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THE DECLINE AND FALL OF THE CONGLOMERATE FIRM IN THE 1980s: THE DEINSTITUTIONALIZATION OF AN ORGANIZATIONAL FORM*

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In 1980, the conglomerate firm, a firm composed of several unrelated businesses, was perhaps the dominant corporate form in the United States. Yet, by 1990 this form had in effect become deinstitutionalized. Using comprehensive time-series data from the 1980s on a population of the largest industrial firms in the United States, we demonstrate that this deinstitutionalization was effected by two processes: First, diversified firms were taken over at a high rate and their unwanted parts were typically sold off, and second, the less diversified firms that survived shunned the strategy of conglomerate growth. The aggregate result was that by 1990 the largest industrial firms in the United States became considerably less diversified. Business rhetoric tracked the shift in this prevalent organizational form and practice by denouncing the "firm-as-portfolio" model in favor of a network model of regularized economic exchange. We argue that an unintended consequence of the successful spread of the conglomerate form was to replace the conceptualization of the corporation as a sovereign actor with a reductionist view of the firm as a network without boundaries or a nexus-of-contracts among separate individuals. We discuss the implications of this conceptualization for organization theory.

The diversified corporation became the dominant form of industrial firm in the United States over the course of the twentieth century. During the 1920s, DuPont and General Motors pioneered the use of the multidivisional form (or M-form) to produce and market a number of related products through separate divisions, and this organizational structure subsequently spread (Chandler 1962). The M-form also allowed easy integration of acquired businesses, which enabled firms to grow through acquisition. Following the enactment of the Celler-Kefauver Act in 1950, horizontal and vertical acquisitions (buying competitors, buyers, or suppliers) fell out of regulatory favor, and firms seeking to grow through acquisition were forced to diversify into other industries. This fueled the conglomerate mergers of the late 1960s and 1970s (Fligstein 1991). The strategy of growth through acquiring firms in unrelated lines of business and structuring them as a collection of separate business units reflected an underlying model of appropriate corporate practice—the "firm-as-portfolio" model. By 1980, the triumph of the firm-as-portfolio model seemed complete, as growth through diversification was perhaps the most widely used corporate strategy among large firms (Porter 1987), and fewer than 25 percent of the *Fortune* 500 largest industrial corporations made all their sales within a single broadly-defined (2-digit SIC) industry.[1]

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[1] The Standard Industrial Classification (SIC) is a system used by the U.S. Office of Management and Budget as well as other public and private agencies to categorize industries at multiple nested levels of aggregation. Broader categories are denoted by numbers with fewer digits; for example, 28 denotes "Chemicals and allied products"; 281 denotes "Industrial and organic chemicals"; and 2812 denotes "Alkalies and chlorine."

During the 1980s, however, a wave of "deconglomeration" restructured American industry and heralded a return to corporate specialization (Bhagat, Shleifer, and Vishny 1990). From an economic perspective, the value of bringing a number of weakly related business operations under a single management had long been suspect, as financial orthodoxy insisted that investors should diversify, not firms (Amihud and Lev 1981). Moreover, the construction of a takeover market for large firms in the 1980s, supported by Reagan-era regulatory policy, empowered a mechanism to support this orthodoxy. So-called "bust up" takeovers, where raiders bought conglomerates and financed the deal through the post-acquisition sale of their separated parts, became accepted and then commonplace (Lipton and Steinberger 1988), while diversified firms not threatened by takeover voluntarily shed unrelated operations to focus on "core businesses." As prevalent corporate practices changed, revisionist views of conglomerate mergers suggested that it was "almost certainly the biggest collective error ever made by American business," a "colossal mistake" that had left American industry uncompetitive relative to international rivals (*Economist* 1991:44). As we document in this paper, by the late 1980s only a tiny handful of firms continued to pursue a strategy of unrelated diversification, the prevalence of conglomerates declined substantially, and business rhetoric denounced both the strategy of diversification and the conglomerate form. Thus, over the course of a decade, the firm-as-portfolio model was abandoned on a large scale across the population of the largest American corporations—in a word, corporate conglomerates became "deinstitutionalized."

In retrospect, the "deconglomeration" of American industry in the 1980s can be seen as economically sensible, if not inevitable. The corporate managers who built the conglomerates of 1980 had made a "colossal mistake," either out of self-interest—larger firms pay better, and diversification buffers the employment uncertainty of operating in a single industry (Amihud and Lev 1981)—or out of simple imitation of other firms that had diversified (Fligstein 1991). By the early 1980s, the antitrust regime that had made diversification preferable to buying competitors during the 1960s and 1970s had fallen away (Bhagat et al. 1990), as had the legal impediments that had previously protected large corporations from hostile takeovers (Davis and Stout 1992). Moreover, the stock market undervalued conglomerates relative to sets of "focused" firms operating in the same industries (LeBaron and Speidell 1987) and, at least during the 1980s, punished firms acquiring unrelated businesses with drops in share price (Morck, Shleifer, and Vishny 1990). In hindsight, all these factors indicate that in 1980 the field of the largest American industrial corporations was fundamentally flawed and that an enormous "collective error" had been made. Yet organization theorists provide a cogent argument that it is exceptionally difficult for organizations to make major changes in strategies and structures (Hannan and Freeman 1989), particularly in those structures that have been "institutionalized" and widely adopted across an organizational field (DiMaggio and Powell 1983). Compelling theory and evidence was purported early on that the firm-as-portfolio model was a financial mistake (Levy and Sarnat 1970; Rumelt 1974; Mason and Goudzwaard 1976), and many individual corporations had their own ample evidence that this model was failing, as they divested upwards of three-quarters of the unrelated businesses they had acquired because of their poor post-acquisition performances (Porter 1987; Ravenscraft and Scherer 1987). Yet little evidence of either individual or collective learning was evident—bust-up takeovers of conglomerates were unknown during the 1960s (Palmer, Barber, Zhou, and Soysal 1993) and firms continued to follow the dictates of the firm-as-portfolio model throughout the 1970s, with the vast majority of mergers representing diversification and half the acquired assets being in unrelated industries (Scherer 1980:124). Thus, the process required to correct the collective error of conglomerate mergers entailed involuntary organizational upheaval on a scale previously unknown in this century.

We believe that the sociology of organizations can benefit from examining the co-evolution of corporate strategies and structures and the underlying models of appropriate practice that occurred during the retreat from conglomeration. Recent theoretical approaches in the sociology of organizations have focused on changes in aggregates of organizations, such as populations (Hannan and Freeman 1989) or fields (Powell and DiMaggio 1991), and thus

deconglomeration is an appropriate topic of study for both. Yet deconglomeration does not readily fit the explanatory categories of either approach. Ecologists seek "to understand the dynamics of organizational diversity, *how social changes affect the mix of organizations in society*" (Hannan and Freeman 1986:52; emphasis in original), primarily by examining the birth and death rates of relatively inert organizational forms. But organizational births and deaths were unimportant in deconglomeration; rather, the parts of conglomerates were reshuffled as going concerns (through takeovers or restructurings), with most of the same employees continuing to produce the same products in the same industries, suggesting that ecological theory would be of little help in understanding deconglomeration.

Neo-institutionalists also seek to explain variations in the prevalence of forms and practices in organizational fields, but their focus is more on voluntary shifts, that is, on how models of appropriate action come to be taken for granted, thereby shaping organizational practice. Thus, institutional theory should be more directly relevant to examining deconglomeration as an instance of deinstitutionalization. But as DiMaggio (1988) noted, "[T]he theoretical accomplishments of institutional theory are limited in scope to the diffusion and reproduction of successfully institutionalized organizational forms and practices. . . . Institutional theory tells us [little] about deinstitutionalization: why and how institutionalized forms and practices fall into disuse" (p. 12). Institutionalists have offered two explanations for deinstitutionalization. First, new practices can displace old ones. Peripheral players in a field may introduce practices which come to be seen as preferable to existing arrangements, or conversely core members of a field may adopt a new practice, and other members of the field follow suit (Leblebici, Salancik, Copay, and King 1991; Burns and Wholey 1993). Second, practices can simply be abandoned, either by force, as when federal antitrust regulation in effect ruled out horizontal mergers (Fligstein 1990), or voluntarily, as when hospitals that had adopted a matrix structure subsequently dropped it (Burns and Wholey 1993). These processes are not mutually exclusive; for example, after the Celler-Kefauver Act of 1950 restricted horizontal and vertical mergers, fringe players introduced the practice of unrelated diversification, which subsequently spread widely among established corporations (Fligstein 1991).

The process of deconglomeration does not fit readily into either of these explanations of deinstitutionalization. Bust-up takeovers did not introduce a new organizational structure, but delegitimated an old one—conglomerate firms were taken over and broken up specifically because of their organizational form. The actors responsible for spreading this tactic were often not other organizations—peripheral or core—but simply groups of individuals who saw an opportunity for profit and, implicitly, held alternative views of appropriate corporate structure (Coffee 1988). From the perspective of large corporations, bust-up takeovers were not a voluntary practice, introduced by either fringe or core players; indeed, takeovers were done *to* core players, not *by* them. Further, in contrast to the conglomeration movement of the 1960s, the state did not single-handedly rule out particular practices (such as unrelated acquisitions), but rather deregulated a wide range of practices, allowing the field to evolve on its own. Finally, both explanations of the process of deinstitutionalization described previously take for granted that an organizational field consists of a set of organizations as meaningfully bounded social actors that is relatively stable over time—it is organizations that act, and they adopt and discard practices (organizational strategies and structures) more or less voluntarily (subject to constraints imposed by the state). Yet perhaps the most radical concomitant of the deconglomeration movement was the undermining of the notion of organizations as primordial social units in favor of a radical individualist view in which corporations were simply "financial tinker toys" which could be rearranged at whim, without regard for organizational boundaries (Gordon 1991). Ironically, it was the firm-as-portfolio model itself that made this imagery credible (Espeland and Hirsch 1990). Thus, to accommodate deconglomeration, institutionalist arguments need to be expanded to accommodate contradictions inherent in institutionalized aspects of organizations (Leblebici et al. 1991).

We investigate empirically how the process of deconglomeration occurred and offer an institutionalist interpretation for how corporate practices and rhetoric co-evolved during the 1980s. Like most institutional stories, ours is

in essence a case study of a single organizational field during a particular time period—the 500 largest American industrial corporations during the 1980s. As with all case studies, it is difficult to draw strong causal inferences, because there are no comparison cases—say, another field of 500 large corporations with an alternative regulatory regime. Thus, while our data comprehensively document the widespread abandonment of practices associated with the firm-as-portfolio model, our interpretation of the cognitive factors underlying the data is of necessity somewhat speculative. Like most singular historical events, deconglomeration was overdetermined. Yet, we believe that the shifts in rhetoric that accompanied deconglomeration reflected an institutional shift that was not simply epiphenomenal (Hirsch 1986). Corporate practices reflect underlying models of appropriate action, which in turn are shaped by prior models and practices. Thus, we contend that the move to extreme vertical disintegration in the late 1980s arose in reaction to the firm-as-portfolio model and the subsequent deconglomeration movement.

INSTITUTIONALIZATION, DEINSTITUTIONALIZATION, AND ORGANIZATIONAL BOUNDARIES

Researchers under the banner of the New Institutionalism have documented several episodes of institutionalization (DiMaggio and Powell 1991). The meaning of "institution," however, is somewhat unclear in their work, except that it resembles the notion of "norm" (Scott 1991): Social relations and actions are institutionalized when they come to be taken for granted (Zucker 1983) or associated with situations via rules of appropriateness (March and Olsen 1984); conventions are institutions when they "take on a rulelike status in social thought and action" (Meyer and Rowan 1977: 341); and so on. In short, organizational forms and practices are institutionalized when they are adopted because actors take them for granted, rather than because a rational choice process found them to be best suited for the technical requirements of the task. Judgments of appropriateness are not based solely in individual cognitions, but follow from cognitive structures, such as scripts and schemas, that are more-or-less shared across societies (DiMaggio and Powell 1991). Moreover, notions of appropriateness impose what is in effect a cognitive viability test on organizational forms and practices: While a variety of social structural arrangements may be possible and technically adequate in principle, to be adopted they must be cognitively "available" to the relevant actors—to both potential adopters and those providing resources. What is available, as well as what is ruled out, follow in part from what has gone before. Thus, imitation and rule-following reduce some of the "cognitive start-up costs" for organizations (DiMaggio and Powell 1991).

In empirical work, institutionalization is typically operationalized by prevalence within a given population of organizations rather than through direct assessments of "taken-for-grantedness" by aggregates of relevant actors. One sign of institutionalization is widespread adoption of a form or practice, independent of evidence that it "works." Thus, Tolbert and Zucker (1983) found that cities implementing civil service reforms early on tended to have good reasons for doing so, while late adoption of the reforms was not associated with such reasons, indicating that the reforms had become institutionalized. Controlling for the individual characteristics that commonly prompt adoption, Fligstein (1985) showed that firms were more likely to adopt a multi-divisional structure when other firms in their industry had done so, and Burns and Wholey (1993) found that hospitals were more likely to adopt a matrix structure when a large proportion of other hospitals in their region had.

But these characterizations of institutionalization offer little sense of when deinstitutionalization can or will occur and imply that institutionalization is a once-and-for-all process. According to this view, absent a disruptive exogenous force, such as the state ruling out a practice that has become common (Fligstein 1990), institutions apparently don't budge: Once a sizeable proportion of actors adopt a social structural arrangement, it remains widespread. Unlike most institutionalist writers, however, Douglas (1986) has given an exceptionally clear notion in cognitive terms of what defines institutions and what sustains them; from Douglas we can derive implications regarding when deinstitutionalization is likely to occur. An institution is a convention that has become legitimized. Conventions arise when

parties have a common interest in a rule or arrangement that coordinates their actions (e.g., having a speed limit). A convention is legitimized when it is able to withstand challenges based on instrumental grounds. The source of this legitimacy is the "naturalizing analogy," a parallel cognitive structure that sustains the institution by demonstrating its fit with the natural order. When a convention has been institutionalized, it is no longer simply mutual convenience that accounts for why things are done in a particular way, but the convention parallels other aspects of the way the world works and is therefore "natural" (Douglas 1986).

Analogies provide a source of stability for conventions by "scripting" appropriate behavior, and they are a potent rhetorical resource for ordering social arrangements. For example, radio airwaves were initially an unfamiliar medium, and the way that radio frequencies should be allocated by the government was initially unclear. Radio was seen as analogous to a public utility (like the post office) or a "magazine of the air," but eventually an analogy to transportation was settled on—"radio as public waterway"—and appropriate regulatory structures then fell into place (Leblebici et al. 1991).[2] Analogies have their limits, however, and not just any analogy is sufficient to legitimate a practice or structure. Without an authoritative analogy, an institution becomes vulnerable, suggesting a basis for deinstitutionalization and a limit to what institutions can be sustained.

The use of naturalizing analogies to legitimate organizational arrangements has a long history, with the "organization as body" analogy playing a particularly prominent role since before the Middle Ages. Sewell (1980) described the status of corporate actors in France prior to the Revolution, when the king established social groupings, such as guilds, "en corps et communaute"—as a body and community, subsequently considered a single person under the law. The term "corps"—body—implied a set of analogical characteristics:

> All bodies were composed of a variety of organs and members, which were hierarchically arranged and were placed under the command of the head. Each body was distinct from every other, with its own will, its own interests, its own internal order, and its own esprit de corps. Each body was made of a single internally differentiated but interconnected substance, and harm inflicted on any member was felt by the whole. (Sewell 1980:36–37)

Thus, organizations were sovereign, and members were wholly contained within them having no separate legal existence. The French Revolution manifested an explicit effort to do away with such bodies, recognizing as sovereign only the individual and the state with no intermediary entities, but the compelling force of the body analogy was not so easily displaced (Sewell 1980). Coleman (1974) documented the origins of the modern corporate form and showed how corporations came to be "juristic persons" with rights and interests that are not simple aggregations of their members' interests. These artificial persons had distinct legal personalities and, unlike their Medieval predecessors, did not wholly contain their (voluntary) members. Yet, they were still meaningfully referred to as actors. Thus, the legal conceptualization of the corporation relied on and furthered the analogy of the organization as body. Moreover, the perceived rightness and naturalness of the analogy is evident even in theoretical discourse on corporations. Discussions of organizational birth, growth, and death are considered unexceptionable, not transparently metaphorical (Scott 1992).

The body analogy implies a way of thinking about what an organization is—a bounded social structure composed of members—as well as a set of desiderata (e.g., growth and survival) that can guide action and provide a basis for the adoption of organizational practices and forms. Perhaps the most basic aspect of an organizational form is the placement of boundaries—which activities are done inside or outside the organization and which individuals are considered "members" underlie an organization's very identity. Divergent notions about the appropriate placement of organizational boundaries for business corporations have been prevalent in different industries and at different points in history. Transaction cost economists analyze this as the "make or buy" or "efficient boundaries" problem—should an organization buy an input on the market or make the input itself, thus bringing the activity within the organization's boundary. For example, auto manufacturers may have different answers to the question of whether steel should

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[2] Compare this to recent national discussions about the "information superhighway."

be made or bought. Transaction cost analysis suggests that the appropriate answer turns on asset specificity—in short, the extent to which buyers and sellers make investments that are specific to their relationship and which lose value if the relationship is discontinued (Williamson 1975). When such relationship-specific investments are necessary, Williamson argued, it is more efficient to bring the activity within the boundary of the firm. Against this view, however, Granovetter (forthcoming) pointed out that there is interesting variation across cultures and over time in how economic activities are grouped together, with parts of production processes differentially grouped within firms and firms often grouped into culturally specific supraorganizational structures, such as the *keiretsu* in Japan and the *grupos economicos* in Latin America. The degree of variation across cultures suggests that more than efficiency considerations are governing decisions and that there is an institutional or normative element to the placement of organizational boundaries.

Prevalent ideas about the appropriate placement of organizational boundaries have changed in substantial ways throughout U.S. corporate history (Chandler 1977; Fligstein 1990). A driving principle throughout this history is that bigger is better—that organizational growth (expanding the organization's boundary) is an appropriate end to pursue. Organizations can grow through internal expansion or through acquiring or merging with other organizations. Three merger waves prior to the 1980s manifested each of the following as prevalent means of expanding organizational boundaries: horizontal growth (acquiring competitors) at the turn of the century, vertical growth (acquiring buyers or suppliers) during the 1920s, and diversification (acquiring businesses producing related or unrelated products) during the 1960s (Weston, Chung, and Hoag 1990). The question for institutional analysts is, what was legal and what was appropriate? Because the historical shifts underlying each of these different dominant notions of appropriate organizational growth have been amply documented elsewhere (Chandler 1977; Fligstein 1990), we focus here on only the last model—that of diversification as an organizational growth strategy and on the conglomerate as an organizational form—which we refer to as the "firm-as-portfolio" model.

THE CONTEXT OF CONGLOMERATION

In the United States in 1980, the dominant model of strategy and structure for large corporations was the firm-as-portfolio model (Fligstein 1991). The firm-as-portfolio model implies both a practice (growth through diversification) and a form (the conglomerate). Unrelated diversification entails buying businesses in industries that are neither potential buyers, suppliers, competitors, or complements to the firm's current business. For example, an appliance manufacturer buying a stock brokerage house is an instance of unrelated diversification. The organizational form that typically results from unrelated diversification is the conglomerate, a corporation with relatively autonomous business units operating in numerous unrelated or weakly related industries and a corporate headquarters acting as an internal capital market, allocating resources among the units. The firm-as-portfolio model was promoted through a range of institutional processes over a period of three decades, including the actions of the state, organizational imitation, the advice of business consultants, and the efficiency rationales of organizational theorists.

The federal government inadvertently promoted corporate diversification through its antitrust policies, which successively eliminated horizontal and vertical growth as viable options for large firms (Bhagat et al. 1990). Unrestrained horizontal growth can lead to an industry being dominated by a monopoly; unrestrained vertical integration where supplies are limited may allow firms to bar their competitors from access. In either event, the effects of such growth were thought to be anticompetitive, and antitrust policy—particularly the Celler-Kefauver Act of 1950—substantially reduced the possibility of horizontal and vertical growth after 1950 (see Weston et al. 1990:chap. 23 for a concise discussion of U.S. antitrust law). Thus, firms seeking to expand their boundaries were forced to look beyond their primary industry and their buyers' and suppliers' industries for acquisition candidates, and large numbers of firms did this during the 1960s and 1970s, creating the conglomerate merger wave. A handful of highly visible firms—the "acquisitive conglomerates"—experienced dramatic growth through unrelated diversification, prompting other or-

ganizations seeking growth to imitate their strategy. The prevalence of this strategy within industries also appears to have been self-reinforcing, as firms were more likely to switch to a strategy of unrelated diversification when others in their industry had previously done so (Fligstein 1991). Corporations rushed to adopt the firm-as-portfolio model, despite the fact that the evidence on conglomerates' profitability was ambiguous at best and disastrous at worst (Black 1992), thus supporting the interpretation that the model was spread more through institutional than market-based processes (Fligstein 1991).

The firm-as-portfolio model was also promoted by management consultants, who spread so-called "portfolio planning" techniques that allowed top corporate managers to deal with the unrelated business units they faced by treating them as analogous to stocks in a portfolio (Haspeslagh 1982). Portfolio planning entailed (1) defining "strategic business units" within the corporation, (2) classifying the units according to their position in their industry and the attractiveness of that industry, and (3) assigning resources across the business units based on a corporate strategy. The Boston Consulting Group, McKinsey, Arthur D. Little, and other consulting firms developed "portfolio grid technologies" for the second part of this process, which reduced what top managers had to know about a business unit to simply the unit's position on an industry grid. Coupled with cash-flow statements, this was virtually all headquarters management needed to manage the corporation as a portfolio. Such techniques spread rapidly during the 1970s, and by 1979, 45 percent of the *Fortune* 500 companies—upwards of 75 percent of the diversified ones—had adopted portfolio planning, with more companies joining the firm-as-portfolio fold every year (Haspeslagh 1982). Operational knowledge about particular industries was no longer required to manage businesses in those industries, in principle allowing organizational boundaries to expand without limit.

Finally, organizational economists provided a theoretical legitimation for the firm-as-portfolio model. From a financial perspective, conglomerates are merely "mutual funds with smokestacks" and redundant headquarters staffs (Espeland and Hirsch 1990:78). Moreover, unlike individual investors, who can easily change the distribution of holdings in their portfolios, conglomerates are more attached to their divisions and it is more costly to move into and out of businesses as conditions warrant (Porter 1987). The prevalence of the conglomerate form was therefore puzzling to economists with an efficiency orientation. While isolated instances of diversification into unrelated businesses could be dismissed as managerial empire-building, the large number of conglomerates developing in the United States required an efficiency-based explanation. Thus, Williamson (1975:chap. 9) argued that conglomerate acquisitions were a tool for well-run multidivisional form (M-form) corporations to spread their management talents. Conglomerate acquisitions by M-forms did not represent inefficient empire-building by managers, according to Williamson (and contrary to most empirical evidence [Amihud and Lev 1981]); rather, these acquisitions were missionary work meant to rehabilitate poorly-run businesses—the M-form's burden. The M-form conglomerate profited by identifying and buying undervalued targets and running them more effectively by implementing appropriate internal financial controls, ultimately benefiting economic efficiency (Williamson 1975).

The result of these processes was the widespread adoption of the firm-as-portfolio model by large corporations. By the early 1980s "almost all of the [100] largest firms [were] significantly diversified and set up in divisions" (Fligstein 1990:256), and "the concept of corporate strategy most in use [was] portfolio management, which is based primarily on diversification through acquisition" (Porter 1987:49). Only about 25 percent of the 1980 *Fortune* 500 operated exclusively in a single 2-digit SIC industry, while over half operated in three or more. Prevalence of forms and practices is an imperfect proxy for institutionalization, to be sure. Yet all the indicators suggest that the firm-as-portfolio model was widely regarded as an appropriate one for the management of large corporations. To the extent that notions of institutionalization are applicable to large corporations, there is a strong case for regarding the spread of the firm-as-portfolio model—in the absence of good evidence that the model promoted profitability—as an instance of institutionalization.

CHANGES IN THE INSTITUTIONAL CLIMATE DURING THE EARLY 1980s

Despite the widespread adoption of the firm-as-portfolio model by the largest American corporations during the 1960s and 1970s, there was little evidence that it "worked" and mounting evidence that it did not work by one crucial metric: the stock market valuation. According to Black's (1992) review, "The evidence that corporate diversification reduces company value is consistent and collectively damning" (p. 903). Even as early as the 1960s, the financial performance of conglomerates was, on average, inferior to that of randomly-selected portfolios of firms operating in the same industries (Mason and Goudzwaard 1976). By the 1980s, the practical implications of this fact had become apparent, and a small industry developed around detecting corporations undervalued by the stock market. For example, LeBaron and Speidell (1987) of Batterymarch Financial Management created a "Chop Shop" valuation model to determine how much a conglomerate would be worth if it were broken up and the parts were sold off. They found that, in general, the sum of the potential stock market value of the parts of a conglomerate was substantially more than the actual stock market value of the whole. Furthermore, this differential increased with the degree of diversification: "The more divisions a company has, the more it is likely to be undervalued" (LeBaron and Speidell 1987:87). Note that inherent in this valuation model is the idea that activities "inside" the organizational boundary should be subject to the same market tests as those "outside" it (Meyer 1991) and, moreover, that decisions about what activities are appropriate within a particular corporate boundary are not the sole province of those running the corporation, but are revocable by the market.

In addition, the policies that supported the conglomerate form changed substantially during the early Reagan years. The so-called Chicago School of antitrust law and economics gained policy dominance in the early 1980s at the Federal Trade Commission (FTC) (where Chairman James C. Miller III attempted to eliminate the FTC's antitrust arm entirely), and at the Justice Department (where William F. Baxter, assistant attorney general for antitrust, required that any proposed antitrust investigations and cases be cleared with the house economists). Horizontal mergers were no longer scrutinized simply on the basis of the industry concentration that would result; rather, several factors were taken into account before a merger would be considered anticompetitive. In effect, this reduced the barriers to acquisitions in the same industry (Weston et al. 1990). Reduced antitrust barriers meant that in principle the parts of conglomerates could be sold to acquirers in the same industries. Legal barriers to hostile takeovers also fell early in the Reagan years. In the *Edgar v. MITE* (457 U.S. 624 [1982]) decision, the U.S. Supreme Court overturned the laws that made takeovers difficult in most states, and the Reagan Administration, relying on the arguments of Chicago School economists who lauded the efficiency effects of an active market for corporate control, demonstrated a principled resistance against regulations that might make takeovers more difficult (Stearns and Allan 1993).

At roughly the same time as these regulatory changes, innovations in takeover financing emerged that made conglomerates potential targets for "bust-up takeovers" by outside raiders. In a typical bust-up takeover, the raider would identify a conglomerate with readily separable parts and find buyers for some or all of the parts in advance of the takeover attempt. Based on the presale of the separated parts, the raider could secure short-term debt financing through junk bonds or other financial vehicles to complete the takeover, sell the parts, and retire some or all of the debt with the proceeds from the bust-up (see Lipton and Steinberger 1988 for a discussion). One implication of this is that the raider could complete a takeover using very little of his or her own cash—like a mortgage on a house, the value of the property being purchased secured most of the financing. This enabled small firms or even groups of individuals to buy much larger corporations, whereas previously the privilege of acquiring large firms was effectively limited to a pool of even larger corporations (Coffee 1988).

By the early 1980s, then, the model of appropriate corporate practice that had guided the strategies and structures of the largest American corporations had been drastically undermined. The firm-as-portfolio model had weakened corporate financial performance, the regulatory regime that had promoted and sustained the model was gone, and the financial barriers to outside challengers were reduced.

Nonetheless, fundamental change in the strategies and structures that prevail across a large organizational field is not a trivial matter, particularly when these practices have been championed by powerful actors. Voluntary change under such circumstances is unlikely, as institutional theorists point out (DiMaggio and Powell 1983). Indeed, by some accounts one of the defining features of an institution is that powerful actors take an active role in its reproduction (Stinchcombe 1968). Firms had continued to make unrelated acquisitions long after they had solid reasons to doubt their profitability, which some have argued indicates that unrelated corporate diversification flowed from managerial discretion (Amihud and Lev 1981). An alternative route to widespread change would entail ousting the individuals who ran the largest American firms and who had assembled the conglomerates in the first place through hostile takeovers. The last time unwanted takeovers had threatened the position of the corporate elite on a large scale, the call for federal protection was swift and effective, culminating in the Williams Act of 1968 (Hirsch 1986), and by some accounts the Reagan Administration was uniquely indebted to the corporate elite for its election (Useem 1990). No such protection was forthcoming during the 1980s, however, as Reagan-era policy was guided by a free market stance that ruled out regulation of the so-called "market for corporate control" (Roe 1993). Appeals by the powerful would not be sufficient to save the firm-as-portfolio model.

Perhaps the only remaining barrier to widespread abandonment of the firm-as-portfolio model was its status as an institution, which by definition provides a buffer against challenges that arise out of instrumental or pecuniary concerns alone (Douglas 1986). Institutionalized organizations are, in Selznick's phrase, "infused with value" not reducible to economic measures (Selznick 1957), which helps account for the vigorous efforts put forth by members of chronically underperforming organizations to prevent their (economically sensible) demise (Meyer and Zucker 1989). For external actors to compare parts of organizations to market alternatives and to buy and bust up those that fail the market test is to undermine the notion that corporations as organizations can carry noneconomic value (Meyer 1991). Bust-ups render organizational boundaries provisional at best, meaningless at worst, leaving corporations to be financial tinker toys rather than bounded social structures (Gordon 1991). In short, widespread deconglomeration challenges some of the most fundamental aspects of organizations as institutions.

The tensions we have outlined between the firm-as-portfolio model and pressures for market performance drove much of the evolution of the field of the largest U.S. corporations during the 1980s. We now examine four types of evidence regarding changes in these firms' structures and practices: (1) the degree to which diversified firms experienced a greater risk of being taken over, (2) the prevalence of conglomerate (and other) acquisition strategies during the late 1980s, (3) changes in the prevalence of the conglomerate form between 1980 and 1990, and (4) changes in business rhetoric regarding appropriate organizational structures and practices.

THE TAKEOVER RISK OF DIVERSIFIED FIRMS

Bust-up takeovers of diversified firms received a great deal of attention in the media, but despite research documenting the extent to which takeovers were followed by sell-offs (Bhagat et al. 1990; Ravenscraft and Scherer 1987), no previous research has documented whether diversified firms faced a systematically greater risk of takeover than undiversified firms in the 1980s. Our first task, then, is to determine whether this was the case. We examine the effect that a firm's degree of diversification had on its risk for takeover using dynamic analyses covering all takeovers of firms in the 1980 *Fortune* 500 over the course of the 1980s. Based on prior research on the factors that lead to takeover (Palepu 1986; Morck, Shleifer, and Vishny 1989; Davis and Stout 1992), we control for size (sales), performance (market-to-book ratio), age, growth rate, debt structure, ownership by financial institutions, and whether the CEO came from a background in finance.

Data and Variables

Because we were interested in assessing changes affecting large U.S. corporations in general, we focused on an entire population rather than on a sample. Thus, we tracked the

1980 *Fortune* 500 from January 1, 1980 to December 31, 1990. Of interest to us was whether a firm became subject to a takeover attempt, successful or otherwise, during this time period. Because firms can only be taken over if their stock is publicly traded, we excluded any nonpublic firms, such as foreign subsidiaries, joint ventures, and agricultural cooperatives. We were left with an effective sample size of 467 firms before exclusions for missing data.

Under the Williams Act, anyone offering to buy 5 percent or more of a firm's shares is required to immediately disclose the details of the offer by filing Form 14D-1 with the Securities and Exchange Commission. The dates of these filings are available in the *SEC Bulletin* and, for the years after 1985, on *Compact Disclosure*. Using these sources, we determined the date on which any firm in our population was first subject to a takeover bid. Details of the offers, including whether they ultimately ended with a takeover, were compiled using the *Wall Street Journal Index*. In 10 cases the first bid was a "friendly" offer initiated by the firm's own management (i.e., a management buyout attempt). These were not considered to be takeover attempts, but rather censoring events which removed the firms from the population at risk for takeover.

Data on diversification were acquired from Standard and Poor's Compustat service for 1980. Firms are required annually to disclose accounting data from operations at the level of the business segment on Form 10-K filed with the SEC. Compustat reports sales and other data by segment as well as classifying segments into industries using up to two 4-digit SIC codes for each segment. Using these data, we calculated the entropy measure of diversification for each firm (Jacquemin and Berry 1979). The entropy measure of total diversification (DT) taps the extent to which a firm operates in a number of industries using a weighted average of the proportion of a firm's sales made in each of the industry segments in which it operates:

$$\mathrm{DT} = \sum P_i \ln(1/P_i),$$

where P_i is the proportion of the firm's sales made in segment i. An advantage of this measure is that it is continuous: Rather than crudely classifying firms as "diversified" or "undiversified," this measure captures the *degree* of diversification, which gives it more subtlety than the categorical measures of diversification popular in the 1970s (see Palepu 1985 for a discussion of the properties and merits of the entropy measure). For firms that operate in only a single industry, $\ln(1/1) = 0$ and therefore DT = 0. Among the 1980 *Fortune* 500, the median firm's level of diversification was DT = 1.0; Minnesota Mining and Manufacturing was the most diversified, with DT = 2.2, followed by Beatrice, AMF, US Industries, and ITT.

Size is measured by sales. *Performance* is measured using the market-to-book ratio, that is, the ratio of the stock market value of the firm's equity to its book (accounting) value. A high market-to-book value indicates that the stock market values the firm more highly than its reported value, and consequently, that the firm cannot be bought at a bargain price. *Age* is the number of years between the year of incorporation and 1980. *Growth rate* is the yearly percentage increase (decrease) in the size of the firm's work force. *Debt structure* is the ratio of the long-term debt of the firm to its market value. A higher value on this measure implies that the firm is financed more through debt than equity. *Institutional ownership* is measured as the percentage of the firm's equity held by financial institutions (primarily banks, insurance companies, pension funds, and mutual funds). *Finance CEO* is a dummy variable indicating whether the CEO's educational and departmental background was primarily in finance or in another functional area. Annual data on size, performance, growth, and debt for 1979 through 1989 (inclusively) were taken from Standard and Poor's Compustat. Dates of original incorporation were taken from *Standard and Poor's Stock Market Encyclopedia* (various years b) and *Moody's Industrial Manual* (Moody's various years). Institutional ownership data came from the *Spectrum 3 13(f) Institutional Stockholding Survey* (Computer Directions Advisors, Inc. 1980). CEO functional backgrounds were coded from annual surveys of executive compensation in large corporations published by *Forbes* (1980, 1981). The *Forbes* sample of firms covered only about three-quarters of the firms in the *Fortune* 500; thus, we ran two sets of models, with and without this indicator.

Method

Because we had data on the exact dates of all takeover attempts for all firms in our popula-

Table 1. Event History Analysis of Takeover Bids for 1980 *Fortune* 500 Firms, 1980 to 1990

Variable	All Bids		All Successful Bids	
	Model 1	Model 2	Model 3	Model 4
Sales	-.0001 (-1.546)	-.0001 (-1.639)	-.0001 (-1.492)	-.0001 (-1.461)
Market/book	-.3178* (-3.639)	-.2968* (-3.302)	-.2837* (-2.883)	-.2725* (-2.653)
Age (log)	.2519 (1.321)	.1685 (.763)	.2019 (.990)	.1256 (.523)
Growth rate	-.0125* (-2.116)	-.0093 (-1.405)	-.0110 (-1.698)	-.0059 (-.797)
Debt structure	-.6553* (-2.677)	-.7209* (-2.430)	-.7587* (-2.634)	-.9256* (-2.497)
Institutional ownership	-.0115 (-1.863)	-.0143 (-1.956)	-.0161* (-2.386)	-.0207* (-2.555)
Diversification	.6545* (3.401)	.6543* (2.890)	.5688* (2.717)	.6453* (2.568)
Finance CEO	—	.5019* (1.987)	—	.2649 (.874)
Number of cases	423	322	423	322
χ^2	43.7*	45.1*	35.7*	34.7*
d.f.	7	8	7	8

*$p < .05$ (two-tailed test)

Note: Numbers in parentheses are t-values.

tion, we were able to use event history techniques to determine the effects of the covariates on the firms' risks of takeover over time. We used a Cox model with time-changing covariates, where a firm's risk of takeover depended on its prior level of diversification, size, and so on (Cox 1972; Tuma and Hannan 1984:chap. 8). Roughly 30 percent of the firms at risk for takeover (i.e., publicly traded) were subject to a takeover attempt during our time frame. The others were considered censored cases. Firms in these models were deleted after the first takeover attempt; that is, a takeover attempt was considered a fatal event. A second set of models included only successful takeover attempts, that is, nonmanagement tender offers that ended with the firm being acquired. In these models, firms not taken over were considered censored cases.

The data were divided into up to 11 spells (firm-years). Firms that were not subject to an outside takeover attempt and did not leave the population for other reasons (such as bankruptcy or a management buyout) had 11 years of data, while those that were taken over or otherwise left the population of publicly-traded firms had fewer years of data. Level of diversification, age, institutional ownership, and finance CEO were measured as of 1980; the other measures were updated annually.

Results and Discussion

The results of our analysis are presented in Table 1. The first two columns present results when the outcome is defined as the initiation of an outside takeover bid (that is, a tender offer not initiated by management). The third and fourth columns present results when the outcome is defined as the initiation of an outside takeover bid that ultimately ended in the firm being acquired (i.e., a "successful" bid). Consistent with previous research, firms with a high market-to-book ratio and firms with substantial debt faced a significantly lower risk of becoming takeover targets in all four models. Firms owned proportionally more by institutional investors were significantly less likely to be subject to successful takeover attempts in Models 3 and 4, but this effect was only marginally significant ($p < .10$) when all bids were included (Models 1 and 2). Growing firms

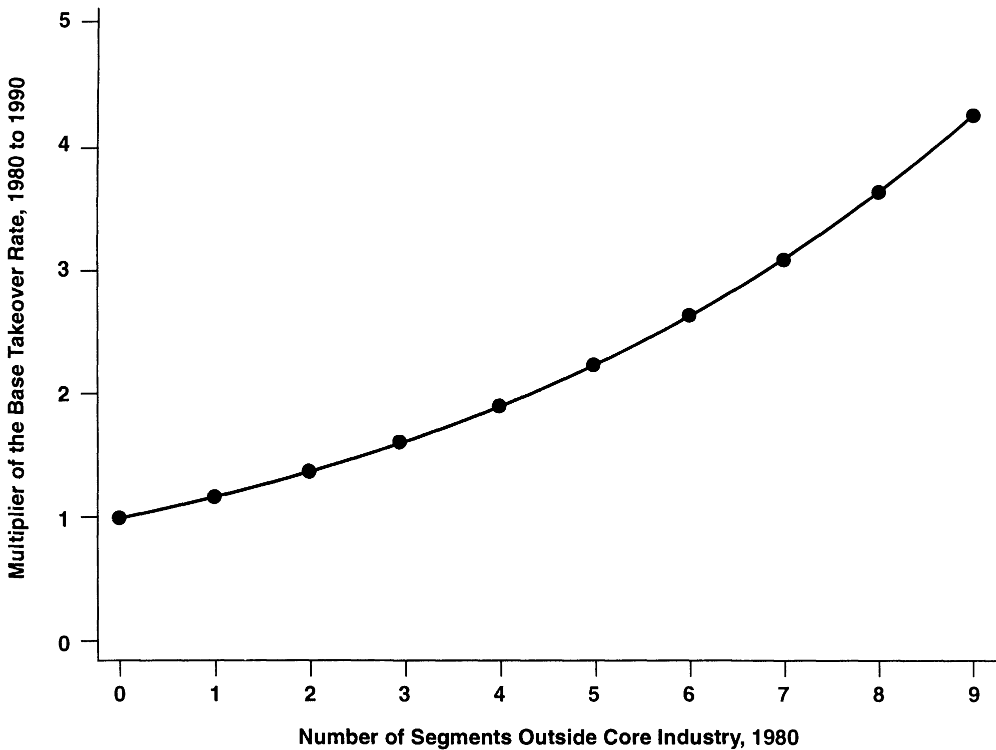

Figure 1. Effect of Corporate Diversification on Risk for Successful Takeover: 1980 *Fortune* 500 Firms, 1980 to 1990

were less likely to become subject to a takeover attempt (Model 1), but this effect was not statistically discernible in Model 2 when the Finance CEO variable was included, or in Models 3 and 4 when only successful bids were considered. Finally, firms with finance CEOs were significantly more likely to become targets (Model 2), but were no more likely to be taken over successfully (Model 4).

Controlling for all these other factors, firms faced a significantly greater risk of takeover to the extent that they were diversified in all models ($p < .05$). To interpret the effect of diversification on takeover risk, we exponentiated its estimated coefficient, which gives the multiplier of the rate of takeover that firms in this population experienced. The estimated multiplier effect of diversification is about 1.92 in Model 1; thus, firms at the median level of diversification (DT = 1.0) were subject to takeover attempts at a rate 92 percent higher than comparable firms operating in a single industry (DT = 0), while firms at the 75th percentile of diversification (DT = 1.36) faced 2.6 times the risk of takeover. These results are not dependent on our measure of diversification: identical results were obtained when a simpler measure—the raw number of business segments in which a firm operated—was substituted. Figure 1 shows the effect that the number of segments in which a firm operated had on the firm's risk of being successfully taken over using a model that substitutes number of segments for the entropy measure of diversification in the third column of Table 1. As the figure shows, firms operating in the largest number of business segments in 1980 were taken over at more than four times the rate of firms operating in only one business segment. Thus, net of other variables and using different measures, the more diversified a firm was, the higher the rate at which it was subjected to takeover attempts and the more likely it was to be taken over.

The finding that diversified firms were substantially more likely to be taken over than focused firms differs markedly from the results of a study of takeovers of *Fortune* 500 firms during the previous merger wave in the 1960s. Using similar measures and statistical analyses for a parallel sample over the years 1963

through 1968, Palmer et al. (1993) failed to uncover any significant relation between a firm's level of diversification (measured as the number of 2-digit SIC industries in which the firm operated) and its risk of being taken over. The effect of diversification on takeovers thus appears to have been new in the 1980s.

Although we cannot directly address the subsequent fate of the firms in our sample that were taken over, other researchers have done so for the middle years of our sample period. Bhagat et al. (1990) analyzed the outcomes of all hostile takeover bids between 1984 and 1986 that involved a purchase price of $50 million or more; these data encompass all hostile bids in our sample for those years. Bhagat et al. found that 72 percent of the acquired assets ended up by being owned by corporations in the same businesses. In over one-fourth of the cases, the proceeds from selling off parts of a firm after an acquisition amounted to at least 50 percent of the purchase price. "By and large, then, bustups fit very closely into the picture of strategic acquisitions. Either the original buyer in a hostile takeover keeps the parts it wants, often selling the others to strategic buyers as well; or the company is broken up and sold off largely to strategic buyers" (Bhagat et al. 1990:51). In combination with our results, this indicates that conglomerates were substantially more likely to be taken over than focused firms and that the individuals or firms which bought them busted them up in whole or in part, keeping the divisions that were in related lines of business and selling the unrelated parts to other related buyers.

ACQUISITIONS IN THE LATE 1980S

It is now clear that the firms that had previously pursued diversification were at a substantially greater risk of takeover during the 1980s than the firms which had shunned conglomerate growth. It is less evident, however, whether the firms that remained independent recognized the implication of this increased risk, or whether the firm-as-portfolio model maintained influence over the growth strategies of large firms. Research on patterns of acquisitions during the 1980s has been somewhat limited, and no prior study has systematically examined the prevalence of different types of acquisitions during this time period. Much of the relevant literature has been in financial economics and has focused on the effects of acquisitions on the acquiring firm's share price, rather than on providing a "census of acquisitions" (e.g., Lewellen, Loderer, and Rosenfeld 1985; Mitchell and Lehn 1990; Morck, Shleifer, and Vishny 1990). Thus, to characterize broad trends in the prevalence of different acquisition practices, we collected data on all significant acquisitions by *Fortune* 500 firms for the five years from 1986 to 1990, inclusively.

Data and Variables

Our population included all firms listed in the 1986 *Fortune* 500. Again, firms were excluded if they were not publicly-traded corporations. This left us with an effective sample size of 437 firms, after exclusions for missing data. To allow for the construction of a takeover market to have an effect on firms' acquisition patterns, our time frame began in 1986 and ended in 1990; thus, we had five complete years of data on acquisitions.

For acquisitions prior to 1980, the Federal Trade Commission published data on merger activity in the United States, breaking mergers into horizontal, vertical, product extension, market extension, and pure conglomerate. Unfortunately, this service was discontinued and no replacement has been implemented. Thus, we compiled comparable data for the years of our study by (1) determining all significant acquisitions made by the firms in our sample and (2) coding each acquisition using a scheme comparable to the one used by the FTC. Data on acquisitions were drawn from *Mergers and Acquisitions* (1986–1990), which contains compendia widely acknowledged to be the most complete sources of information on merger activity in the United States (Golbe and White 1988). We included only full acquisitions that were large enough to be considered significant. We used a purchase price of $25 million as a minimum cutoff; for comparison purposes, the annual sales of the smallest firm in the 1986 *Fortune* 500 was $424 million. For each acquisition, a 4-digit SIC code for the business was assigned from *Standard and Poor's Register of Corporations* (Standard and Poor's various years a). In cases where *Standard and Poor's* had no data on the acquired business, SIC codes were assigned based on the description of the business in *Mergers and Acquisitions* (1986–1990).

We classified acquisitions as horizontal, related, vertical, and conglomerate using a modified version of Ravenscraft and Scherer's (1987) scheme. *Horizontal acquisitions* were those where the acquiring and target firms shared a 4-digit SIC code; *related acquisitions* were those where the acquiring and target firms shared a 2-digit SIC code, but not a 4-digit code; and *vertical acquisitions* were those where the acquiring firm and target firm operated in industries with significant buyer-supplier relationships (that is, where 5 percent or more of the dollar value of the acquiring firm's industry's inputs came from, or outputs went to, the target firm's industry, according to the Bureau of Economic Analysis's [1991] 6-digit Industry Input-Output matrix for 1982). *Conglomerate (unrelated) acquisitions* were those that did not fit any of the above categories.

Categorizing mergers posed unique problems, because most firms in this population were already somewhat diversified. Thus, for example, imagine a vertically-integrated auto manufacturer that generates 75 percent of its sales in its auto division and 25 percent in its steel division. Acquisition of a steel company could be classified as vertical (for the auto division) or horizontal (for the steel division). We overcame this by using business segment data for the acquiring firm for 1985 from *Standard and Poor's Compustat*, *Moody's Industrial Manual* (1985), and annual reports. For each business segment we had the percentage of the firm's sales and a primary and secondary 4-digit SIC code pertaining to the segment. Firms report financial information on up to 10 segments; thus, an acquirer could have up to 20 SIC codes. Using these data, we broke acquisitions into three size classes, pertaining to matches with segments composing 70 percent or more of the acquirer's sales, 20 percent to 70 percent, or below 20 percent. An acquisition's final categorization was determined by the largest of the three classes to which it could be assigned. Thus, in our hypothetical example, the steel company acquisition would be classified as vertical for the first size class and horizontal for the second size class; therefore, we would categorize it as a vertical acquisition.[3]

[3] Details of our classification procedure are available upon request from the authors.

Table 2. Percentage Distribution of Acquisitions by 1986 *Fortune* 500 Firms, 1986 to 1990

	Type of Acquisition			
Number of Acquisitions	Horizontal	Vertical	Related	Conglomerate
0	76.1	94.7	75.5	85.1
1	16.7	4.6	17.9	11.5
2	5.3	.7	5.0	2.5
3	.7	.0	.9	.0
4	.5	.0	.7	.5
5	.2	.0	.0	.0
6	.0	.0	.0	.0
7	.2	.0	.0	.5
8	.2	.0	.0	.0
Total percent[a]	99.9	100.0	100.0	100.1
Number of firms	436	436	436	436

[a] Percentages may not add to 100.0 because of rounding errors.

Results and Discussion

Table 2 presents distributions of acquisitions by type. Perhaps most striking is the fact that less than 15 percent of the firms in our population made any conglomerate acquisitions at all, and less than 4 percent made more than one. A small handful were quite active, however. If we define a diversification program as completing three or more unrelated acquisitions within a five-year period, then only four firms among the *Fortune* 500—General Motors, General Electric, Ford, and International Paper—engaged in such a program during the late 1980s. Put another way, four large firms were responsible for almost one-quarter of the conglomerate acquisitions completed by all *Fortune* 500 firms during the second half of the 1980s. Three of the four most active conglomerate acquirers—GM, Ford, and GE—were, in 1986, also among the four largest industrial firms in the United States in terms of employment levels and were three of the five largest non-oil companies in terms of sales.

The results provide a fairly consistent portrait of corporate acquisitions in the late 1980s. Firms clearly made the best of the lax antitrust enforcement of the 1980s—the incidence of horizontal acquisition increased substantially compared to the 1970s (Scherer 1980), while the vast majority of firms rejected the strategy

of growth through unrelated acquisition, and virtually all avoided vertical integration. The results are most striking when put in historical context. Mueller (1980) tracked acquisitions by large U.S. firms from 1962 to 1972, during which time horizontal and vertical mergers were extremely rare and conglomerate acquisitions were most common. He reported that the eight firms responsible for the most acquisitions were Litton, ITT, Teledyne, Beatrice, Gulf+Western, Occidental, Boise Cascade, and TRW—acquisitive conglomerates intent on growth through acquisition. In contrast, during the 1980s the most active conglomerate acquirers were a small number of enormous corporations that had established themselves long before. General Electric, General Motors, and Ford, three of the most active acquirers, each expanded their domain by buying financial and business service firms. GM and GE, the two most active acquirers, had already established a substantial presence in the financial services sectors with General Motors Acceptance Corporation and General Electric Capital Corporation, and GM's purchase of Electronic Data Services in 1984 had established it in the business services sector as well. These acquisitions were part of a larger program of expansion into the service sector by these industrial giants. Ironically, their expansion was occurring at precisely the point when some of the older conglomerates were abandoning the service sector—Ford purchased The Associates, the third-largest independent finance company, from Paramount Communications (formerly Gulf+Western) in 1989, at which point Paramount was moving to spin off unrelated divisions in order to focus on its core movie and publishing businesses.

Although we do not have direct evidence on this point, the findings of Bhagat et al. (1990) indicate that conglomerate acquisitions during the 1980s were often made with the explicit intent of selling off divisions in unrelated industries to buyers in those industries and hanging on to divisions in related industries. That is, when firms in our population made conglomerate acquisitions, it is possible or even likely that they subsequently divested those parts of the acquired firm that were not in their core industries. Where previously conglomerate acquisitions were used to achieve rapid growth by integrating the acquired firm into the acquirer's portfolio, in the 1980s they were used almost exclusively by firms that were already enormous. Ironically, the most active conglomerates all ended the decade with fewer employees than they started it, suggesting that their growth was of a curious type.

Table 3. Median Levels of Diversification Among *Fortune* 500 Firms: 1980, 1985, and 1990

Variable	1980	1985	1990
Total diversification (4-digit SIC segments)	1.00	.90	.67
Unrelated diversification (2-digit SIC segments)	.63	.59	.35
Number of firms	468	453	448

Note: Level of total diversification is calculated using the entropy measure, $DT=\sum P_i ln(1/P_i)$, where P_i is the proportion of a firm's sales made in industry segment *i*. Industry segments are defined at the 4-digit SIC level. Unrelated diversification is calculated in the same manner, except that segments are defined at the 2-digit SIC level; that is, the measure is calculated after first summing sales across 2-digit SIC categories. See Palepu (1986) for an explication of this measure and its properties.

AGGREGATE CHANGES IN CORPORATE FORM

We have demonstrated that diversified firms were taken over at higher rates than focused firms in the 1980s and that during the second half of the decade very few firms pursued conglomerate growth. Next, we assess the impact that the events of the decade had on the overall level of diversification in the population of the largest corporations. Although roughly one-quarter of the 1980 *Fortune* 500 firms disappeared through takeover during the 1980s (largely as a consequence of being diversified), it is possible that the new firms that joined the population of the largest U.S. industrial corporations were themselves highly diversified, as was the case during the 1960s (Fligstein 1990). Conversely, many diversified firms went through deconglomeration programs by selling off divisions and seeking to focus on a "core competence." Thus, changes in aggregate levels of diversification are indeterminate given the results we have presented. However, we can compare levels of diversification between 1980 and 1990 using data on business segments.

Table 3 compares the median level of diversification using the entropy measure (calculated at the 4-digit and 2-digit SIC industry levels)

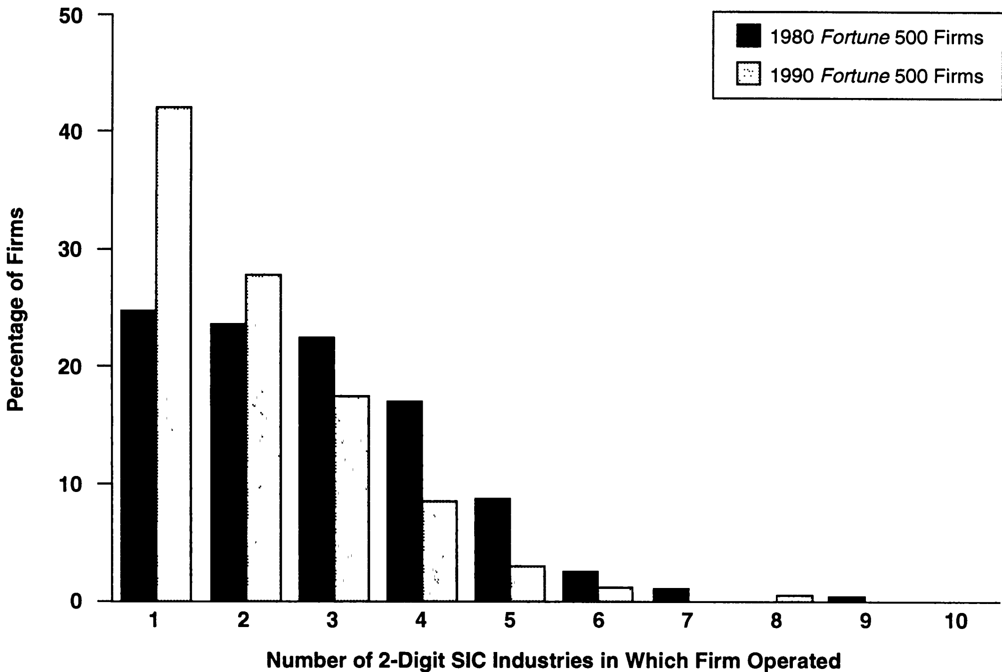

Figure 2. Frequency Distribution of Unrelated Diversification: *Fortune* 500 Firms, 1980 and 1990

for the *Fortune* 500 companies in 1980, 1985, and 1990. Note that the *Fortune* 500 is defined as the 500 U.S. industrial firms with the largest sales in the previous year; thus, although there is a fair degree of overlap among the firms appearing on this list over time, they are not identical. The level of total diversification (i.e., calculated at the 4-digit SIC level) among firms in this population dropped from 1.0 in 1980, to .90 in 1985, and to .67 in 1990—a one-third drop over a decade. Even more dramatic is the decline in the level of unrelated diversification (i.e., calculated at the 2-digit SIC level), which declined from .63 in 1980, to .59 in 1985, and to .35 in 1990—a 44 percent drop. Figure 2 shows the distribution of firms across 2-digit industries in 1980 and 1990. Whereas roughly 25 percent of the largest firms in 1980 operated in only a single 2-digit industry, 42 percent of the largest firms in 1990 did so.

Thus, there was a marked migration toward more focused organizational forms over the course of the decade—the median large industrial corporation looked quite different in 1990 compared to 1980. The majority (52 percent) of large firms operated in three or more 2-digit industries in 1980, while only 30 percent did so in 1990. To the extent that large firms were diversified in 1990, diversification tended to be into closely related industries. Moreover, large firms that started the decade highly diversified overwhelmingly ended the decade more focused: Among the largest firms in 1980 that were not acquired, 76 percent of those that were above the median level of unrelated diversification in 1980 were less diversified in 1990. It is particularly instructive to look at the fate of the so-called acquisitive conglomerates of the late 1960s and early 1970s. Of the 10 firms Rumelt (1974) classified as acquisitive conglomerates for which data were available in 1980, three (Bangor Punta, Colt Industries, and Lear Siegler) were bought out, and one (Brunswick) fended off a hostile takeover bid. Of the 7 firms still operating independently in 1990 (Brunswick, FMC, General Host, W. R. Grace, LTV, Litton Industries, and Whittaker), all but one (FMC) were less diversified.

The results suggest that, in general, highly diversified firms were either taken over or voluntarily restructured to be more focused. The aggregate effect was that the population of the largest firms was considerably more diversified before the 1980s than after.

CHANGES IN BUSINESS RHETORIC DURING THE 1980S

Our analyses show a substantial decline in the prevalence of the form and practice of the firm-as-portfolio model in the United States during the 1980s, but they do not speak directly to the issue of deinstitutionalization as a cognitive phenomenon. Reports in the business press and pronouncements from corporate leaders and Wall Street, however, indicate both a re-evaluation of the firm-as-portfolio model and a support for new models of strategy and structure. While there is less agreement about the specifics of a new model, there is virtually universal agreement that the firm-as-portfolio model, and the conglomerate merger movement it facilitated, have been discredited. "The [conglomerate] mergers of the 1960s were almost certainly the biggest collective error ever made by American business. . . . Synergies from diversification did not exist. . . . This was a colossal mistake, made by the managers, for the managers," according to *The Economist* (1991: 44). This collective error had substantial consequences for the American economy: "[T]he lesson of Britain and America in the 1960s and 1970s is that conglomerates are a short-sighted way out. . . . Corporate America's sluggish response to oil crises, Japanese competition, and other changes had much to do with its conglomerate tangles of the 1960s" (*Economist* 1992:18). "The 'portfolio' or 'holding company' approach . . . has been increasingly discredited" (Kanter 1991:69). Two articles in the *Harvard Business Review*, the most prominent quasi-academic business journal, provide a stark comparison of changing evaluations of the firm-as-portfolio model: Philippe Haspeslagh (1982) concludes his review by stating, "[P]ortfolio planning is here to stay and represents an important improvement in management practice" (p. 73), while five years later strategy guru Michael Porter (1987) pronounced, "In most countries, the days when portfolio management was a valid concept of corporate strategy are past" (p. 51).

This changing evaluation of corporate conglomeration influenced the rationales offered by business executives for their strategies. For example, Martin Davis, appointed CEO of venerable conglomerate Gulf+Western in 1983, concluded, "[C]onglomeration is dead. It doesn't make any sense. . . . You can't manage that kind of diversity" (quoted in Morgello 1989:83). Thus, he reorganized the firm and sold off its financial arm (The Associates, responsible for almost 40 percent of Gulf+Western's earnings) to focus on entertainment and publishing, changing Gulf+Western's name to Paramount Communications in 1988. Textron, an acquisitive conglomerate in the 1960s, reversed course by selling off 24 businesses, "from flatware to foundries," between 1985 and 1990. When the firm bought Cessna Aircraft in 1992, however, Textron's CEO felt compelled to argue that Cessna was closely related to its core aerospace businesses in response to critics on Wall Street, who had charged that the repentant conglomerate had fallen off the wagon (Putka 1992).

No clear-cut alternative has arisen to replace the firm-as-portfolio model, but broad outlines indicate that the logic defining what is appropriate to bring within a single organizational boundary has gone from being exceptionally broad (the conglomerate) to strikingly narrow, encompassing ever more specialized components of production processes. In contrast to the firm-as-portfolio model, which supported bringing virtually any type of business within the organization's boundary, rhetoric around appropriate business practices during the late 1980s and early 1990s has suggested extreme specialization and contracting for any aspects of production outside of the firm's "core competence." "Business schools and management consultants preach a unanimous gospel: make it lean, mean and centred on a core business" (*Economist* 1989:75). Under such circumstances, producing complete products often entails forming temporary alliances with several other specialists and results in a network, or "virtual corporation," composed of formally separate entities rather than a single bounded organization. "In a leap of industrial evolution, many companies are shunning vertical integration for a lean, nimble structure centered on what they do best. The idea is to nurture a few core activities . . . and let outside specialists make the parts, handle deliveries, or do the accounting" (Tully 1993:106). "Today's joint ventures and strategic alliances may be an early glimpse of the business organization of the future: The Virtual Corporation. It's a temporary network of companies that come together to exploit fast-changing opportunities. . . . It will have neither central office nor organization

chart. It will have no hierarchy, no vertical integration" (Byrne 1993:98–99). "Companies are replacing vertical hierarchies with horizontal networks; linking together traditional functions through interfunctional teams; and forming strategic alliances with suppliers, customers, and even competitors. . . . For many executives, a single metaphor has come to embody this managerial challenge and to capture the kind of organization they want to create: the 'corporation without boundaries'" (Hirschhorn and Gilmore 1992:104).[4] Unfortunately, by their very nature it is difficult to track the prevalence of network forms of organization: Because they do not have stable boundaries and are composed of shifting arrays of specialized elements, they cannot be readily counted in the same manner as bounded actor-organizations. Their prevalence in business rhetoric, however, is clear.

As with the firm-as-portfolio model in the 1970s, academics have provided rationales for the firm-as-network model. Sabel (1991) calls such production structures "Moebius-strip organizations because, as with a looped ribbon twisted once, it is impossible to distinguish their insides from their outsides. . . . [This form of organization] hedges its risks not through portfolio diversification into unrelated activities but by learning to move rapidly from declining markets or market segments into prosperous ones in the same or related industries. [The consequence of this strategy] is the opening of the borders between corporations and between the economy and local society" (pp. 25–26) Kanter (1991) heralds the arrival of a "new model of organization structure. . . . A key concept guiding the new corporate ideal . . . is focus: maximizing the core business competence. This contrasts sharply with a tendency to form diversified conglomerates in the period beginning around the 1960s" (p. 66). Two recurring themes in the writings on new organizational forms, both in the business press and in academic discourse, are (1) that organizational boundaries are increasingly blurred or irrelevant and (2) that the appropriate model of the organizational structures that prevail now is not the bounded body, but the (unbounded) network.

DISCUSSION

Conglomerates were prevalent in 1980; many were taken over and broken up; most of those that remained became more focused through voluntary restructuring and sell-offs; and the firms that joined the set of the largest U.S. industrials were less diversified than the ones they replaced, leaving the largest firms in 1990 roughly half as diversified in the aggregate as their predecessors. With few exceptions, firms rejected both vertical integration and growth through conglomerate acquisition. Business rhetoric tracked the trend away from the firm-as-portfolio model. The business press denounced the conglomerate merger movement as a bout of collective madness on the part of American businesses and announced the coming of a firm-as-network model to replace the now-discredited firm-as-portfolio model. Thus, what firms did and how they looked—their practices and structures—as well as how members of the business community talked about corporate practices and structures reflected a mass rejection of the firm-as-portfolio model. In short, the firm-as-portfolio model was deinstitutionalized during the 1980s, and the field of the largest corporations was vastly restructured in a relatively brief period.

Although this characterization of the deconglomeration movement of the 1980s is descriptively accurate, it raises a fundamental question for institutional theory: How was organizational change on such a massive level possible if the firm-as-portfolio model had indeed become institutionalized? Certainly, there was substantial evidence that diversification reduced corporate performance (Black 1992) and that there was money to be made by buying conglomerates and busting them up (LeBaron and Speidell 1987). But not every economically attractive activity is pursued, and not every economically questionable practice is abandoned: Forms and practices (such as bust-ups)

[4] Ironically, the rhetoric of the boundaryless corporation has crept into the discourse of the one corporation that continued to operate businesses in a wide array of unrelated industries and to pursue acquisitions of unrelated businesses throughout the 1980s: General Electric's Annual Report for 1989 stated, "Our dream for the 1990s is a boundary-less Company, a Company where we knock down the walls that separate us from each other on the inside and from our key constituencies on the outside," which "will level its *external* walls . . . reaching out to key suppliers to make them part of a single process" (General Electric 1989:5).

must be cognitively available to a number of actors in society for them to achieve prevalence. Bust-up takeovers violated the interests of powerful actors—the individuals running diversified firms, who typically ended up unemployed following successful takeovers. When the prevailing institutional order is threatened, the actors who benefit from that order have compelling reasons to engage in collective action and to seek protection from the state (DiMaggio and Powell 1991). But the threat posed by bust-ups and other takeovers generated little collective action by the corporate elite at the federal level, and while states eventually stepped in to regulate takeovers, it was too late to save the firm-as-portfolio model (Roe 1993). As we have shown, the only firms clearly able to resist the pressures to abandon the portfolio model during the 1980s were a handful of enormous corporations at the core of the intercorporate network that were presumably large enough and powerful enough to evade the pressures of takeovers. Our definition of legitimacy implies the ability of an institutionalized practice or structure to withstand challenges based on purely instrumental grounds (Douglas 1986). But where the firm-as-portfolio model was sustained, it was power, not legitimacy, that supported it.

We suggest that what has been deinstitutionalized is not just the firm-as-portfolio model, but also the very idea of the corporation as a bounded social entity analogous to a sovereign body. Bust-up takeovers were only the most visible manifestation of a more general institutional process in which the ontological status of the corporation as a social structure, including the sovereignty of organizational boundaries, was directly challenged. Growth through acquisition, such as the conglomerate mergers of the 1960s, could be naturalized with reference to analogous processes—the acquired firm becomes a member of (is eaten by) a larger corporate body, and is now inside its boundary rather than outside. But bust-ups undertaken by outsiders are unlike natural processes such as birth, growth, and death—a more gruesome analogy is dismemberment, with body parts being grafted onto other bodies. Bust-up takeovers required the body analogy and the sacrosanct status of the organizational boundary to be jettisoned. Corporations had to be re-conceived as voluntary and impermanent social arrangements—as mere conventions, not institutions. This transition had a precedent in the French Revolution, during which the model of the organization as body was replaced, in legal theory if not social reality, with the Enlightenment concept of a social compact among free individuals that was constructed, and could be ended, voluntarily. The architects of this shift sought to rest sovereignty only in individuals and the state and to explicitly disallow efforts to vest sovereignty in an intermediate social structure (Sewell 1980).

We suggest that two factors helped undermine the sovereignty of organizational boundaries and thus allowed bust-ups: the rise to predominance of the nexus-of-contracts theory of the firm and the spread of the conglomerate form. The nexus-of-contracts model maintains that

> . . . most organizations are simply *legal fictions which serve as a nexus for a set of contracting relationships between individuals*. . . . Viewed in this way, it makes little or no sense to try to distinguish those things which are 'inside' the firm (or any other organization) from those that are 'outside' of it. There is in a very real sense only a multitude of complex relationships (i.e., contracts) between the legal fiction (the firm) and the owners of labor, material and capital inputs and the consumers of output. . . . We seldom fall into the trap of characterizing the wheat or stock market as an individual, but we often make this error by thinking about organizations as if they were persons with motivations and intentions. (Jensen and Meckling 1976:310–11, emphasis in original)

By this account, corporations are not actors but merely "dense patches in networks of relations among economic free agents" (Zukin and DiMaggio 1990:7). The convention of viewing the organization as a bounded body is simply reification, a cognitive error to be overcome. Notably, the natural attraction of thinking about corporations in these terms is so strong that the analogy requires explicit rejection. The fact that "we often make this error" means that the analogy needs to be exposed as false. To paraphrase Jensen and Meckling (1976), it makes little or no sense to refer to a "corporation without boundaries" unless one starts from the assumption that corporations are otherwise perceived as having an "inside" and "outside" that are separated by a boundary. Not only is the boundary of the organization not sacrosanct, according to this approach; it is nonexistent. Thus, there is no sovereignty to be violated by

busting up a nexus-of-contracts if it fails to produce an adequate return in share price. Beginning in the early 1980s, this approach came to dominate normative discourse on the corporation, particularly in the courts (Easterbrook and Fischel 1991) and Reagan-era regulatory policy. Thus, bust-ups that would have been considered dismemberment under the body analogy were simply the reallocation of assets under the nexus-of-contracts model.

Ironically, by turning the corporation into a portfolio, the spread of the conglomerate form also facilitated the shift away from the notion of the corporation as sovereign bounded entity. Conglomerates strained the body analogy, because they offered no credible basis for a myth of identity. Like a gerrymandered congressional district, the lack of contiguity of the parts rendered the whole suspect—the parts did not *belong* together by any "natural" link. For example, Beatrice Foods counted among its businesses in the late 1970s various packaged foods, dairy products, lunch meats, plumbing supplies, audio equipment, luggage, and travel trailers, among others (see Baker 1992 for a history of Beatrice). Such an agglomeration of businesses bore little resemblance to a unit actor organization; the only apparent principle linking the businesses together was common ownership. Following Douglas's (1986) account, it is clear that the naturalizing analogy of organization as body was strained to the breaking point by organizations such as Beatrice. A few such deviant organizations might not be fatal to the analogy, but when conglomerates became the modal type of large corporation, the analogy could not be sustained. Without an authoritative analogy, conglomerates could not maintain the legitimacy that otherwise might have prevented them from being dismembered simply because money could be made by doing so. Conglomerates may have resulted from strategies for attaining organizational growth, but they inherently undermined the notion of the firm as a bounded actor, capable of growth, and distinct from its environment; and the poor financial performance of conglomerates invited challenges in the form of bust-up takeovers. Moreover, once bust-ups were possible, the sovereignty of any organizational boundary was rendered problematic: Any aspect of what an organization did was a potential candidate for externalization if it failed to meet a market test (Meyer 1991), and actors both inside and outside the organization could render such judgments.

Our interpretation is also consistent with the trend in business rhetoric away from the firm-as-portfolio model and toward the "boundaryless network" model. The repeated reference to the "corporation without boundaries" would be meaningless unless the default model were a corporation *with* boundaries. Once the special status of the organizational boundary was repudiated, a range of new social structural possibilities for regularized economic exchange was opened, including the widespread use of dynamic networks in place of vertical integration (Miles and Snow 1992), temporary employees in place of organizational members (Pfeffer and Baron 1988), and ultimately the "hollow corporation" in which virtually all functions that do not add sufficient value are subcontracted rather than brought within the firm's "boundary" (e.g., Handy 1989). Conglomerates strained the actor analogy; hollow corporations dispense with it entirely. The emerging naturalizing analogy for recurring structures of economic activity would seem to be the network, which makes possible a broad array of new quasi-organizational forms that do not conform to the body analogy, with models emerging from several industries including book publishing, movie production, biotechnology, and construction (Powell 1990). It remains to be seen whether the network model will diffuse as successfully as the firm-as-portfolio model that preceded it.

CONCLUSION

We have provided the first systematic assessment of organizational changes in the population of the largest American industrial firms in the 1980s, and we have offered an institutional interpretation for a disparate set of findings. Over the course of a decade, the dominant form of corporate organization in the United States, which had taken decades to evolve and attain its normative status (Fligstein 1991), was effectively deinstitutionalized, while new "boundaryless" production structures were advocated as credible quasi-organizational alternatives. This was not a gradual, evolutionary shift in which one type of organizational form died out and was replaced with another. It was an abrupt change, effected through both voluntary and involuntary processes at political, economic,

and cognitive levels. We argue that deconglomeration manifests an underlying institutional shift in which the organization-as-body analogy, which sustained the corporate form for centuries (Coleman 1974), was undermined, and that as a result a new range of social structural arrangements for production has emerged to provide alternatives to bounded organizations (Sabel 1991). Our findings and interpretations raise a number of pressing questions for institutional theory and for the sociology of organizations more generally.

It has become a commonplace in social theory that we live in a "society of organizations," created by the spread of corporate forms to all aspects of social life, and that "natural persons" have been eclipsed by corporate persons which stand between individuals and the state (Jepperson and Meyer 1991). But this imagery faces challenges in the form of radical individualist theories about corporations (Jensen and Meckling 1976) and actual corporate practices aimed at creating "corporations without boundaries" (Kanter 1991). Economic theorists of the firm reprise the project of the Enlightenment thinkers who influenced the revolutionaries in late eighteenth-century France (Sewell 1980)—to remove the social entitivity of the bounded corporate form and rest sovereignty in individuals only. Sovereign individuals may voluntarily enter into contracts with each other, but they cannot in principle form a sovereign corporate body at a level below the state. Sociologists may bristle that such methodological individualism reflects bad social scientific epistemology. Nevertheless, social structures of production increasingly resemble the nexus-of-contracts described in recent approaches to the firm in economics: individualistic, transient, network-like, with production accomplished by shifting sets of individuals tied through impermanent contracts. As Demsetz (1991) argues, the relevant question now is not the absolute, "When is a nexus-of-contracts *a firm*?" but the relative, "When is a nexus-of-contracts *more firm-like*?" (p. 170). Such "firm-like" arrangements create obvious difficulties for organizational theories that take for granted that the organization is an entity and study analogous processes such as birth, growth, and death, while they create openings for approaches to social structure that take the network as a guiding analogy.

Institutional theory faces these changes from a curious position. On the one hand, the New Institutionalism has focused primarily on sectors, such as schools and mental hospitals, where technical ("market") pressures have traditionally been weak and where the ability to adopt organizational practices and forms is presumably less hampered. The application of such institutional models to business is more problematic, and one might argue that our results demonstrate that eventually the market catches up with institutionalized-but-inefficient organizational practices. On the other hand, business practices are guided to a great degree by analogies and shared norms, as the initial spread of the conglomerate form demonstrates (Fligstein 1991). Moreover, mental models of "what Wall Street wants" have come to have a powerful influence on how top managers of large corporations choose organizational forms and practices, and these models were behind much of the voluntary deconglomeration observed during the 1980s (Useem 1993). "The people who pick stocks find it easier to deal with simpler corporate structures," according to the head of strategic planning at Union Carbide, which helps explain the increase in share price that results from hints that a company will deconglomerate (Fisher 1992:12). Thus, the New Institutionalism, particularly Douglas's (1986) theory of analogies, may provide crucial theoretical guidance for understanding the production structures that emerge and persist based on their ability to sustain naturalizing analogies. We have provided initial evidence for how the inability to sustain such an analogy may have led to the deinstitutionalization of the firm-as-portfolio model, and we anticipate that institutional theory will be able to clarify the production structures that come into dominance in the future.

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