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HENRY MANNE: SCHOLAR, ACADEMIC ENTREPRENEUR, AND FRIEND

Harold Demsetz†

The task formally set for me is to comment on Professor Carney's discussion of Manne's work on corporate control, and I turn to this task first. I have also been told that, if I desire, I may write about other matters, and the temptation to do so is irresistible. Thus, after completing my formal assignment, I discuss the Henry Manne I know.

Professor Carney's discussion of Manne's articles on corporate control is competent, insightful, and correct in its description of Manne's work on this topic.¹ Few scholars can lay claim to a discovery of the workings of unsuspected economic forces. Even fewer have the words by which they identify their discovery become an indelible part of the language of a field of investigation. Manne's *Market for Corporate Control* is such a discovery.

I do have one complaint about Professor Carney's discussion of this work. In the draft article, he claims a bit too much for Manne in saying that in these articles Manne "had essentially outlined most of the concepts that we now think of as constituting the theory of the firm..."² I think Manne can go home happy even if I cannot accept the full scope of this claim. Were I to accede to this claim, I would be compelled to accept what it implies, that a large part of my work is simply redundant. It is easy to see why Carney's focus, which is on the issue of the separation between ownership and control, might lead to such a claim. The truth is, there is much more to the theory of the firm. Armen Alchian assures me that I write about this as at least half an authority. Ken Lehn gives me the same assurance. And two halves make a complete authority. There are problems in the theory of the firm that have little to do with issue of separation between ownership and control, and there are other lines of attack on this is-

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² Id. at 225.
sue. Among such problems are vertical integration, franchising, pricing practices, contractual arrangements with suppliers, product mix, compensation methods, capital structure, and ownership structure to name only a few.

Manne's work on the market for corporate control is as much, or in my opinion more, a contribution to our understanding of market competition than to our understanding of the firm. It describes an important variant of competition that had gone unrecognized—the market for control—and it enlightens us about the consequences of competition in this market. This competition constrains the behavior of corporate management and helps us understand how the quality of business management is maintained. But competition, even of this sort, is first and foremost a phenomenon of the market competition, not a phenomenon of the firm.

The premise underlying Manne's argument is that the transfer of assets in an acquisition or takeover yields an improvement in the management of the acquired assets. But why are we so confident that this is so? Some theories of mergers and takeovers suggest that improvement is not to be expected. Jensen's free cash flow theory, for example, gives reasons for thinking that some acquisitions are undertaken by an entrenched management whose objective is to keep control of the corporation's wealth instead of paying it out to shareholders as dividends. In this view, the acquirer's firm is subject to a "separation between ownership and control," and this suggests that there will not be a significant increase in the productivity of acquired assets.

Studies of mergers, moreover, do not offer convincing evidence that such benefits are the dominant result of acquisitions. True, they show that target company shareholders secure a premium for their shares in the event of a hostile takeover, but the reason for this premium is unclear. It may be that it is paid in anticipation of a forthcoming improvement in the management of the acquired assets, an explanation that is consistent with Manne's view. However, the premium may also result from the willingness of the entrenched management of the acquiring company, in its haste to put the firm's wealth beyond the reach of its shareholders, to over-pay for the target's shares. Statistics show that investors think poorly of an acquisition in some instances, resulting in the reduction in the price of the acquiring company's shares when the acquisition is announced and completed. In other instances, they think well of an acquisition. The

two reactions largely cancel each other out statistically, so that acquiring company share prices, on average, for large samples of acquisitions, do not change much in the event of an acquisition.

This may reflect competitiveness in the market for control, the result of which is to keep the rate of return earned from acquisitions at levels no larger than can be earned elsewhere. Still, the near-zero average gain may obscure a systematic difference between acquirers. Positive, or larger, returns to acquiring company shareholders may reflect the presence of acquiring company management that heed shareholder interests. Negative, or smaller, returns to acquiring company shareholders may reflect the presence of entrenched management serving their own interests. Introducing a variable correlated with the degree to which we expect management to serve their shareholders would reveal this systematic difference. Ownership concentration is such a variable. An ownership structure that is highly concentrated facilitates easy monitoring and discipline of management by a corporation’s owners. On this plausible presumption, ownership concentration should correlate positively with acquisition profitability.

There is some evidence that tightly held firms do earn a positive return for their shareholders when competing in the market for control, but even this evidence does not compellingly deal with the problem I have described. The issue here is not really the degree to which acquiring company shareholders are made better off, which is what such a correlation would attest to. An improvement in the management of the acquired assets is not the only way acquiring company shareholders can be made better off. They can be made better off because the management of their firm succeeds in securing assets for a price that makes them a good buy even if there is no subsequent improvement in the productivity of the acquired assets. A well-run acquirer, which I shall presume is one for which ownership is concentrated, probably gets assets at lower prices than does a poorly-run acquirer, but the appropriate test is to determine if more concentration in the ownership structure of the acquiring firm is correlated positively with improvements in the productivity of the assets it acquires through mergers and takeovers. This is not easy to ascertain, but the successful pursuit of this objective would provide us with better material on which to base our understanding of the market for control.

Now, to the Henry Manne I know. I am not sure precisely where and when Henry and I first met, but I think it was in the first half of the decade of the 1960s. It is hard to believe that almost forty years have passed since we met. Manne is a distinguished member of a rare breed, one part successful academic entrepreneur and a second part
scholarly talent. His entrepreneurial successes include, importantly, innovating a new type of law school curriculum and creating the Law & Economics Center. It is the Center with which I am most familiar.

Armen Alchian and I were the first regular lecturers of the Center, beginning our work at the University of Rochester sometime during the decade of the 1960s. I continued this work for about ten years. Armen stayed much longer, but he put a higher value than I did on free golf at good courses. Teaching in the Center was a superb experience—new friends, new problems, and new ways to think about these problems. And the teaching generated new income, too. My family is grateful for this. Henry Manne showed considerable skill in setting my compensation. It was too low for me to escape from a debt I had incurred speculating on Treasury bond prices and just high enough to cover many months of margin calls. Working for Henry became hardly-voluntary servitude.

The Center’s pay did not come easily. The dormitory room in which Manne imprisoned me at Rochester was in proportion to the compensation package he had designed: just big enough to contain me but too small to allow straying from the desk. Lectures were given in the morning and the afternoon. Lunch and dinner were to be used to extend these lectures in a conversation mode. The extension was not easy. Law professors and judges have plenty to say on their own, some of it correct. Agitation from what I was hearing, combined with frustration in not being able to get a word in, brought repeated attacks of indigestion. Now, in preparation for a meal with judges and/or law professors, I put a roll of Tums in my pocket.

Manne shepherded the Center for almost four decades. He guided it with great skill through three relocations, staying just beyond the reach of the posses sent by the establishment to arrest his efforts. The importance of the Center is not easily exaggerated. It became the premier institution by which the logic of economics met the problems of law. Teaching in it has been an honor.

The Center yielded results much grander than I had thought possible. Judicial outcomes and the study of the law have been changed, probably forever. Preponderantly, improvement has resulted. Occasionally, a former student renders a decision that suggests the need for a refresher course, but perfection is not of this world. The Center’s success is easy enough to see now, but only Manne had the foresight, the willingness to commit the time and energy, and the courage to bear the attendant professional risks.

I retired from the Center before Manne became Dean at George Mason, but I did visit the Law School on a few occasions. I was
struck by the initial building that housed the School—a former department store. He had come full circle, back to a glorified ex-dry goods store after leaving his father’s Memphis dry goods store. Henry’s store, of course, was bigger than his father’s, and it had an escalator. But his father sold his business, a feat that Manne failed to replicate despite many attempts. The State always managed to intercede just before the cash changed hands. True enough, he and his father sold different goods. Henry sold ideas, not dry goods, and some of these ideas were just the opposite of dry. His father offered customers a money back guarantee. The best Henry could do was to mount a suggestion box in the main lobby of his department store. Henry Manne had become Dean of a school that had no tradition in legal education and that was housed in a building having no academic or other architectural feature worthy of the name. Yet, he made the world of legal education stand up and take note of the very useful and imaginative curriculum he set in place.

Beyond these considerable accomplishments, Henry Manne possesses a joy of life and a spirit of adventure that has enriched those who have traveled with him. He pressured me to eat raw poisonous blow fish in Japan. When I asked him how do we know if the poison bladder has been successfully removed, he answered that, if not, we had a good case. We motored to Monte Carlo, and he got me to lose a few bucks in the cheap outer-lobby gambling hall. While investigating the Everglades, he kept me looking up at a strange bird whose feeding habits he was explaining to me, and I almost stepped on a large alligator. Despite all this, and more, we still live. Our pockets brim with retirement money. The world can use a few more changes. So, Henry, my good friend, what’s next?