their divestitures of Delphi and Visteon (e.g., Walker and Weber 1984). But GM's declaration of bankruptcy in June 2009 also signified the bankruptcy of the corporate-industrial model that has been the basis of much of our theory and research.

Theories that relied on evidence based in manufacturing may have limited application in a service economy. Resource dependence theory, for instance, drew largely on studies of industry input-output tables in manufacturing to understand the sources of vertical integration and board interlocks (Pfeffer and Salancik 1978). The basic insights of resource dependence theory into power dynamics will have lasting value, although the sources and uses of organizational power will require a reconceptualization.

More broadly, views of organizations that take the sovereignty and boundaries of the organization for granted – e.g., those that study birth and death rates (Hannan and Freeman 1977) – will

yield a misleading view in an economy where reconfigurable supply chains in manufacturing and service are the most critical units of analysis. As I have described it, the ontological status of many corporations is closer to that of a web page than an organism. It is easy to create a Liberian corporation over the Internet with a credit card, and just as easy to dis-incorporate by failing to pay the annual fee. Should we be counting birth and death rates of such entities?

On the other hand, finance-based theories of the corporation will also not replace sociological theories. The imagery of the firm as a nexus-of-contracts (e.g., Jensen and Meckling 1976) is appealing in a world of OEM corporations, banks, and states. One might argue that finance scholars and their fellow travelers with influence in government helped make this view of the firm become true (cf. Ferraro *et al.* 2005). But the finance-based theory of the corporation has lost credibility in the wake of the financial crisis. The central premise of this approach is that financial markets are informationally efficient, and thus that it is appropriate for corporate governance mechanisms to guide corporations toward share price as their North Star. The merits of this view are debatable; less so are the hazards to the economy when it is broadly accepted by executives, investors, and policymakers. Indeed, some would go as far as to argue that the financial view of the corporation helped create the crisis we are in now.

It appears that for many corporations in the US, «creating shareholder value» will no longer be their animating purpose in the years to come. A fitting epitaph for this view came from Jack Welch, former CEO of GE, who said to the «Financial Times» in March 2009, «On the face of it, shareholder value is the dumbest idea in the world. Shareholder value is a result, not a strategy...Your main constituencies are your employees, your customers and your products.»¹² With the partial or complete government takeover of the country's largest bank (Citigroup), insurance company (AIG), and manufacturer (General Motors), along with mortgage behemoths (Fannie Mae, Freddie Mac) and other corporations deemed too big to fail, it is clear that a more informed sense of political economy will be essential to organizational scholarship in the years to come. American schol-

¹² Welch condemns share price focus, Grancesco Guerrero, «Financial Times», 3/12/09.

ars are distinctly ill-informed about the operations of a mixed economy. Organizational research rooted in the US traditionally treats governments as elements of an external «environment», to be obeyed or co-opted, or as a drag on the natural operations of markets. Examinations of the corporation going forward will require insights from scholars outside North America, where states have long played more active roles in the operations of business. This will be a welcome addition to a research tradition that has for too long taken the American case to be an exemplar to be documented and exported, rather than one path among many.

Within the economic crisis is a unique opportunity for sociological scholarship to provide direction. With broad sectors of the economy from finance to defense to health care on the verge of large-scale reorganization, we have a chance to inform change and apply lessons learned from other contexts, from self-organizing collective activities (e.g., open source software and Wikipedia) to social movements. Times of major economic upheaval have also been times of theoretical ferment--consider the burst of social theory at the turn of the 20th century (Adler 2009). Perhaps we can draw on this same impulse to yield more productive contributions to efforts at reform.

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