Critical Perspectives on Accounting 24 (2013) 273–318

Contents lists available at ScienceDirect

Critical Perspectives on Accounting

journal homepage: www.elsevier.com/locate/cpa

Americanism and financial accounting theory – Part 2: The 'modern business enterprise', America's transition to capitalism, and the genesis of management accounting

Rob Bryer

Warwick Business School, University of Warwick, Coventry CV4 7 AL, United Kingdom

ARTICLE INFO

Article history:
Received 9 February 2012
Received in revised form 21 June 2012
Accepted 5 September 2012
Available online 26 September 2012

Mots clés:
Critique
Intérêt public
Social

Palabras clave:
Crítica
Interés Público
Social

Keywords:
Critical
Public interest
Social
Accounting history
Capitalism

ABSTRACT

The paper uses accounting evidence to explore when and how capitalism came to America. It continues the search for capitalists in American history begun in 'Americanism and financial accounting theory. Part 1: Was America Born Capitalist?' Part 1 concluded that America was not 'born capitalist' in Marx's sense, and that the capitalist mentality had not appeared in farming even by the late 19th century, on southern slave plantations by the Civil War, or in manufacturing enterprises by the 1830s. This paper (Part 2) challenges Alfred Chandler's thesis that the 'modern business enterprise' brought 'a new type of capitalism' from around the mid-19th century. It re-examines accounting evidence from the Boston textile mills, the railroads, and the iron and steel industry. It concludes that the Boston Associates who historians often see as 'proto-capitalists', the 'managerial capitalists' Chandler sees on the railroads, and the 'entrepreneurial capitalists' he sees in the iron and steel industry and elsewhere, remained semi-capitalists because their capitals and workers were not 'free'. The paper re-examines the 'costing renaissance', the introduction and spread of product costing, standard costing, ROI and flexible budgets, and the evidence in Chandler's and Johnson and Kaplan's studies of the DuPont Powder Company and General Motors. This suggests that capitalism only appeared in America by around 1900, after more than two decades of intense conflict between 'capital and labour', and became established by the 1920s. This is the critical turning point in American business history, not the appearance of 'managerial capitalism', the paper argues. It concludes that America did not catch up with British capitalism until the late 1920s because its ruling elite faced an ideological problem created by its exceptional transition from a society of simple commodity producers and semi-capitalists, particularly the threat of popular socialism. The final paper, Part 3: 'Adam Smith, the rise and fall of socialism, and Irving Fisher's theory of accounting', argues that Fisher made a seminal contribution to solving this problem, but his legacy is a pathological theory of financial accounting.

When and how did America become a capitalist society? This paper (Part 2) continues the search for capitalists in American history started in 'Americanism and financial accounting theory. Part 1: Was America Born Capitalist?' Part 1 used Marx's theories of the transition to capitalism in England, of colonisation, and ideology, to construct an accounting history model of America's transition, and tested its predictions of the calculative mentalities we should find with accounting evidence from early farmers, merchants, slave owners, and manufacturers. It defined the capitalist mentality as a focus on

E-mail address: Rob.Bryer@wbs.ac.uk.

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doi:10.1016/j.cpa.2012.09.002

the return on investment (ROI, net profit divided by capital employed), defined the capitalist labour process as the 'real subordination of labour', holding managers and workers accountable for the circulation of capital, and defined capitalist social relations of production as 'free' capital employing 'free' wage labour. By these tests, America was not 'born capitalist', its farmers were not capitalists by the end of the 19th century, nor its slaveowners by the end of the Civil War, nor its manufacturers by the 1830s. This evidence raises the questions of where, when and how it made the transition, and the consequences for America and accounting of its exceptional path? To address these questions, the paper challenges Alfred Chandler's thesis that the "modern business enterprise" brought "a new type of capitalism to the American economy" (1977, p. 9) from around 1850, Johnson and Kaplan's (1987) management accounting history, Miller and O'Leary's (1987) alternative explanation of standard costing, and Fleischman and Tyson's (e.g., 2009) empirical criticisms of all explanations. It argues that America only began to make its transition to capitalism in manufacturing industry around 1900 and did not catch up with Britain until the 1920s because its exceptional starting point – a society dominated by 'simple commodity producers' and 'semi-capitalists' – created an ideological problem for its ruling elite. The major consequences of its solution, Part 3 argues, were the ideological defeat of popular socialism and Fisher's pathological theory of accounting.

Chandler's 'modern business enterprise' is an influential alternative to the farmer, merchant, small manufacturer, or slave owner, as the prime mover to capitalism in America, which he would have us believe appeared as an 'efficient' solution to the problem of 'transactions costs'.[1] According to his story, before the modern business enterprise the "small traditional family firm" focused on either finance, production, or distribution, "handled only a single economic function", and was guided only by the 'invisible hand' of the competitive market (Chandler, 1977, pp. 1, 3). As output grew and the number of transactions multiplied, manufacturers specialised to minimise production costs, but continued with traditional methods of production, and merchants specialised to minimise marketing costs, but continued with traditional methods of selling and administration. However, there came a point when technology and the size of the market allowed a 'large enough' output to make it profitable to reduce total costs by internalising hitherto separate production and distribution functions within a large business enterprise.[2] Chandler acknowledged that output grew "enormously" from the early to the mid-19th century without the help of the modern business enterprise (1977, p. 14). However, he argued it was only when technology (particularly using coal energy) "generate[d] a volume of output in production and number of transactions in distribution large enough to require the creation of a large managerial enterprise or to call for new business forms and practices", was there sufficient "pressure to innovate" (Chandler, 1977, p. 14). In short, in his story the "modern business enterprise appeared for the first time in history when the volume of economic activities reached a level that made administrative coordination more efficient and more profitable than market coordination" (Chandler, 1977, p. 8). As controlling this much larger flow of materials and money required highly educated and skilled 'managers', "an entirely new class of businessmen" appeared who created the modern business enterprise to maximise profits by minimising 'transactions costs' (Chandler, 1977, p. 3).

This reasoning is an example of the widely criticised, "deeply damaging tautology" embedded in transactions cost theory, "the complaint that it can be used to rationalize virtually any economic phenomena" (Robins, 1987, p. 72). In Chandler's case, the tautology runs: when technology and the market allow a 'large enough' output, enterprises innovate to reduce 'transactions costs', so where we see the introduction of administrative coordination this was because it was more 'efficient' or 'profitable'. Rooted in the general equilibrium theory of neo-classical economics, whose benchmark is 'general economic efficiency', the maximisation of society's 'welfare', Chandler's notions of 'efficiency' and 'profitability' reduce to the assumption of perfectly competitive markets, which deprives them of historical relevance. Chandler (1977, 1980) followed Williamson (1975) who "saw a process of economic evolution in which markets exist in the beginning", started from the idea that "markets are the natural form of exchange" (Robins, 1987, pp. 76, 77). In reality, in the early 19th century local communities "existed in relative isolation" (Robins, 1987, p. 76) and competition only developed following the railroads' creation of a national market, which prompted big corporations to subdue or control it, as we shall see. Before the modern enterprise, Chandler says, there was "individual [sic] capitalism", where "owners managed and managers owned" (1977, p. 9), but we saw in Part 1 that small social capitals were common. From the late 1830s, merchants and manufacturing firms increasingly organised as corporations (Robertson, 1973, p. 263), but many were effectively partnerships because their capital typically remained in the hands of a few individuals or families. Because "These corporations remained single-unit enterprises, which rarely hired more than two or three managers", Chandler concluded, the "traditional capitalist firm can, therefore, be properly termed a personal enterprise" (1977, p. 9), but it is doubtful whether such a firm was in fact 'personal' or 'capitalist'. Chandler never explicitly defines 'capitalism', but as his major "theme . . . is that modern business enterprise took the place of market mechanisms in coordinating the activities of the economy and allocating its resources", and his "first proposition" is that it did so when "administrative coordination permitted . . . higher profits" (1977, pp. 1, 6), he evidently assumes 'capitalism' equals competitive markets. As managers replaced markets and individual capitalists to make 'higher profits', this reduces 'capitalism' to the market mentality that maximises 'profit', a critical term in his analysis that Chandler also nowhere defines. Few would deny that the search for 'higher profits' dominated American business history, but to

[1] Chandler adopts the neo-classical economists' definition of 'transactions cost' – any addition to the 'general equilibrium price' of a commodity or service in 'perfectly competitive markets' (Robins, 1987, fn. 1, p. 69) – which is not helpful, as we shall see.

[2] This reduced the 'transactions costs' of organising business entities and of buying and selling, but it also reduced the costs of production and distribution, increased economic 'efficiency' by increasing supply at reduced prices because, in theory, competition eliminated all but 'normal' profits.