

Personal Capitalism as Charismatic Authority: the Organizational Economics of a Weberian Concept

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This article is dedicated to the memory of László Csontos.

Introduction.

What kind of capitalism creates rapid and sustained economic growth? One perspective on this question, going back at least to Adam Smith, has focused on those background institutions of civil society that are able to channel the rent-seeking proclivities of individuals into the production of new wealth rather than into the redistribution of existing wealth. Somewhat more recently, however, a perspective has arisen that stresses the role in economic growth not of abstract institutional structures but of the concrete institutions of business organization, notably the modern business firm. Preeminent among living proponents of this latter view is Alfred Chandler (1977, 1990), who retells the story of recent (nineteenth- and twentieth-century) economic growth in the now-developed countries as a history of the rise of managerial capitalism. In at least some understandings of Chandler, this managerial capitalism, in which trained professional managers run large multidivisional organizations, is to be contrasted with the more backward structures of “personal” capitalism, in which individual owner-managers continue to control business firms.

Before there was Chandler, of course, there was Schumpeter, whose work is a source not only of an important view similar to that of Chandler but also — perhaps astonishingly — of the opposite view, namely that the source of economic growth is indeed to be found in the behavior of individuals — of entrepreneurs — who create new wealth, often at the expense of old wealth, within the constraints of a particular kind of civil society. In an earlier paper (Langlois 1987), I presented an argument that, contrary to the conventional wisdom, these two visions of capitalism and economic growth do not track the difference between an earlier (or “Mark I”) and a later (or “Mark II”) Schumpeter; rather, these two views coexist in a way that is remarkably

consistent over time in Schumpeter's work. Like Chandler (McCraw 1988), Schumpeter was heavily influenced by Max Weber's theory of bureaucracy and social progress (Csontos 1991). In both his early (1934) and his later (1950) work, Schumpeter consistently espoused the view that "progressive rationalization" in Weber's sense would make innovation a matter of routine, thus rendering obsolete the personal capitalism of the entrepreneur and bringing to dominance in economic growth the role of the large bureaucratic organization.

In that earlier paper, I criticized Schumpeter's account of the obsolescence of the entrepreneur on the grounds that it reflects an illegitimate shift of underlying epistemology or, to put it another way, that it rests on a confusion about the nature of scientific knowledge and its role in what we would nowadays call the competences of the firm. In this paper I take up the argument again, moving it away from the realm of the doctrine-historical and the epistemological into the provinces of the economics of organization. I will suggest that the notion of personal capitalism is a far more subtle and complex one than its detractors have recognized. Moreover, far from being a primitive holdover from pre-corporate times, personal capitalism — properly understood — is in fact an important engine of economic change and growth.

One Schumpeter not two.

Let me begin by summarizing my argument about the obsolescence of the entrepreneur in Schumpeter. First off, the thesis that the individual entrepreneur will come to be replaced by corporate bureaucracy does not in any sense reflect a change of heart on Schumpeter's part: it was there from the beginning, and its expression remained remarkably unchanged between the second German edition of *The Theory of Economic Development* (1926; English

translation 1934) and *Capitalism, Socialism, and Democracy* (1942; third edition 1950). The following is from the earlier book.

And if the competitive economy is broken up by the growth of the great combines, as is increasingly the case today in all countries, then this must become more and more true of real life, and the carrying out of new combinations must become in ever greater measure the internal concern of one and the same economic body. The difference made is great enough to serve as the water-shed between two epochs in the social history of capitalism. (Schumpeter 1934, p. 67.)

In view of how clear the text is on this matter, it is indeed astounding that the conventional wisdom should have developed as it did: perhaps it is an instance of “social contagion.”¹

For Schumpeter, the reasons behind the obsolescence of the entrepreneur (in later capitalism, not the “later Schumpeter”) are to be found in the logic of economic development itself, namely the “progressive rationalization” of bourgeois capitalist society. The following passage is from the “later” Schumpeter.

This social function [entrepreneurship] is already losing importance and is bound to lose it at an accelerating rate in the future even if the economic process itself of which entrepreneurship was the prime mover went on unabated. For, on the one hand, it is much easier now than it has been in the past to

¹ In my 1987 paper, I document in detail the extent to which the conventional wisdom has uniformly bought into the view that Schumpeter “changed his mind.”

do things that lie outside the familiar routine — innovation itself is being reduced to routine. Technological progress is increasingly becoming the business of teams of trained specialists who turn out what is required and make it work in predictable ways. The romance of earlier commercial adventure is rapidly wearing away, because so many things can be strictly calculated that had of old to be visualized in a flash of genius. (Schumpeter 1950, p. 132.)

Schumpeter quickly goes on (p. 133) to liken the changes he foresees in the entrepreneur's role with those that have already taken place in the function of military commander. Now consider the following passage from the “early” Schumpeter.

The more accurately, however, we learn to know the natural and social world, the more perfect our control of facts becomes; and the greater the extent, with time and progressive rationalisation, within which things can be simply calculated, and indeed quickly and reliably calculated, the more the significance of this [entrepreneurial] function decreases. Therefore the importance of the entrepreneurial type must diminish just as the importance of the military commander has already diminished. (Schumpeter 1934, pp. 85-86.)

Not only do the passages in *Capitalism, Socialism, and Democracy* not contradict the ones from *The Theory of Economic Development*, those later passages are clearly *cribbed* from the earlier ones.

Schumpeter and Weber.

The broad outlines of Schumpeter's theory of entrepreneurship are of Weberian provenance.² Indeed, one might say that Schumpeter's schema is an application of Weber's social theory to the problem of economic growth. Schumpeter's innovation is to associate Weber's category of charismatic leadership with the concept of entrepreneurship.

As it is for Weber, capitalist development is for Schumpeter a march from traditional behavior to rational behavior. In "the circular flow of economic life," Schumpeter's version of equilibrium in early capitalism, behavior is rational only within the bounds of traditional or habitual behavior.

The assumption that conduct is prompt and rational is in all cases a fiction. But it proves to be sufficiently near to reality, if things have time to hammer logic into men. Where this has happened, and within the limits in which it has happened, one may rest content with this fiction and build theories upon it. It is then not true that habit or custom or non-economic ways of thinking cause a hopeless difference between the individuals of different classes, times, or cultures, and that, for example, the "economics of the stock exchange" would be inapplicable say to the peasants of to-day or the craftsmen of the Middle Ages. On the contrary the same theoretical picture in its broadest contour lines fits the individuals of quite different cultures, whatever their degree of intelligence

² The influence of Weber is explicit in the second German edition, but the references were largely expunged from the English translation, probably because Schumpeter saw methodological fashions, and his intended audience, as having changed in the interim (Csontos 1991).

and of economic rationality, and we can depend upon it that the peasant sells his calf as cunningly and egotistically as the stock exchange member his portfolio of shares. But this holds good only where precedents without number have formed conduct through decades and, in fundamentals, through hundreds of thousands of years, and have eliminated unadapted behavior (Schumpeter 1934, p. 80).

This picture of economic behavior as guided by routines — indeed, by routines that seem to be the result of some kind of selection process — is the inspiration for much of the association of Schumpeter with modern evolutionary economics (Nelson and Winter 1982), an association that, *pace* Hodgson (1993), is not at all unwarranted despite Schumpeter's negative remarks about evolutionary biology (Langlois and Everett 1994).

Economic growth can take place only when the circular flow is upset, which requires the entrepreneur. Since — in early capitalism, at least — rational action can occur only within the bounds of evolved habit, the behavior of the entrepreneur must be non- or extra-rational; it must be a matter of intuition.

What has been done already has the sharp-edged reality of all things which we have seen and experienced; the new is only the figment of our imagination. Carrying out a new plan and acting according to a customary one are things as different as making a road and walking along it.

How different a thing this is becomes clearer if one bears in mind the impossibility of surveying exhaustively all the effects and counter-effects of the projected enterprise. Even as many of them

as could in theory be ascertained if one had unlimited time and means must practically remain in the dark. As military action must be taken in a given strategic position even if all the data potentially procurable are not available, so also in economic life action must be taken without working out all the details of what must be done. Here the success of everything depends on intuition, the capacity of seeing things in a way which afterwards proves to be true, even though it cannot be established at the moment, and of grasping the essential fact, discarding the unessential, even though one can give no account of the principles by which this is done. Thorough preparatory work, and special knowledge, breadth of intellectual understanding, talent for logical analysis, may under certain circumstances be sources of failure. (Schumpeter 1934, p. 85.)

I will return to the cognitive implications of this view presently. For the moment, however, the important point is that entrepreneurial action is an instance of charismatic leadership, which, for Weber as for Schumpeter, is central to the theory of social change (Parsons 1949, p. 663).

Weber is principally concerned with the religious leader or prophet, and to a lesser extent with military and political leadership; Schumpeter borrows heavily from that analysis in his characterization of the entrepreneur. Here we begin to see the outlines of Schumpeterian “personal capitalism,” which in its pure form is the antithesis of bureaucratic organization. Consider Weber’s account of the organization of charisma.

The corporate group which is subject to charismatic authority is based on an emotional form of communal relationship. The

administrative staff of the charismatic leader does not consist of “officials”; at least its members are not technically trained. ... There is no hierarchy; the leader merely intervenes in general or in individual cases when he considers the members of his staff inadequate to a task to which they have been entrusted. There is no such thing as a definite sphere of authority and of competence. ... There are no established administrative organs. ... There is no system of formal rules, of abstract legal principles, and hence no process of judicial decision oriented to them. But equally there is no legal wisdom oriented to judicial precedent. Formally concrete judgments are newly created from case to case and are originally regarded as divine judgments and revelations. ... The genuine prophet, like the genuine military leader and every true leader in this sense, preaches, creates, or demands *new* obligations. In the pure type of charisma, these are imposed on the authority of revolution [*sic*] by oracles, or of the leader’s own will, and are recognized by the members of the religious, military, or party group because they come from such a source. (Weber 1947, pp. 360-361.)

But the charismatic organization is perhaps best understood in contrast to what it is *not*.

Charismatic authority is thus outside the realm of everyday routine and the profane sphere. In this respect it is sharply opposed both to rational, and particularly bureaucratic, authority, and to traditional authority, whether in its patriarchal, patrimonial, or any other form. Both rational and traditional authority are

specifically forms of everyday routine control of action; while the charismatic type is the direct antithesis of this. Bureaucratic authority is specifically rational in the sense of being bound to intellectually analysable rules; while charismatic authority is specifically irrational in the sense of being foreign to all rules. Traditional authority is bound to the precedents handed down from the past and to this extent is also oriented to rules. Within the sphere of its claims, charismatic authority repudiates the past, and is in this sense a specifically revolutionary force. (Weber 1947, pp. 361-362.)

It is the charismatic, and therefore revolutionary, quality of entrepreneurship that makes it a source of economic growth, that allows it to play the role of “industrial mutation — if I may use that biological term — that incessantly revolutionizes the industrial structure *from within*, incessantly destroying the old one, incessantly creating a new one” (Schumpeter 1950, p. 83, emphasis original).

Recast in these explicitly Weberian terms, Schumpeter’s theory of entrepreneurship looks something like this. In its undeveloped state, an economy is based largely on traditional behavior, which bounds the possibilities for conscious economic activity. Under the right institutional setting — bourgeois capitalism — charismatic leadership arises, in the form of the entrepreneur, to break the crust of convention and to create new wealth by “‘lead[ing]’ the means of production into new channels” (Schumpeter 1934, p. 89). Charisma is personal and revolutionary; “in its pure form charismatic authority may be said to exist only in the process of originating. It cannot remain stable, but becomes either traditionalized or rationalized, or a combination of both” (Weber 1947, p. 364). In the economic sphere, of course,

the tendency is toward rationalization. Not only do imitators rush in once the entrepreneur has blazed the trail, but also the problem of succession within the entrepreneurial organization leads (if the organization is to continue) to bureaucratization, that is, to the substitution of rules for personal authority; to the creation of abstract offices divorced from their individual holders; and to the increasing preeminence of specialized knowledge and spheres of competence (Weber 1947, pp. 330-334).

Progressive rationalization.

The transformation from the traditional to the rational takes place at two levels. At the level of each entrepreneurial organization, charismatic authority, having destroyed the traditional, must eventually give way to bureaucracy as the problem of succession arises. It is here that we can locate Chandler's notions of personal and managerial capitalism. What Chandler finds wanting in personal capitalism is precisely the extent of rationalization in the Weberian sense. Compared with the foremost examples of managerial capitalism (*e.g.*, in the United States), the British, he argues, failed adequately to extend hierarchical control and to create management based on abstract rules and spheres of competence.

In most British enterprises senior executives worked closely in the same office building, located in or near the largest plant, having almost daily personal contact with, and thus directly supervising, middle and often lower-level managers. Such enterprises had no need for the detailed organization charts and manuals that had come into common use in large American and German firms before 1914. In these British companies, selection to senior positions and

to the board depended as much on personal ties as on managerial competence. The founders and their heirs continued to have a significant influence on top-level decision-making even after their holdings in the enterprise were diminished. (Chandler 1990, p. 242.)

British personal capitalism thus represented a kind of half-way house between the charismatic founders and full rationalization on the American model.

At another level, however, resides the claim that progressive rationalization affects the entire economic society, eventually displacing traditionalism completely. The entrepreneur is both the agent and the victim of this transformation. In uprooting the deeply planted traditional ways of life, the entrepreneur prepares the field for rational authority.³ But — and this is the heart of Schumpeter's thesis — once the hard work of crust-breaking has been done, charismatic leadership is no longer necessary, and the entrepreneur must ride into the sunset. The entrepreneurial role is then taken up by large bureaucratic firms, organized along rational lines, who can engineer change without need for charisma. The final result of the process of progressive rationalization, indeed, is a kind of bureaucratic socialism, since, without any substantive function or source of legitimacy, entrepreneurial capitalism as a system must ultimately follow the entrepreneur westward.

³ “A high degree of traditionalism in habits of life, such as characterized the labouring classes in early modern times, has not sufficed to prevent a great increase in the rationalization of economic enterprise under capitalist direction. ... Nevertheless, this traditionalistic attitude had to be at least partly overcome in the Western world before the further development of the specifically modern type of rational capitalist economy could take place.” (Weber 1947, p. 167.)

At first glance, Schumpeter's brief in favor of large organizations seems consistent with Weber, who praised the efficiency of rational bureaucracy in the most lavish terms.⁴

Experience tends universally to show that the purely bureaucratic type of administrative organization — that is, the monocratic variety of bureaucracy — is, from a purely technical point of view, capable of attaining the highest degree of efficiency and is in this sense formally the most rational known means of carrying out imperative control over human beings. It is superior to any other form in precision, in stability, in the stringency of its discipline, and in its reliability. It thus makes possible a particularly high degree of calculability of results for the heads of the organization and for those acting in relation to it. It is finally superior both in intensive efficiency and in the scope of its operations, and is formally capable of application to all kinds of administrative tasks. (Weber 1947, p. 337.)

Notice, however, that this *paean* does not portray bureaucracy as innovative. It is precise and reliable, but not necessarily dynamic. “Both rational and traditional authority,” as we saw, “are specifically forms of everyday routine control of action” (Weber 1947, p. 361). Bureaucracy is designed for “imperative control over human beings,” that is, making people do what the boss wants, but not necessarily for performing the multifold tasks of an entire economy. And it produces results that are “calculable” because it reduces internal variance, not

⁴ Weber did not, however, see bureaucracy as generally good, and he worried about its stultifying effect on humanity (Coleman 1990, p. 95).

necessarily because it (or rationalization more generally) extends the scope of human ability to “calculate” or predict the future.

Indeed, one could argue that Schumpeter goes well beyond Weber — into what, in my view, is illegitimate territory. Recall that, for Schumpeter, progressive rationalization seems to mean more than the Weberian idea of demystification; it seems also to mean that the growth of scientific knowledge will extend the bounds of rationality in the sense of Herbert Simon: with progressive rationalization, our “control of facts” becomes more perfect, and we become able “quickly and reliably” to calculate what had previously required intuition and a “flash of genius.” Schumpeter is thus making a claim about the cognitive, not merely the command-and-control, possibilities of bureaucracy.

I doubt that we live in a wiser age; but I do think that we are perhaps more accustomed today than in Schumpeter’s time to question the cognition-expanding character of conscious, scientific knowledge. The best and the brightest have too often failed to live up to their billing. As F. A. Hayek (1948) argued in the context of the socialist calculation debate, such stout claims for conscious scientific knowledge (on which the possibility of socialist calculation depends) are an insupportable *hubris* that ignores the large and ineradicable role of rules, of routine, of tacit knowledge. Rationality — or, more correctly, cognitive ability — is perhaps even more bounded today, in the avalanche of information that “progressive rationalization” has generated, than it was in more traditional times.

Interestingly, it is far from clear that Weber would have been on Schumpeter’s side in this matter. For one thing, Weber, as we saw, stressed the static character of bureaucracy. Bureaucracy is about imposing rules, not about changing the rules. It is a way to marshal well-defined means in service of a

well-defined end; but, like the ideal type of traditional authority, rational authority is not dynamic. On the matter of bureaucracy replacing entrepreneurial capitalism, we can note that Weber came down explicitly *against* the possibility of socialist calculation, effectively endorsing the views of von Mises.⁵

Organizational capabilities.

We learn the most from writers like Weber and Schumpeter not when we approach them from the perspective of the antiquarian or of the adoring disciple but when we treat them as capable of engaging our own research programs. How, then, can we apply their ideas to the present-day discussion of capitalism, organizational form, and economic growth?

Much of the modern literature has focused on the idea of *organizational capabilities*, which provides a language large enough to encompass the ideas of Weber and Schumpeter. Broadly speaking, organizational capabilities are what organizations can do well; and Weber was arguably talking about organizational capabilities when he described the efficiency of rational bureaucracy.

The term “capabilities” was first used by G. B. Richardson (1972, p. 888) to refer to “the knowledge, experience, and skills” of the organization. In Richardson, however, the import of the concept was not to emphasize the *extent*

⁵ This was not an intellectually fashionable view in the 1930s and 1940s, when Weber’s ideas began filtering into the English-speaking academic world. In a fit of early political correctness, indeed, Talcott Parsons found it necessary to insert into his translation of Weber a footnote apologizing for his author’s failure to hold views in accord with “the principal weight of technical opinion” on the subject (Weber 1947, p. 194n). That weight must not have been tied down very tightly, however, as it has lately shifted decidedly to Weber’s side.

of organizational capabilities but rather to stress their *limitations*. Because of what are effectively cognitive constraints, all organizations must specialize; and, since the chain of production in an advanced economy requires a diversity of very different capabilities, the costs of integrating across many links in that chain are necessarily high, and firms must rely on various kinds of market arrangements to coordinate their activities even in the face of the “contractual hazards” emphasized in transaction-cost economics.

This point has also been made in a slightly different way by Nelson and Winter (1982) and to some extent by the “dynamic capabilities” literature they helped to inspire (Teece and Pisano 1994; Langlois and Robertson 1995). In Nelson and Winter, economic action, even within large organizations, is a matter of rule-following behavior. Agents possess repertoires of routines, which are habitual patterns of behavior that consist in tacit, skill-like knowledge. These agents are “boundedly rational” and do not consciously survey their environments and choose a substantively rational course of action, except within the bounds of what routine behavior has made possible.⁶ The parallels here with Schumpeter’s account of traditional behavior in the circular flow should be obvious. The crucial difference, however, is that Nelson and Winter see such behavior not as limited to earlier society but as an inescapable implication of the mechanics of human cognition. Agents in advanced capitalism also follow rules and abide by habits. By implication, economic change in Nelson and Winter is a non-rational or entrepreneurial activity: it is taking a leap into the unknown, not a matter of conscious planning.

⁶ To put it another way, substantive or “optimizing” rationality of the neoclassical sort is itself a learned routine or set of routines.

There are, however, some present-day writers who are inclined to take the notion of organizational capabilities in a different direction and to extract from it some very large claims for the efficacy of large organizations and for their superiority to individual action and to smaller, more personal enterprises.

For example, William Lazonick (1991) offers what is arguably a historicist account of the progressive development of capitalism, which reaches its apex in “collective capitalism.”⁷ As in Schumpeter’s portrayal of later capitalism, large organizations in Lazonick’s collective capitalism are not only effective at managing existing structures but are also prime engines of innovation. And, as in Schumpeter, the basis for the innovativeness and the wealth-creating character of large organizations resides in their ability effectively to break cognitive boundaries and consciously to reinvent the division of labor.

The more technologically complex the innovation, the greater the need for innovative skills and the more extensive the specialized division of labor required to develop and utilize these skills. The organization must not only develop these specialized skills so that they can contribute to the innovation, but also coordinate them so that they constitute a collective productive power. *Organizational capability permits the enterprise to plan and coordinate the*

⁷ More recently, Lazonick has made clear that he includes in collective capitalism — or “organizational integration,” as he now terms it — the activities of “individuals and groups who are employed by legally distinct firms that pursue common goals” (Lazonick and West 1995, p. 231). Taken seriously, however, this idea renders unhelpful if not tautological the notion of “collective capitalism,” since it embraces activities that economists have viewed, and ought rightly to view, as reflecting the capabilities of markets (properly understood) rather than of firms, and thereby calls into question any implications in the analysis for the advantages of large firms *per se*. On this point see Loasby (1993) and Langlois (1994).

development of these innovative skills, integrating them into an enterprise-specific collective force. As far as the innovation process is concerned, therefore, *organizational capability permits the planned coordination* of the horizontal and vertical division of labor required to generate an innovation. (Lazonick 1991, p. 203, emphasis altered.)

It is not clear what are the details of how this planning and coordination takes place, but we are left with the strong impression that it is decidedly not the handiwork of some charismatic central individual, or of the firm's owners in any sense, but is instead the product of professional managers.

In this respect, Lazonick has chosen Schumpeter over Chandler. Despite their similar Weberian influences, the Schumpeterian story of the obsolescence of the entrepreneur is not identical to the Chandlerian account of the rise of the visible hand. In Chandler, as in Weber, the emphasis is not on the innovative character of the large bureaucratic organization but on its ability to deliver the goods. The managers "administer, monitor, coordinate, and plan." They do not carry out new combinations. For Chandler, economic growth is underpinned by an imperative to high-volume throughput; the personal element in organization stands in the way of fully realizing this imperative, for which an abstract and professional structure is required.

As we saw, however, Schumpeter's claims are much different. He associates "personal" capitalism with charismatic leadership. It is the entrepreneur who makes dramatic, and often creatively destructive, changes. In Schumpeter, those who come along and fill in the details are important, but it is the changes that really matter. The obsolescence thesis is a claim not that large,

fully articulated enterprises may be necessary to realize the vision of an individual entrepreneur; rather, it is a claim that those enterprises will be the sources of change. Let us put it succinctly. In Chandler, large organizations are the result of economic change; in Schumpeterian later capitalism, economic change is the result of large organizations.

The rationality of the personal element.

Less than a decade ago, the late sociologist James Coleman (1990) attacked the legacy of Weber in the analysis of organizational design. In Weber's schema, the functional goals of organizations— carrying out a narrow set of purposes — can best be attained only by a mechanical bureaucratic structure. As we saw, this is the legacy that influenced Chandler: the residual charismatic elements of personal capitalism stand in the way of the full deployment of the articulated, professionally managed structure of modern industrial capitalism. For Coleman, however, this approach to organizational analysis and design is both misleading and dangerous, as it fails to understand what economists call the principal-agent problem: agents in a bureaucracy do not act as cogs in a machine but have purposes and interests that may diverge from those of the organization. Coleman uses the theory of principals and agents to suggest why many different kinds of well-functioning organizations — merchant banks, diamond merchants, Japanese manufacturing systems — are not structured as machine bureaucracies but retain a personal element as a necessary condition of smooth operation.

Most interestingly, perhaps, Coleman (1990, pp. 99-101) suggests that even fully charismatic authority can be a rational (economists would say “efficient”) structure of organization. This is so because charismatic authority solves a coordination problem in a situation of “chaos” in which rights, roles,

and responsibilities are in flux. All participants would prefer some structure or constitution; but the costs of coordination are high, as each is willing to constrain himself or herself to a new order only if many others simultaneously agree to do so. Charismatic authority cuts through these costs and establishes a structure, which then presumably evolves in a Weberian way as stability is achieved. The parallel with Schumpeter's theory of entrepreneurship is clear.

Coleman was not, of course, the first or only writer to object to the idea that an organization functions best when it is organized like a machine. This was in some ways the theme of Chester Barnard's *The Functions of the Executive* (1948), even if Barnard does not stray far from Weber in other respects. Barnard's conception of the executive is essentially Chandler's — a professional elite running a highly articulated organization.⁸ Nonetheless, Barnard objects specifically to the idea of a bureaucracy as a machine, and insists on the personal element of executive leadership. Moreover, he anticipates the modern economics of organization in his discussion of incentives. But, unlike many modern economists, Barnard believes that motivating workers is more than a matter of creating pecuniary incentives. It is also, and perhaps more importantly, a matter of creating what would nowadays be called a corporate culture. "The inculcation of belief in the real existence of a common purpose," he writes, "is an essential executive function" (Barnard 1948, p. 87).

⁸ Indeed, Barnard is often portrayed as the inventor of the 1950s corporate man and as the promoter of a managerial ideal that blurred the boundaries of government and private industry (Scott 1992). A recent article in the *Wall Street Journal* (Jenkins 1997) depicts Barnard — at one time president of New Jersey Bell — as the Bell System's "resident ideologist," who promoted Theodore Vail's vision of "a technocratic uberclass to introduce the blessings of technology and corporate bigness in a cautious, orderly way, without any of that messy creative destruction."

An organization can secure the efforts necessary to its existence, then, either by the objective inducements it provides or by changing states of mind. It seems to me improbable that any organization can exist as a practical matter which does not employ both methods in combination. In some organizations the emphasis is on the offering of objective incentives — this is true of most industrial organizations. In others the preponderance is on the state of mind — this is true of most patriotic and religious organizations (Barnard 1948, p. 141).

Thus even Chandlerian managers must retain some element of the charismatic.

In the end, Barnard too sees the organization as embodying a kind of constitution. Individual motivation is controlled by a hierarchy of moral codes or rules of conduct. The persuasive function of leadership, for Barnard, consists in “the creation of moral codes for others” (Barnard 1948, p. 279). It is not a long leap from here to Coleman’s observation that (in effect) charismatic authority is the creating of a particular kind of moral code, a particularly simple or direct one useful for responding to — or initiating — rapid change.

Philip Selznick (1957) provides a similar account that emphasizes even more clearly the role of the leader in economic change. Like Barnard, Selznick (p. 10) sees the organization as embodying a constitution.⁹ Also like Barnard, he considers it a function of administrative leadership to define the organization’s mission and to promote its values (p. 26). Taking inspiration from a passage in Barnard, Selznick goes on, however, to stress that leadership is necessary not for routine administration but for more-or-less radical change, what he calls “dynamic adaptation” (p. 34). Barnard wrote:

⁹ In this respect Selznick clearly anticipated more recent interest among economists in the idea of organizational constitutions (Gifford 1991, Vanberg 1992, Langlois 1995). Indeed, as Christian Knudsen (1995) has pointed out, Selznick anticipated not only the constitutional idea but also the notion of “distinctive competences” that is at the heart of much present-day theory in management.

The overvaluation of the apparatus of communication and administration is opposed to leadership and the development of leaders. It opposes leadership whose function is to promote appropriate adjustment of ends and means to new environmental conditions, because it opposes change either of status in general or of established procedures and habitual routine. This overvaluation also discourages the development of leaders by retarding the progress of the abler men and putting an excessive premium on routine qualities (Barnard 1948, p. 240, cited in Selznick 1957, p. 36).

For Selznick, the crucial issue is not the personal element *per se* but the non-routine character of leadership. A personal touch can help a static organization function more smoothly; real leadership shows itself when the organization faces a “crucial experience” that requires the making of critical decisions (Selznick 1957, pp. 36-37).

Even in the relatively more arid fields of neoclassical economics, where only incentive models normally grow, one can also find some strains of thought that suggest a rationality to leadership. It is a central insight of the economics of organization, going back to Knight (1921), Coase (1937), and the early Williamson (1975), that a rationale for the firm may be found in its adaptability in a changing world. Production that is organized “internally” — a notoriously slippery idea — may be able to cut through the transaction costs of using arms’-length contracts and thus may be more efficient. Where does leadership fit in? In what I view as a naïve reading, the Coasean theory of the firm can be understood as a vindication of central planning: in superseding market forces, the organization necessarily directs resources consciously. As Coase put it, “[i]f a workman moves from department Y to department X, he does not go because

of a change in relative prices, but because he is ordered to do so” (Coase 1937, p. 387). Notice, however, that all the illustrations in the literature are in terms of individuals giving direction, not in terms of organizations “planning.” The economist’s models are usually models of personal capitalism. This may be a limitation of the economist’s approach; but it certainly does not give any credence to the idea that complex organizations are instances of central planning.

In Knight, the superior flexibility of internal organization comes from the need for entrepreneurial judgment in a radically uncertain situation and the costliness of markets for such judgment (Langlois and Cosgel 1993). More recent economists tell a similar tale. In the work of Oliver Hart, the necessary incompleteness of contracts in an uncertain world requires the existence of a residual right of control — that is, a right to make decisions in circumstances unforeseen. The ownership structure of production turns on whose possession of that right minimizes the sum of production and transaction costs.¹⁰ Unlike Knight and Coase, Hart and his coauthors insist on portraying the issue as one of misaligned incentives in the presence of highly specific assets. In my view, however, the real issue is that the holder of the residual rights of control is empowered to redirect the capabilities of the cooperating parties in situations of

¹⁰ For an accessible summary and references, see Hart (1989). Barzel (1987) offers a similar theory from a slightly different perspective.

novelty or change — situations in which contracts are not merely incomplete but often irrelevant (Langlois 1992).

In other words, radical change creates situations of constitutional “chaos” (as Coleman put it) that render costly any kind of highly articulated structure, whether it be a fully specified contract or a complex Weberian bureaucracy. The more radical the change — the greater the chaos — the more decision-making must be shifted into the “residual” category. One party must dictate; and of necessity that party’s decision making cannot be based entirely on established procedures, routines, or contractual provisions. It must be in some measure *sui generis*.

Occasionally, the issue may be a clash of two cultures or corporate visions of the Barnard sort. In the much-discussed (perhaps excessively discussed) case of General Motors’s 1926 acquisition of Fisher Body, GM wished to possess the residual rights of control in order to impose on Fisher its corporate vision of the future of automobile design and production (Langlois and Robertson 1989). The more radical the change, however, the greater must be the scope of the residual rights of control and the more charismatic must be the leadership necessary to exercise those rights. For example, the radical technological change of electronic watch movements in the 1970s and 80s, and the chaos it created for the mechanical watch industry in Switzerland, was met by the rise of a single charismatic individual who tightly and personally controlled the residual rights in order to reshape the Swiss industry (Langlois 1998).

Toward an economics of charismatic authority.

Let me conclude with some suggestion for how further thinking about charismatic authority, perhaps including explicit modeling, might proceed. The foregoing discussion suggests that an economic theory of charismatic authority would address three tightly interrelated factors: the *constitutional* element, the *transaction-cost* element, and the *cognitive* element.

The constitutional element. A constitution is a set of rules to which individuals bind themselves and which in turn guide or channel individual behavior. One aspect of this process of commitment is trust. And, as Frank Knight argued in a relevant context, situations of radical uncertainty necessitate that people place their trust not in rules and procedures (whose outcomes cannot be easily predicted under such circumstances) but in other people. Charismatic authority is an instance of this, in which individuals make a commitment not to a complex set of rules but to a simple one: follow the dictates of the leader. As Knight (1921, p. 291) points out, this is not necessarily “irrational,” as it is often easier in a world of uncertainty to judge the general capabilities of individuals to deal with unknown future events than it is to predict the specific course of those events.

The transaction-cost element. Charismatic authority can also be understood as one mechanism for economizing on transaction costs in a situation of radical uncertainty or economic change. As Coleman’s account hints, such

authority would be particularly effective in dealing with what I call “dynamic” transaction costs (Langlois 1992), the costs of coordinating a major recombination of economic capabilities. Such costs are in part the costs of overcoming the resistance of vested interests — the aspect on which neoclassical theory has most consistently focused. Both Knight and Hart would argue that individuals will not put their trust in an entrepreneur in the absence of safeguards against the expropriation of rents. Placing of the residual rights of control in the hands of the entrepreneur is one way of obviating such concerns. But dynamic transaction costs are often a matter not of clear-cut pecuniary incentives but rather of cognitive resistance — a point both Weber and Schumpeter emphasized. Reorganizing economic capabilities is often a process of informing, teaching, and persuading those who hold complementary assets and abilities rather than a matter of merely aligning incentives (Silver 1984; Langlois 1992). The benefits of charisma in such a process should be clear.

The cognitive element. As Klamer and McCloskey (1995) argue, much of economic communication in general is not a dispassionate transmission of information but rather an active investment in persuading others and engendering their trust. Nonetheless, information and persuasion cannot be neatly separated; and persuasion cannot take place without the transmission of ideas. As Schumpeter pointed out, the informational demands of the circular flow are relatively small; but information requirements rise dramatically in a situation of economic change. It is thus another benefit of charismatic leadership

that it can economize on information costs by tapping into symbolic expression — by using the language of the sacred rather than that of the profane. This point has not been lost on organizational sociologists, who see leadership as importantly a symbolic process (Scott 1995). But economists have not seized upon the idea with much vigor, apart from the literature on signaling.¹¹ Anthony Downs (1957) recognized early on that a political ideology is an institution that economizes on information by condensing complex ideas into a symbolic or shorthand representation so voters can more cheaply determine whether political outcomes will favor their private interests. The symbols of charismatic authority arguably serve a similar function, standing as a kind of shorthand for the instructions necessary to generate a complex reorganization of economic capabilities.

¹¹ For a promising recent effort in what is broadly the signaling tradition, see Posner (1998).

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