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CHAPTER 2

The Significance of an Incorporation

In recent years enterprises have on occasion been chartered in the morning, accomplished their purposes in the early afternoon, and filed dissolution papers before the close of business on the same day. The knowledge that such a short-lived 'legal person' has sometimes been used to facilitate a single transaction and the suspicion that the process is often a mere matter of manipulation challenge the economic significance of an incorporation. Each incorporation certainly does not carry the same import. Some reflect the situation just mentioned; the vast majority have more enduring implications.

D. H. Macgregor, discussing the meaning of an incorporation, states: "But it is assumed that in general the assumption of the company form means an expansion of enterprise."¹ This position is perhaps justifiable, but it may be more appropriate to contend merely that many incorporations in an industrial field are evidence of activity on the part of entrepreneurs. The activity may be associated with either the organization of new producing units or the enlargement of old ones. It may be associated also with the mere adoption of the corporate form, without any expansion of facilities, by enterprises previously operating under some other form of organization. For the public, these conversions, even when they do not need substantial additional capital, create possibilities that may eventuate in investment opportunities; these potentialities could not exist when the enterprises operated as unincorporated units. Hence from the investor's point of view, an increase in incorporations may open new investment opportunities even though there is no "expansion of enterprise". Whenever incorporations in any one industrial field are numerous, it seems reasonable to infer that movements of economic significance are in process: enterprise is restive and seeking an object for its energy; opportunities to invest are being multiplied either through the creation of entirely new outlets or the opening of existing outlets to more people.

To assert or assume that an increase in incorporations indicates a big expansion of enterprise or the opening of old investment outlets to a larger number of capitalists is not to substantiate the proposition. Proof is hard to obtain. The nature and significance of a Maryland incorporation, however, is revealed, to some extent, in its first tax assessment return. When a company files its first report, it is required to state whether it is a new company, a partnership converted into a corporation, or

¹ *Enterprise, Purpose & Profit* (Oxford University Press, 1934), p. 78.

a combination of several corporations, etc. These data may be supplemented by information, discussed below, concerning the extent to which incorporators failed to utilize their charters—indicating the force of the impact of an incorporation upon the economy. But it must be borne in mind that the problem of measuring the impact of an incorporation is different from the problem of using incorporations as an indicator of entrepreneurial plans. Many charters taken out at one time might indicate that entrepreneurs desired to develop certain plans. If the charters were forfeited without being put to use, the repercussions upon the community might be negligible. While the emphasis of this study is upon incorporations as a reflection of entrepreneurs' hopes and beliefs, this chapter contains some data that are not strictly relevant but are helpful.

The tax assessment returns of Maryland corporations reporting for the first time revealed that many companies subject to the requirement of filing had not done so, and that of those that had filed some failed to answer the question concerning pre-incorporation status. The incompleteness of the returns is to be attributed partly to the fact that a fairly large portion of the charters were never exercised and incorporators who did not complete their promotions did not file tax returns. Why some of the reporting concerns were not compelled to give the required information is not as easily explained.

The tax returns for the companies chartered in 1934 and 1935 were selected for a study of pre-incorporation history because the State Tax Commission could make them accessible without much difficulty. About 60 percent of the companies that were supposed to give their pre-incorporation history did so. If, however, the companies that may be assumed to have operated less than one year²—hereafter called abortive—are deducted from those that were supposed to report, and the difference is taken as the number that might be expected to report,³ then about 51 percent reported no previous

² For the purposes of this study, companies that forfeited their charters for nonpayment of taxes at the first opportunity after incorporation, called abortive companies, were treated as though they had remained in business less than one year. Some of these corporations doubtless lived longer, but others never operated at all. The size of the abortive group is discussed below.

³ The number of those that might be expected to report was computed as follows:

	1935	1934
1) Maryland charters granted	771	816
2) Corporations not required by law to report previous status	14 ^a	31 ^b

business history (that is, they considered themselves new enterprises), about 24 percent failed to give the pre-incorporation information, and about 25 percent reported a previous existence.⁴ Since more than half of the incorporations that functioned through the first year were new ventures, variations in total incorporations would seem to reflect fairly well "expansion of enterprise" in its narrow sense—the opening of entirely new outlets for capital. It is difficult to guess whether few or many of the companies that failed to disclose their pre-incorporation history were new enterprises. One could argue with some plausibility that many had a previous existence and were trying to hide it from the State Tax Commission in an effort to get an assessment unbiased by the record; the assessors are aware of such efforts. It would nevertheless probably be safe to guess that among the nonreporting 24 percent there were more reconstituted old enterprises than new business ventures.

Maryland corporations of 1934 and 1935 that both had a previous business existence and operated for at least one year after their incorporation were studied further (Table 2). A large proportion—about 32 percent—answered the tax return question concerning pre-incorporation history vaguely. It would not be unreasonable to distribute those in this category among the other groups—except two, to which the vagueness in phraseology never seemed to apply—in proportion to the numbers that clearly belong in each group. The two categories that would not receive any of this uncertain class are those containing incorporations: (1) that took place when corporations of other states procured Maryland charters; (2) that represented consolidations. If the 'uncertain' group is distributed and the percentages of the total in the different categories are averaged for the two years, the following becomes the picture of the pre-incorporation status of these companies: 49 percent had been individual proprietorships; 26 percent had been

partnerships; 18 percent were reincorporations of single Maryland companies; 4 percent had been single out-of-state corporations; and 3 percent resulted from combinations of two or more corporations.

The 4 percent for out-of-state corporations is probably not a fair index of the extent to which an American company switches its state of incorporation during any given year. Since Maryland has a 'liberal' chartering policy, its experience cannot be expected to be typical. A few figures for Pennsylvania may be given as evidence. For three two-year periods (June 1, 1909 to May 31, 1911; June 1, 1913 to May 31, 1915; and June 1, 1915 to May 31, 1917) the documents that list incorporations in Pennsylvania contain the names of 13, 6, and

TABLE 2
Previous Status of Maryland Companies Incorporated in 1934 and 1935 that had Predecessors and Remained in Business more than One Year after Incorporation

PREVIOUS STATUS	1935		1934	
	No.	% of Total	No.	% of Total
1 An individual proprietorship	38	29.7	41	35.7
2 A partnership	18	14.1	23	20.0
3 A corporation	23	18.0	16	13.9
a) Maryland	15	11.7	14	12.2
b) Foreign	8	6.2	2	1.7
4 Several corporations	4	3.1	3	2.6
5 Companies with statements too vague to permit definite assignment	45	35.2	32	27.8
Total	128	100.1	115	100.0

Constructed from corporate tax returns filed with the State Tax Commission of Maryland.

10 "Foreign corporations made domestic".⁵ As total incorporations numbered 3,191, 2,808, and 3,416, three-tenths of 1 percent of business charters granted were on the average issued to enterprises that switched their domiciles from another state to Pennsylvania.

Pre-incorporation histories reveal information about the nature of entrepreneurial activity and by implication about possible demands for capital. In contrast, the extent to which charters were exercised reflects primarily the initial success of entrepreneurs in carrying out their projects. Incorporations tell something about what entrepreneurs wanted to do; incorporations less abortive enterprises tell something about what entrepreneurs were able to do. It must be admitted, however, that in some, perhaps many, of the abortive corporations the promoting groups did something. The something may have involved raising capital, but the entire effort must in each case have soon come to an end and must have resulted in little or no production.

An abortive corporation was defined as one that

⁵ For a description of these documents, see the Pennsylvania section of Appendix 3.

3) Subtotal 757 785

4) Abortive corporations not included in line 2 294 280

5) Those that might be expected to report 463 505

^a Includes 1 abortive company.

^b Includes 4 abortive companies.

⁴ The 51 percent, which can probably be increased because of the unknown 24 percent, may be compared with percentages calculated from the Dun & Bradstreet figures on 'completely new' incorporated and unincorporated business enterprises in the United States for 1936-39—58.0 to 61.0 percent of all new firms (see *Dun's Review*, Aug. 1941, p. 23). Alfred R. Oxenfeldt has questioned the Dun & Bradstreet figures and estimated that completely new firms, excluding what he terms 'extensions', constituted annually about 37 percent of all new business formations (see his *New Firms and Free Enterprise*, American Council on Public Affairs, 1943, pp. 40-2).

forfeited its charter in consequence of having paid no state taxes except at the time of its incorporation. Such corporations forfeited their charters at the earliest possible date. Until 1939 a Maryland company that was chartered in the year X was first assessed and billed for property taxes in the year X+1. If taxes remained unpaid for the years X+1, X+2, and X+3, the company forfeited its charter in the spring of the year X+4. There is little doubt that some of these companies operated though they did not pay taxes, but the State Tax Commission staff is of the opinion that few remained in business for a full year. A large portion of the first tax bills, which were based on arbitrary assessments and mailed to these companies in the year X+1, regularly returned unclaimed. Successive assessments were raised arbitrarily when taxes were not paid or assessments were disputed, but in only rare cases did such procedure bring forth a response. It seems likely that the economic significance of the corporations that forfeited at the first opportunity has been negligible.

Since the law concerning charter forfeiture was changed in 1939, the definition of an abortive corporation had to be modified. A company chartered in the year X forfeited its charter in the fall of the year X+2 if it had not paid taxes for the year X+1. The consequent modification in the definition must be borne in mind when examining the following percentages of Maryland incorporations that were abortive: 1927, 35.8; 1928, 35.9; 1929, 36.3; 1930, 43.6; 1931, 46.3; 1932, 42.8; 1933, 38.3; 1934, 34.8; 1935, 38.3; 1936, 45.7; 1937, 34.5; and 1938, 31.3. Except for the transitional period the effect of the change is not great. The 1927-35 data were computed in a comparable way; the 1936 figure is in a class by itself since the change in the Maryland forfeiture law affected the calculation for that year;⁶ the annual figures for 1937 and 1938 are based on the new definition. On the average about 39 percent of Maryland incorporations were abortive; the variations in the figures making up the average suggest a relation between business conditions and the proportion of abortive companies.⁷ In examining the annual data the reader must not jump to the conclusion that the low

⁶ Two forfeiture lists were issued in 1939, the first in February under the old law and the second in October under the new law. No company chartered in 1936 appeared on the February 1939 list. The October list, however, included an unduly large number of companies created in 1936, since it contained 1936 companies that would have appeared on the February 1940 and February 1941 forfeiture lists, had the old law remained in effect.

⁷ Compare English abortive company figures of about 30, 27, and 25 percent for 1893-1902, 1902-13, and 'recent years', respectively, in Macgregor, *op. cit.*, pp. 101-2; also data on first-year failures among retailers in Oxenfeldt, *op. cit.*, pp. 174 and 179. The latter data do not pertain to any particular form of business organization.

values for the years since 1936 indicate an error in the procedure used for the years before. Voluntary dissolution was an unusual way of terminating a Maryland corporation's existence until a simplified procedure was introduced by a statute enacted in 1935.⁸ As voluntary dissolutions increased, forfeitures for nonpayment of taxes decreased. Thus the 1927-35 figures record almost all corporate 'deaths'; the 1937 and 1938 rates have a smaller coverage.

TABLE 3
All Maryland Business Corporations Chartered in 1925, 1926, and 1927 and the Number of those Companies on the Maryland Forfeiture List of February 22, 1931 (classified by authorized capital stock)

AUTHORIZED CAPITAL STOCK	COMPANIES CHARTERED		FORFEITURES IN 1931		% NO. OF FORFEITURES IS OF NO. CHARTERED
	No.	% of Total	No.	% of Total	
1927 Corporations					
Under \$25,000	354	33.9	135	36.1	38.1
\$25,000- 50,000	102	9.8	34	9.1	33.3
\$50,000- 100,000	148	14.2	64	17.1	43.2
\$100,000-1,000,000	373	35.7	126	33.7	33.8
\$1,000,000 & over	68	6.5	15	4.0	22.1
All size groups	1,045	100.1	374	100.0	35.8
1926 Corporations					
Under \$25,000	283	27.0	35	25.7	12.4
\$25,000- 50,000	127	12.1	16	11.8	12.6
\$50,000- 100,000	160	15.3	21	15.4	13.1
\$100,000-1,000,000	405	38.6	61	44.9	15.1
\$1,000,000 & over	74	7.1	3	2.2	4.1
All size groups	1,049	100.1	136	100.0	13.0
1925 Corporations					
Under \$25,000	291	28.2	24	28.6	8.2
\$25,000- 50,000	116	11.2	6	7.1	5.2
\$50,000- 100,000	161	15.6	11	13.1	6.8
\$100,000-1,000,000	398	38.6	36	42.9	9.0
\$1,000,000 & over	66	6.4	7	8.3	10.6
All size groups	1,032	100.0	84	100.0	8.1

Constructed from the forfeiture list of February 22, 1931 and other records in the office of the State Tax Commission of Maryland.

Abortive corporations are not confined to any particular size (using authorized capital stock as a measure of size), nor are the companies that live from one to two years and those that live from two to three years.⁹ These points are brought out in Table 3. In Appendix 2, other tables are presented for those who care to explore the matter further. Since the 1931 forfeiture list is the first on which companies incorporated in 1927 could have appeared, they are considered to be abortive, that is, to have lived less than one year. Similarly, the companies on that forfeiture list that were chartered in 1926 and 1925 are said to have lived between one and two years

⁸ *Maryland Laws, 1935*, Ch. 551.

⁹ See Chapter 6 for a justification of the use of capital stock as an indicator of size.

and two and three years, respectively. Comparison of the percentage-of-total figures bears out the contention that, as far at least as the first three years of life are concerned, the corporations of any given size are no more or less likely to survive than corporations of any other size.¹⁰ Of the abortive group, 36.1 percent had an authorized capital stock of less than \$25,000, while 33.9 percent of all incorporations were in this size group. In the higher size groups the figures for the abortive companies are 9.1, 17.1, 33.7, and 4.0 percent; the figures for all business incorporations are 9.8, 14.2, 35.7, and 6.5 percent. Examination of the ratios in the last column of Table 3 confirms the lack of correlation between size and a short life-span. Some observers may think they can see in the figures of this table (and the tables in Appendix 2) a slight tendency for the small company to succumb in infancy to misfortune more easily than the large concern. The Maryland figures, however, certainly do not seem to justify the fairly widespread belief that the small company is a 'fly-by-night' affair.¹¹ This generalization is doubtless due to the impressively large absolute number of forfeitures among small concerns.

The Maryland forfeiture lists were used also to construct a corporation life table. The companies on each list were classified by the year of their incorporation, and the number for each year was expressed as a percentage of the total incorporations of that year. The procedure will be easier to follow if the reader studies the accompanying tabulation. For example, of the total number of companies on the February 22, 1931 forfeiture list (815), 374 were chartered in 1927 and 136 in 1926. Those corporations of 1927 constituted 35.8 percent of all companies chartered by Maryland in that year, and those of 1926 constituted 13.0 percent of all Maryland corporations of 1926.

To put these data into the life table, the years of incorporation in column 1 were replaced by figures on the estimated life span. That is, a 1927 corporation that forfeited at the first opportunity—namely, February 22, 1931—was considered to have lived not more than one year; and 1926 corporations on that same forfeiture list were considered to have lived more than one but less than two years. The resulting table and similar ones

¹⁰ The percentages of the total in Table 3 and in the last table of Appendix 2 should be used to supplement the data on the size distribution of incorporations in Chapter 6.

¹¹ See, for example, the comment by the Secretary of State of New York: "... they [recently incorporated companies] have a substantial capitalization and are not of the fly by night sort that spring up like mushrooms and vanish almost as quickly" (Press Release on Incorporations, Oct. 1927). See also a Press Release dated July 1928 issued by the same office: "... the greater number of companies are substantially capitalized and there are few of the so-called fly-by-night concerns which incorporate at low capitalization and sooner or later vanish from sight."

built upon subsequent forfeiture lists were combined to form Table 4, hereafter referred to as the Maryland Corporation Life Table.¹² The procedure may have produced a slight bias toward a short life, but it seems justifiable in the light of what has been said above about the tax assessment and billing of corporations by the State Tax Commission. The figures of Table 4 can be

Year of Incorporation of Business Corporations on the Maryland Forfeiture List of February 22, 1931

YEAR OF INCORPORATION	NO. OF CORPORATIONS ON 2/22/31 FORFEITURE LIST	NO. OF INCORPORATIONS IN GIVEN YEAR	% (2) IS OF (3)
(1)	(2)	(3)	(4)
1927	374	1,045	35.8
1926	136	1,049	13.0
1925	84	1,032	8.1
1924	43	934	4.6
1923	29	903	3.2
1922	39	881	4.4
1921	17	852	2.0
1920	18	946	1.9
1919	14	864	1.6
1918	7	403	1.7
1917	2	563	.4
1916	7	580	1.2
1915	4	562	.7
1914	5	521	1.0
1913	3	541	.6
1912	1	566	.2
1911	1	531	.2
Prior to 1911	28		
Unknown	3		
Total	815		

Column 2 was built up through the use of the forfeiture list and the corporate records in the office of the State Tax Commission of Maryland. For the source of column 3, see the Maryland section of Appendix 3.

tied to the above figures by observing the diagonal of data that appears in Table 4 in the first line under 1927, the second line under 1926, the third line under 1925, etc. The diagonal that should have been constructed from the forfeiture list of 1939 (and would appear in Table 4 in the first line under 1936, in the second line under 1935, etc.) was not calculated because of the two forfeiture lists in 1939 (see note 6). As explained above,

¹² Several studies provide comparative data on the life spans of business enterprises. Usually figures are for all firms in a few industries; sometimes data on corporations are given. In comparing figures on corporations, one must note whether the mortality tables are built upon all incorporations or merely corporations that have opened for business. Compare Ruth G. Hutchinson, A. R. Hutchinson, and Mabel Newcomer, *A Study in Business Mortality: Length of Life of Business Enterprises in Poughkeepsie, New York, 1843-1936*, *American Economic Review*, XXVIII, 3 (Sept. 1938), pp. 497 ff.; A. E. Heilman, *Mortality of Business Firms in Minneapolis, St. Paul, and Duluth, 1926-1930*, *Bulletins of the University of Minnesota Employment Stabilization Research Institute*, II, 1 (May 1933); E. D. McGarry, *Mortality in Retail Trade* (University of Buffalo Studies in Business, No. 4, 1930); and A. E. Boer, *Mortality Costs in Retail Trades*, *Journal of Marketing*, II, 1 (July 1937), pp. 52 ff.

1936 was the year chiefly affected by the change in the Maryland law with respect to forfeitures. In the final columns of Table 4, the maximum, minimum, simple average, and 'chained' average percentages for each line are given, together with the cumulations of the average percentages. In calculating each average figure the two percentages at the left of each line were not used, because they were rather seriously affected by the change in the law relating to forfeiture. The 'chained' average needs some further explanation. The figure for 0-1 year of estimated life is the same as that obtained for the simple average. Succeeding 'chained' figures were procured by computing average percentages for each two adjacent life spans for identical sets of years, computing the percentage the second of each pair was of the first, and chaining the results together on 39.1 percent, the figure for 0-1 year of estimated life. These 'chained' figures are given as an alternate series to those obtained by the simple average, because the latter are built on the incorporations of different sets of years.

According to the Maryland Corporation Life Table, almost half of the corporations lived less than 2 years, about 70 percent less than 10 years, while 75-80 percent did not survive their twenty-fifth year. Of course, total incorporations are not fully accounted for except by the inference that 20-25 percent survived more than a quarter of a century. Table 4 indicates a slightly longer life-span for Maryland corporations than the facts warrant, because it is made up only of terminations that were brought about by nonpayment of taxes. (This bias is perhaps partly counteracted by the possible bias referred to above.) The omission of other causes of 'death' is not especially important for the period covered since

the voluntary dissolutions and the involuntary dissolutions under court decrees were relatively few.¹³

The extent to which the Maryland Corporation Life Table may be a basis for generalizations about the life span of American corporations cannot be stated precisely. Since Maryland is one of the so-called 'liberal' states, the mortality rates of the first year or two may be somewhat higher than those of the average state. This hypothesis was partly confirmed by a life table constructed from Virginia forfeiture lists. The table is not reproduced here, because it does not reflect corporate mortality as completely as the table built on Maryland forfeitures; voluntary dissolutions and surrenders have been important methods of terminating Virginia corporations, and it was not feasible to dig out the figures to combine with those from the forfeiture lists.¹⁴ In attempting to generalize about a life table for all American corporations from the Maryland figures, it must also be realized that we know little or nothing about trends in the life span of corporations. Life expectancy of individuals has been lengthening in recent years; it would not be rash to predict that studies of corporate life would reveal similar changes.

¹³ For example, during 1932-35 there was roughly one voluntary dissolution for every 11 forfeitures. (Dissolution figures are published in the biennial reports of the State Tax Commission of Maryland; the data on forfeitures can be calculated from Table 4, but care must be taken to get the sets of diagonal figures that pertain to the forfeiture lists for the years under discussion.)

¹⁴ Voluntary dissolutions and surrenders of Virginia charters have averaged about 320 annually during the last 27 years; charters revoked and annulled have averaged about 570.