Volume Title: A History of Corporate Governance around the World: Family Business Groups to Professional Managers

Volume Author/Editor: Randall K. Morck, editor

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-53680-7

Volume URL: http://www.nber.org/books/morc05-1

Conference Date: June 21-22, 2003

Publication Date: November 2005

Title: Why Has There Been So Little Block Holding in America?

Author: Marco Becht, J. Bradford DeLong

URL: http://www.nber.org/chapters/c10278

11

Why Has There Been So Little Block Holding in America?

Marco Becht and J. Bradford DeLong

11.1 Introduction

A century ago European academics like Werner Sombart worried why the United States was exceptional, in that it had no socialism. Today we academics worry about a different form of American exceptionalism: why is there so little block holding in the United States?

Most other countries have powerful family groups that control substantial numbers of corporations through large blocks, some held through pyramids of holding companies and special classes of shares with extraordinary voting rights. The United States, by and large, does not. Most other countries have holding or other parent companies that maintain substantial control over the affairs of publicly traded and listed operating corporations. The United States, by and large, does not: large parent companies do not have listed subsidiaries. Many other countries have large blocks of shares in individual corporations held or voted by financial intermediaries that play a key role in monitoring and supervising corporate managers. The United States, by and large, does not.

The pattern found in the United Kingdom is in some ways closest to the United States. In the United Kingdom, like the United States, ownership is

Marco Becht is a professor of finance and economics at Université Libre de Bruxelles (ULB), a resident fellow at the European Center for Advanced Research in Economics and Statistics (ECARES) at ULB, and the executive director of the European Corporate Governance Institute (ECGI). J. Bradford DeLong is a professor of economics at the University of California, Berkeley, and a research associate of the National Bureau of Economic Research (NBER).

We would like to thank Fabrizio Barca, Lucien Bebchuk, Patrick Bolton, Chris DeLong, Barry Eichengreen, Randall Morck, Carlos Ramirez, Mark Roe, Ailsa Röell, Andrei Shleifer, participants in seminars at Berkeley, ECARES, INSEAD, and the NBER, and many others for helpful discussions and comments.

diffused. Yet in the United Kingdom institutional shareholders are powerful. In the United States they are not.[1] In most countries the market for corporate control follows the U.K. model—tender offers are rapidly put to a shareholder vote, with the board condemned to passivity. In the United States active boards bargain with bidders, motivated by fiduciary duties, stock options, severance pay packages, and other considerations.[2] In the United Kingdom shareholders rarely litigate. In the United States class-action lawyers are looking for new cases they can bring all the time.

America's peculiarity is made even more striking by the fact that it is not a long-standing historical tradition. America's corporate control exceptionalism has emerged in the past century. Before 1900 America did not lack for powerful family groups, for parent companies, or for financial intermediaries that aggressively embraced the role of monitoring and supervising corporate managers. Turn-of-the-last-century analyst John Moody—founder of the firm that is still one of America's two leading bond-rating agencies—wrote a very influential book, *The Truth about the Trusts,* in 1904, which detailed his understanding of the small and powerful networks of financiers and investors who controlled the governance of America's corporations.

Moody looked forward to a future in which America would have effectively delegated complete control over the "commanding heights" of its economy to an alliance made up of one single family group and one single financial intermediary. The family group was the Rockefellers, who had leveraged their initial Standard Oil fortune into control of a broad range of America's industry. The financial intermediary was the investment banking partnership of J. P. Morgan and Company, which had transformed J. P. Morgan's father's position as the seller of American railroad bonds to British investors into a role as *the* gatekeeper for access to America's capital markets.

Moody wrote his book to persuade American investors and politicians that the future he saw was a good thing. In Moody's view, the personalized

1. Institutional investors in the United Kingdom often operate behind the scenes. Thus, their influence is relatively hard to measure (see Black and Coffee 1994). Their power did become highly visible in the advisory votes on executive remuneration during the 2003 annual meeting season. By contrast, relative impotence of institutional investors in the United States is well documented; see Black (1998), Gillan and Starks (1998), Karpoff (1998), and Romano (2001) for recent surveys. Outside a fully fledged proxy fight, shareholders in U.S. corporations have little say in the selection of corporate directors (Bebchuk 2003; Posen 2003). Forcing the long-standing chairman and chief executive officer of Walt Disney, Michael Eisner, to relinquish his chairman position—after years of below-average performance and above-average remuneration—has been hailed as a major victory for institutional shareholders (*Financial Times,* 14 March 2004).

2. Of course, shareholders may profit from being represented by a board committee that can behave strategically. Burrough and Helyar (1990) narrate the case of RJR-Nabisco, in which the board committee first demanded "final offers" from the bidders, and then reopened the bidding—successfully extracting higher prices for its shareholders' stock.

oligarchic financial capitalism of controlling blocks held by Rockefellers and other plutocrats would be a profitable, effective, and productive organization of American finance. And, indeed, American capitalism at the start of the twentieth century was one in which *family* was very important.

But the organization that Moody foresaw did not come to pass, or to the extent it did come to pass it was proved ephemeral. Sixty years later John Kenneth Galbraith (1967) marveled at the speed with which American capitalism had become impersonal:

> Seventy years ago the corporation was the instrument of its owners and a projection of their personalities. The names of those principals—Carnegie, Rockefeller, Harriman, Mellon, Guggenheim, Ford—were known across the land. . . . The men who now head the great corporations are unknown . . . [and] own no appreciable share of the enterprise. . . . They are selected not by the shareholders but, in the common case, by a Board of Directors which narcissistically they selected themselves.

But for Americans as of the middle of the twentieth century, "Guggenheim" was an art museum—not a family dynasty of mines and natural resources. "Rockefellers" were politicians and a stray banker—not the lords of petroleum and transport. "Carnegie" meant an endowment for international peace and a large number of libraries—not the controllers of the steel industry.

John D. Rockefeller and his immediate associates *controlled* Standard Oil, and much else, in 1900. But by 1930 Gardiner Means (1930, 1931) is looking at a world in which ownership is greatly dispersed, and is trying to think through the consequences of a financial world in which it is nearly impossible to assemble a block of shareholder votes large enough to credibly threaten the incumbents who have control.[3]

3. Of course, 1932 sees the publication of Adolf Berle and Gardiner Means's (1932) *The Modern Corporation and Private Property.* There are interesting differences between the arguments of Means by himself and those of Berle and Means, or at least our perception of the latter's arguments. The "Berle and Means corporation" is controlled by its professional managers, an arrangement that arises from an inevitable (and—in Berle and Means—undesirable) "separation of ownership and control" in the giant corporation. Means (1930) documents a "remarkable diffusion of ownership from 1917 to 1921" that he concludes is "primarily the result of the heavy surtaxes of the war period, a nonrecurring phenomenon" he likens to the one-off increase in small landholdings after the French Revolution. More significantly, Means (1930) suggests that the WWI surtax "concentrated the attention of the former owners of industry on the possibility of retaining control without important ownership, either through the wide diffusion of stock or through various legal devices [footnote: non-voting common stock, voting trusts, pyramided holding companies etc.] and thereby accelerating that separation of ownership and control" (Means 1930, p. 592), a situation not unlike those found in some other countries of the world where powerful families exert a degree of power disproportionate to their ownership. Means (1931) characterizes "control as something apart from ownership on one hand and from management on the other." The real puzzle of the U.S. corporation, then, is how and why professional managers managed to wrest control from the former owners—who could have stayed in control had they taken steps to set up devices to do so.

At the end of 1929 only 11 percent of the 200 largest corporations in the United States were still controlled by large block holders, while 44 percent were controlled by incumbents with much reduced ownership interest. In another 44 percent of cases management was alleged to have taken over control and to have established itself as a self-perpetuating body that Means saw as resembling more than anything else the organizational structure of the Catholic Church, where "the Pope selects the Cardinals and the College of the Cardinals in turn select the succeeding Pope" (Means 1931, p. 87, footnote 7).[4]

We believe that the origins of American shareholding exceptionalism come a generation before *The Modern Corporation and Private Property.* Immediately after 1900—and in a few cases before—the diffusion of shareholding and the shift of power to salaried managers begin. Thus, we believe Galbraith and Means and even Moody were overly optimistic about the Vanderbilts, Carnegies, and Guggenheims as classic block holders. The American exception, the separation of ownership and control, started early. It was spurred by trust promotion, by antitrust policy, and by the ability of investment bankers like J. P. Morgan to successfully sell large blocks of stock to a wide public.

J. P. Morgan successfully sold William Henry Vanderbilt's majority block in the New York Central Railway to the market in 1879 (Chernow 1990, p. 42).[5] In steel, Andrew Carnegie sold his majority block in the Carnegie Steel Corporation in 1901 as U.S. Steel was assembled. In smelting and refining, the Guggenheims sold their majority block in the American Smelting and Refining Company (ASARCO) in 1908–9.

William Vanderbilt and the Guggenheims *wanted* to separate ownership and control. They believed that they could maintain control through their informal influence over the boards of directors and could invest the proceeds of the sales in new diversified ventures. They believed that they had found a way to achieve the benefits of diversification and the ability to en-

4. In corporations, "control will tend to be in the hands of those who select the proxy [nomination] committee by whom, in turn, the election of directors for the ensuing period may be made. Since this committee is appointed by the existing management, the latter can virtually dictate their own successors. Where ownership is sufficiently subdivided, the management can thus become a self-perpetuating body even though its share in the ownership is negligible" (Means 1931, p. 87). This basic mechanism is largely unchanged, and Yermack (1999) recently found evidence that U.S. chief executive officers (CEOs) continue in this tradition and select their own directors. The point was also well made by Kenneth Lay, then CEO of Enron, in a speech given at an April 1999 Houston conference titled "Corporate Governance: Ethics across the Board": "Of course, the CEO, as well as the board, is very much involved in choosing appropriate board members. The process of building an effective board typically reflects what the CEO thinks the company needs at that point in time." Lay appears to have believed that what Enron did not need was an aggressive board-level audit committee.

5. Carnegie took bonds and no stock from U.S. Steel because he thought the new steel near-monopoly was overvalued. He was sorry.

ter new sectors, all without loosing de facto control over their original enterprises.[6]

> In selling off majority control of ASARCO, the Guggenheims were following advice from their lawyers and bankers that was popular at that time and remained popular for the next half-century. This theory held that it was neither necessary nor possible for individuals or a family to retain actual majority ownership of a large enterprise. Control could be as easily maintained by splitting the stock up into small lots and selling to a broad segment of the public. . . . Morgan showed Vanderbilt how it could be done. He proceeded to show hundreds of other capitalists how they could do the same. (Hoyt 1967, p. 193)

Among the 200 largest U.S. corporations in 1937, few had families with majorities of the voting shares. Many had families that dominated the boards of directors.

And today? La Porta, López-de-Silanes, and Shleifer (1999), ECGN (1997), and Barca and Becht (2001), among others, find that the United States is exceptional in the limited influence and small size of its major block shareholders.[7] Among the 200 largest U.S. corporations in 2004, the Ford family and the Ford Motor Company are exceptions to the exception, just as they were in 1937. In the short run of years the owners who believed that they could use the services of J. P. Morgan and Company to achieve

6. Carnegie sold out to the J. Pierpont Morgan–promoted U.S. Steel trust, which had a J. P. Morgan–dominated board and was run by Carnegie's own professional manager, Charles Schwab. Carnegie did not reinvest the proceeds of the sale for profit but in philanthropic enterprises.

7. La Porta, López-de-Silanes, and Shleifer (1999) rationalize the pattern of block holding around the world as a result of nations' small-investor protections, or lack thereof. One sacrifices the benefits of diversification and takes on extraordinary amounts of idiosyncratic risk when one fears that the legal system will allow the effective expropriation of small shareholders. Thus they would expect to—and they do—find more block holding where legal protections of small shareholders are weak.

It is not clear to us whether this general worldwide argument can explain all of America's absence of block holding, for legal protections against formal expropriation and explicit tunneling appear to us to be insufficient to fully resolve the principal-agent problem first identified by Berle and Means. It is true that today the risk that in the United States small shareholders will be illegally expropriated by managers or large blockholders is small, despite an avalanche of successful class action suits. But (illegal) expropriation is only one danger to shareholder wealth. For example, Bebchuk (2002) makes a powerful and convincing (to us at least) argument that recent American compensation practices amount to shareholder wealth expropriation, a view that is widely shared among institutional shareholders, the general public, and the press. Equally, Moeller, Schlingemann, and Stulz (2002) argue that acquisitions at the end of the 1990s have destroyed billions of dollars of shareholder wealth. However, both views are contested by Holmstrom and Kaplan (2003). Managerial groupthink generated over time as managers choose like-minded sycophants to be their successors provides another reason for shareholders to fear American-style managerial capitalism. Legal protections cannot guard against this source of reduction in shareholder value, which may be a more important spur to block holding and shareholder voice.

diversification and maintain control were probably right. In the long run of generations they were wrong.

This lack of block holders appears to have had important and powerful consequences for American corporate governance. Mark Roe begins his 1994 *Strong Managers, Weak Owners* with an anecdote about General Motors (GM). At the start of the 1990s, the two largest shareholders of GM wanted to express their views on how GM should select its new CEO. The GM Corporation paid no attention to them at all—a degree of managerial autonomy that is hard to imagine being the rule in almost any other industrial economy (Roe 1994, p. xiii).

Becht, Bolton, and Röell (2002) maintain that the key issue is to find the point of balance between managerial discretion and small shareholder protection: too much concern for protecting small shareholders from block holders allows managers to reinterpret their end of the corporate contract. Too much power on the part of large shareholders, and small shareholders are left vulnerable to expropriation, while managers are monitored too closely. If the experience of other industrial countries is any guide, America is way to one side of the point of balance. This suggests that it may well be paying heavy costs as a result of its institutional failure to minimize the damage done when shareholders fail to monitor and enforce their open-ended contracts with top corporate managers.[8]

Mark Roe (1994) believes that America evolved its exceptional form of non-block holding and its exceptional forms of corporate control due to "politics." Ever since the age of Andrew Jackson in the 1830s, Americans have loved the market but hated monopolists. Americans love the market because it makes them free and gives them the power to say no: if you don't like the deal you are being offered here, simply walk down the street a block and bargain with the next potential seller. But suppose that there is only one monopolist? Then you are not free but controlled.

In Roe's political interpretation, those seeking to limit and curb financial concentration and control—whether small rural bankers, corporate managers, or others—found that their arguments struck this deep chord in and resonated with Americans' basic way of viewing the world. By asserting the existence of a "money trust," they mobilized American politics to destroy every effective financial institution that might have held blocks and exerted control over American managers. In Roe's view, technology created the necessity for hundreds of thousands of shareholders. Politics crippled the institutions—*grossbanken,* insurance companies, mutual funds, pension funds—that would otherwise have taken their supervisory and

8. However, the extraordinary relative success of the American economy over the course of the twentieth century does make one much less confident about making judgments of large-scale century-long failure in America's markets for corporate control. This might be due, at least in part, to finance economists' exaggeration of the importance of the widely held managerial corporation in the economy as a whole.

control functions seriously and reduced the magnitude of the shareholder-manager principal-agent problem in corporate finance.

Roe's argument is eloquent, powerful, and largely convincing. But it seems to us that it has four holes. First, the victory of American populism and progressivism in the struggle over the organization of corporate finance was not foreordained. Populists lost in the turn-of-the-twentieth-century struggle over the American monetary system. Progressives won a partial victory in the struggle over the role of unions in the mid-1930s, but that partial victory was itself substantially rolled back little more than a decade later—and ever since then American private-sector unions have been in an inexorable decline. Roe has a hard time answering why "politics" in its American populist-progressive tenor was so strong in corporate finance yet weaker in labor-management relations and completely powerless in monetary affairs.

Second, there are two ways that block holders can function. The block holder can be a financial institution that aggregates the small shareholdings of a great deal of individuals into a block. The block holder can be a plutocratic family that wishes as a matter of family policy to have voting control. Roe (1994) makes a strong case that specific financial regulation prevented financial institutions—banks, insurance companies, pension funds, and mutual funds—from holding blocks, as they allegedly do in German and Japan. Families were not subject to these legal restrictions. What other regulation, if any, prevented families from holding large blocks, as the Ford family has successfully done for more than a century?

Third, in *The Visible Hand,* Alfred Chandler (1977) argues that *ownership* separated from *management* because of technical progress. Roe (1994) follows this argument. Chandler brushed aside the possibility that ownership separated from control and control was also separate from management. We agree with Chandler and Roe that the desire for diversification is a powerful force that can and should induce families to disperse ownership, but we raise the question why control was not separated from both ownership *and* management.

Diversification is a very valuable thing: go drink coffee at Il Fornaio in Palo Alto some weekday morning, and you may see some people—people who failed to diversify—who were worth more than a billion dollars four years ago and are worth some ten million today. But there are ways of dispersing ownership without putting control into the hands of professional managers. The fortune- and control-holding families of other countries have built institutions to retain corporate control with dispersed ownership, even when hiring a professional manager: through pyramids of holding companies and special supervoting classes of stock, they have managed to effectively diversify their portfolios enough to remove most of the idiosyncratic risk without sacrificing effective control. Why didn't the major plutocratic families of turn-of-the-twentieth-century America take this road? Did they believe that the solution J. Pierpont Morgan had pioneered for William Vanderbilt was an effective way of dispersing ownership while retaining effective control? Were they not worried about proxy contests? Could they not foresee that the only reliable means of preventing a corporate palace revolution is voting control?

Fourth, diversification is not the only economic force that can cause dispersion. American corporations could have used debt finance or retained earnings, instead of diluting their founders' stakes through new equity issues and equity-financed acquisitions. Why did America's family-controlled corporations rely so much on equity-based finance and growth through acquisitions? Was it the financial system and the need to transport capital over large distances that drove corporate America to Wall Street? Was it regulation that made Wall Street inevitable for corporate America?

Thus our task in this paper is to fill in these gaps in the story of Roe (1994). We do so in five stages. After this first, introductory section, in section 11.2 we briefly paint a picture of industrializing America's corporate finance in the first decade of the twentieth century, arguing that America then looked like a normal developing family- and finance-capitalist economy as far as corporate oversight and control was concerned. Section 11.3 considers the remarkable democratization of shareholding that took place between World War I and the end of World War II: the benefits of sacrificing control for diversification hinge on how deep the market into which you are trying to sell your controlling block is, and a number of factors from the high-pressure war bond sales campaigns of 1917–18 to the writings in popular magazines of share ownership advocates like Edgar L. Smith (1924) to the media coverage of Wall Street celebrity culture in the 1920s made U.S. markets much deeper—and thus the sacrifice of diversification for control in the United States much more attractive—than elsewhere. It also discusses the attempts by block holders to find durable institutional instruments through which to exercise control, and the government's pursuit of such block holders through the thickets of law and institutions: the original "voting trusts" were replaced by "holding companies"; companies with multiple classes of stock had difficulty getting listed on exchanges (but is that cause or effect?); antitrust regulators sought to put controls on holding companies and pyramids. The coup de grace, however, was dealt by an accidental outside shock: the great crash and the Great Depression. The Insull and Van Sweringen pyramidal empires were completely bankrupted when what had been seen as prudent leverage proved disastrous in the Great Depression itself.

Section 11.4 looks back from the end of the 1930s: no more "money trust," few blockholders, and the approach of managerial capitalism. Section 11.5 then concludes.

Our conclusions do not make as neat a story as we would wish, at least not when we put on our hats as economists. We would wish for a single straight-line narrative: *America's populist-progressive politics made large-scale block holding impossible;* or *America's continental size made its firms enormous, and block holding extremely expensive in terms of the sacrifice of diversification it entailed;* or *the competence of America's managerial class combined with strong protections for small shareholdings greatly diminished the relative benefits of block holding;* or *the early and extraordinary taste on the part of Americans for shareholdings made the relative benefits of diversification much larger in America.*

Yet the story as we have to tell it is messier. The populist-progressive political tradition in America exerted pressure against finance capitalism, but the populist-progressives were not the main current of American politics. Recall that for more than half a century before 1948, the only way a Democrat got into the presidency was (a) in the Great Depression itself and (b) when Theodore Roosevelt's feud with William H. Taft led Roosevelt to split the Republican Party and the Republican vote.

America's continental size made its firms enormous, but it also made its entrepreneurial fortunes enormous as well: the Rockefellers, the Carnegies, the Mellons, even the Morgans had very few peers in Europe. Certainly many American holders of control blocks gradually peeled off shares and watched their influence shrink because they had confidence in their managers, but shouldn't they have been thinking more long term? Were New Jersey's, and later Delaware's, protections for shareholders that much better than anywhere else? Were America's markets really that much deeper and that much more able to absorb diversification than anywhere else?

If Mark Roe's story is one of "politics" (plus the economics that made immense corporations efficient due to their massive economies of scale and the requirement for hundreds of thousands of shareholders), our story is one of fast-growing corporations in a large country with a large single market and a vast appetite for capital—"frenzied finance"—plus a large number of contingent historical accidents, rather than convergence to a "rational" system of corporate governance and control. During the 1990s, when the U.S. Internet boom seemed unstoppable, it was fashionable to predict that corporate governance around the world would soon mirror the U.S. model: private executives would receive high-power incentive pay in the form of stock options, and they would be kept in check chiefly by the specter of mergers or takeovers resulting from low stock prices. Labor unions, major-institution shareholders, and rich-family financiers—key influences in corporate control in other countries—would become less important.

Some signs supported the convergence view. Managers in other countries looked enviously at the magnitude of the capital flowing through U.S. financial markets and the easy terms on which funds could be raised. Corporate governance in Europe, Japan, and emerging markets appeared to be shifting in the U.S. direction, as foreign firms that wanted to be listed on U.S. stock exchanges tried to make their systems appealing to American investors. In at least one aspect—the number of shareholders per firm—convergence is probable. Firms with a broad shareholder base have an easier time tapping pension fund money via the New York and London markets.

But to the extent that the U.S. system is the result of a number of historical accidents that eroded the power of pyramid-dominating families and large institutional investors, perhaps the convergence we can expect in the future is more likely to be toward a mixed model. Recall that widely distributed ownership is compatible with strong institutions that vote large share blocks through proxies, as well as with dispersed voting rights and contestable board control, as in the United Kingdom. And recall that it is just as compatible with uncontestable board control nominally exercised in the interest of shareholders—as in the United States, with their poison pills and entrenched directors, or as with the Netherlands' priority shareholders, who possess the sole right to nominate directors for election to corporate boards.

It is not clear that the next generation of the Gates family will have as little influence on American corporate control as the current generation of the Rockefeller family does. It is not clear that the large American financial institutions of the twenty-first century—two of which are still likely to bear the name of "Morgan"—will have as little influence on American corporate control as the firms of the mid-twentieth century did.

11.2 Rockefellers and Morgans: American Financial Capitalism at the Start of the Twentieth Century

In 1904 John Moody—then perhaps the most respected commentator on and analyst of Wall Street—wrote *The Truth about the Trusts* to give his view of the extraordinary wave of economic development and industrial concentration in turn-of-the-last-century America. John Moody argued that big business was here to stay and was getting bigger. "Trusts" were here to stay.[9] Moreover, "trusts" were by and large good things: economies of scale meant that big business—large hierarchical Chandlerian[10] corporations—were efficient and productive, and they delivered goods to consumers at low cost. It was true that trusts came with elements of monopoly

9. The word *trust* originally referred to the voting trust set up by Standard Oil's lawyer S. C. T. Dodd to bring the various Standard Oil companies operating in different states (and holding corporate charters issued in different states) under centralized control; see Dodd (1893). Moody pioneered the modern usage of the word, referring to any form of industrial combination with an impact on product market power, irrespective of the legal technique used. Hence Moody's "trusts" include voting trusts proper, holding companies, amalgamations, and other types of horizontal combinations.

10. See Chandler (1977).

power attached. But the monopoly element was a necessary cost in order to obtain the enormous economies of scale. Furthermore, the monopoly element was not all bad, for competition led to instability and turmoil, while the higher costs of monopolized markets were somewhat offset by the regularization of supply that large-scale planning by a dominant firm made possible. As Moody wrote (p. xix), "monopoly is the mother of our entire modern industrial civilization. It is institutional and men must reckon with it."

Moody's case was not completely false. After all, muckraker Ida Tarbell's principal objection to the Standard Oil Trust was not that it charged consumers prices that were too high. It was that Standard Oil used its *monopsony* power to force railroads to charge it lower prices for shipping oil, and used its *scale* to reduce manufacturing costs. It thus drove smaller and less efficient oil refiners out of business. From Tarbell's point of view, the prices that Standard Oil charged customers were not too high, but too low.[11] From Moody's point of view, the Progressivist attraction to Tarbell's advocacy of small business was very dangerous for the future of the American economy. For economic progress depended on efficiency. And efficiency depended on trusts: large, hierarchical, integrated corporations with monopoly power that served as islands of efficient central planning within the market economy.[12]

For our purposes, however, the most important part of Moody's argument is what comes next in Moody's logical sequence: his claim that America owes an enormous debt for its industrial development to one extended family (and its partners and allies)—the Rockefellers:

11. See Tarbell (1904). One of the great fights in the early twentieth century was over whether the antitrust laws existed to protect consumers from rapacious monopolies charging them high prices or to protect small-scale business against more-efficient large-scale businesses that threatened to charge customers low prices. In the first half of the twentieth century, this political struggle largely ended in a draw: the answer was "both." Only in the years after the 1970s, in one of the greatest and most extraordinary projects of activist judge-made law in American legal history, did the aggressive and activist judges of Chicago remake antitrust law and give it an explicit rationale: that of maximizing economic surplus. See Bork (1978).

12. In a side argument, Moody (1904) defends the trusts against an alternative critique also made by Progressives: that the trusts cheated investors by being *unsuccessful* and failing to be good enough monopolists to produce the promised dividends. In the decade of the 1900s initial and post–initial public offering (IPO) investors in Morgan's International Mercantile Marine and in the Rockefellers' Amalgamated Copper (see Lawson 1905) lost their shirts, and even investors in Morgan's U.S. Steel took a severe haircut. But Moody writes (p. xxi): "In the majority of instances, however, they no doubt went in with their eyes more or less open. The average man who buys industrial issues . . . knew or ought to have known that he was going into a gamble . . . stocks yielding from 8% to 15% when prevailing interest rates were only 4% to 5%. No sympathy need be wasted on the many noisy speculators who are now condemning all Trusts because they themselves happened to be caught in the speculative crash." Although there is then some backtracking: "Of a different nature, of course, are . . . widows, orphans . . . induced to transfer their hard-earned savings into stocks like Steel common . . . by trusted advisors who ought to have known better."

> The large diagram facing the Introduction [of *The Truth about the Trusts*] gives an indication of the extent to which the Greater Trusts are dominated by that remarkable group of men known as the "Standard Oil" or Rockefeller financiers. These men . . . entirely control or make their influence felt to a marked degree . . . [in] all the Greater trusts. They are in fact the real fathers of the Trust idea. . . . Standard Oil. . . . But it is not merely in oil and its allied industries . . . [that] Rockefeller interests are dominant. . . . [The] Copper Trust and the Smelters' Trust . . . closely identified with the mammoth Tobacco Trust . . . a marked influence in the great Morgan properties . . . U.S. Steel . . . hundreds of smaller Industrial Trusts, the Rockefeller interests are conspicuous . . . different members of the Standard group of financiers . . . identified with a great many of the prominent Trusts. . . . [I]ndirect influence is of great importance in many other industrial consolidations. (p. 490)

Moreover, Moody sees the power of the Rockefeller family and its partners to control the American economy on a steady upward growth curve. In railroads, for example, Moody sees

> S[tandard] O[il] interests . . . [as] steadily increasing their influence. . . . [The] Gould-Rockefeller [group of railroads] . . . is, of course, directly dominated by them; but . . . Standard [Oil] influence [is already] felt . . . forcefully in all the Railroad groups, and . . . is showing a steady growth throughout the entire steam railroad field. (p. 491)

Moody ends his discussion of railroad finance by saying that it is "freely predicted in Wall Street" that within a decade the United States will see the "Rockefeller interests [become] the single dominating force in . . . railway finance and control."

Moreover, Moody sees the Rockefeller interests as only part—although definitely the senior partner part—of the finance capitalists who he expects to see controlling nearly all large American corporations within the near future. First, there are the other major robber baron families that made their fortunes during the Gilded Age and that now work hand in glove with the Rockefellers (p. 493): "smaller groups of . . . Pennsylvania Railroad interests . . . Vanderbilts and . . . Goulds . . . closely allied with the Rockefellers . . . on most harmonious terms with the Moore's of the Rock Island system, and the latter are allied in interest quite closely with . . . Harriman." The picture painted is not one in which rich families typically clash: in Moody's view, the era of the great struggles for control between different robber baron factions was over.[13] The picture painted is one much closer to that of Silicon Valley venture capitalists in the 1990s, where each of a number of venture capitalist firms would contribute capital to one another's

13. He was not completely correct. The great Northern Securities Panic of 1904 occurred while Moody's book was in press. And the late 1920s saw more struggles for control erupt as the stock market bubble grew.

deals, but in which challenges for the lead role as principal financier and advisor appeared to be very rare—and to be thought of as not quite kosher, as breaking the rules of the game as played by gentlemen.

Second, there was the House of Morgan, assisted by the smaller investment banks of the early twentieth century. Here again Moody saw the community of interest among financiers as overwhelming (p. 493):

> It should not be supposed, however, that these two great groups of capitalists and financiers [the Rockefeller and the Morgan interests] are in any real sense rivals or competitors for power, or that such a thing as "war" exists between them. . . . [T]hey are not only friendly, but they are allied . . . harmonious in nearly all particulars. . . . These two mammoth groups jointly . . . constitute the heart of the business and commercial life of the nation, the others all being the arteries which permeate in a thousand ways our whole national life, making their influence felt in every home and hamlet, yet all connected with and dependent on this great central source, the influence and policy of which dominates them all.

Indeed, if the Rockefeller family after its extraordinary upward ride in wealth via Standard Oil possessed the wealth to buy control of whatever company or group of companies it chose, the House of Morgan—and the few other smaller investment banking partnerships—held a near lock on the ability to sell large blocks of bonds and equities into the not-yet-terribly-thick New York and London markets. Morgan had acquired its reputation by being over decades a reasonably honest broker in advising potential British investors about which American railroads were uncorrupt (and by participating in reorganizations to try to guarantee that the newly recapitalized railroad company would remain uncorrupt). It had competitors, but they were few. When questioned by Pujo Investigating Committee Chief Counsel Samuel Untermyer in 1912, Morgan's close associate George F. Baker (president of New York's First National Bank) could not name "a single [securities] issue of as much as $10 million . . . that had been made within ten years without the participation or cooperation" of J. P. Morgan; Kuhn, Loeb; Kidder, Peabody; or Lee, Higginson.[14] With American securities issues then running at a pace of about $500 million a year, that is an extraordinary degree of concentration.

The fact of the matter is that if you wanted to establish or operate a large enterprise—whether railroad, municipal utility, or industrial—in the United States at the start of the twentieth century, you had to work through or please one of a very small number of gatekeepers: the Rockefellers or one of their largely allied families (Elkinses, Wideners, Vanderbilts) for key blocks of capital, and Morgan or one of the other few investment banks for the seal of approval that would gain one's securities a market. These groups appear not to have competed against each other: when capital-stressed

14. See DeLong (1991).

AT&T went looking for rescue during the panic of 1907, it found that Morgan lieutenant George F. Baker offered it take-it-or-leave-it terms: either throw out your president and change your entire corporate strategy, or go bankrupt. AT&T's incumbent management was unable to find another negotiating partner, and acceded to Baker's terms.[15]

11.2.1 Standard Oil

The early history of Rockefeller's Standard Oil illustrates the influence of legal innovations and antitrust regulation on the evolution of ownership and corporate organization in the pre-WWI period.

1865–67: Partnership

Standard Oil has its origins in a partnership set up by John D. Rockefeller and the English engineer Sam Andrews in Cleveland in 1865 trading under the name "Rockefeller and Andrews."[16] On 4 March 1867 they were joined by Henry M. Flagler, whom Rockefeller liked and who gave him access to financing from the wealthy Cleveland businessman Stephen V. Harkness.[17] William Rockefeller, John D.'s brother, provided a Wall Street connection. The expanding "Rockefeller, Andrews, and Flagler" partnership was soon in need of further capital and confronted with problem of bringing in outside investors without losing control.

1870–78: Ohio Corporation

It was Flagler who found the solution: in 1870 the Standard Oil Company (Ohio) was incorporated, with Rockefeller family members holding 50 percent of the shares, as shown in table 11.1: John D. Rockefeller (the president) held 26.7 percent, William Rockefeller (the vice president) 13.3 percent, and William Rockefeller's brother-in-law, Oliver B. Jennings, another 10 percent. Flagler (the secretary and treasurer) held 13.3 percent, his relative S. W. Harkness 13.3 percent, and Sam Andrews 13.3 percent.[18]

Over the course of the next decade the shareholdings of Standard Oil be-

15. See DeLong (1991): "The investment bankers' price for continuing to finance the company was that its next president should be . . . Theodore N. Vail . . . [because] George F. Baker had been very impressed with Vail's performance in other dealings" and that it should adopt Vail's previously proposed strategy of "rapid nationwide expansion . . . to a true nationwide telephone system."

16. Rockefeller and Andrews were breaking away from a previous partnership with the Maurice, James, and Richard Clark (Andrews, Clark, and Co.), whom Rockefeller did not get on with and who had the majority of the votes in the partnership (Chernow 1998, p. 85). Rockefeller, the junior partner, essentially eliminated the three Clarks from the partnership that continued as "Rockefeller & Andrews" (Chernow, pp. 87–88).

17. Harkness had made his money with liquor deals, but this did not seem to disturb puritan Rockefeller (Chernow 1998, p. 106).

18. Chernow (1998, p. 133) states that the remaining 10 percent were "divided among the former partners of Rockefeller, Andrews and Flagler," which seems to imply that the partnership had other partners. We have not yet tracked down the original structure.

Table 11.1 **Standard Oil shareholders, 1870**

Name of shareholder	Shares	%
John D. Rockefeller	2,667	26.7
Henry M. Flagler	1,333	13.3
Sam Andrews	1,333	13.3
William Rockefeller	1,333	13.3
Stephen Harkness	1,334	13.3
Oliver B. Jennings	1,000	10.0
Former partners	1,000	10.0
Total	10,000	

Source: Chernow (1998).

came more complex, as shown in table 11.2. Principals gave some of their shares to family members. Other executives and local Cleveland financiers acquired stakes. And the enterprise grew at staggering speed.

1879–82: Ohio Trust

Under Ohio corporation law the Standard Oil Company (Ohio) could not own stock in other corporations and operate outside the state. In reality the Standard Oil companies were run from 26 Broadway in New York. In 1879 a first legal solution to this problem was found, a trust agreement that gives us a second glimpse at the shareholder structure of Standard Oil. Three middle-management employees of Standard Oil Ohio were made to hold the shares of the Standard Oil companies outside the state of Ohio in trust (Messrs. Myron R. Keith, George F. Chester, and George H. Vilas). Dividends received were passed on to the thirty-seven shareholders of Standard Oil Ohio, in proportion to their holding (see table 11.2).[19] The group of shareholders had grown to thirty-seven, but the Rockefellers were still holding a 30 percent block that put them in a position of control.[20]

1882–92: New York Trust

The 1879 trust agreement solved the problem of interstate ownership and control but was not suitable for expanding the shareholder base while keeping control in Rockefeller hands. Standard Oil's solicitor, Samuel C. T. Dodd, devised the second trust agreement, which was a legal masterpiece and extremely influential.[21] The shares of all Standard Oil companies were

19. For a facsimile of the 1879 trust agreement see Stevens (1913).

20. Sam Andrews is no longer on the list. In 1878, after a disagreement over payout policy (Rockefeller wanted high retained earnings, Andrews wanted more dividends), John D. Rockefeller bought out Andrews's stake (Chernow 1998, p. 181).

21. As we have seen, the word *trust* became synonymous with all types of major industrial combinations no matter what legal instrument was used and has survived as "antitrust" to this day and age.

Table 11.2 **Standard Oil shareholders, 1878**

Name of shareholder	No. of parts in trust (proportional to shares held in Standard Oil of Ohio)	%
W. C. Andrews	990	2.8
John D. Archbold	350	1.0
F. A. Arter	35	0.1
J. A. Bostwick	1,872	5.3
D. Brewster	409	1.2
Daniel Bushnell	97	0.3
J. N. Camden	132	0.4
H. M. Flagler	3,000	8.6
Hanna & Chapin	263	0.8
S. V. Harkness	2,925	8.4
D. M. Harkness	323	0.9
L. G. Harkness	178	0.5
Gustave Heye	178	0.5
John Huntington	584	1.7
Horace A. Hutchins	111	0.3
Estate of Josiah Macy	892	2.5
Chas. Lockhart	1,408	4.0
W. H. Macy	59	0.2
W. H. Macy, Jr.	28	0.1
A. M. McGregor	118	0.3
O. H. Payne	2,637	7.5
H. W. Payne	292	0.8
O. H. Payne, trustee	61	0.2
A. J. Pouch	178	0.5
Charles Pratt	2,700	7.7
C. M. Pratt	200	0.6
Horace A. Pratt	15	0.0
John D. Rockefeller	8,984	25.7
Wm. Rockefeller	1,600	4.6
O. B. Jennings	818	2.3
Henry H. Rogers	910	2.6
W. P. Thompson	200	0.6
J. J. Vandergrift	500	1.4
W. T. Wardell	78	0.2
W. G. Warden	1,292	3.7
Jos. L. Warden	98	0.3
Warden, Frew & Co.	485	1.4
Total	35,000	100.0

Source: 1878 Trust Agreement (reproduced in Stevens 1913).

placed in a single trust with nine trustees, who exerted central control over all Standard Oil companies but formally did not own anything. As before, dividends were distributed to the holders of the trust certificates in proportion to their holdings. The holders of the trust certificates appointed the trustees in a vote, but the Rockefellers, Flagler, Payne, and Harkness continued to hold a majority of the certificates, and the trustees were appointed for a staggered term.[22] In fact, Dodd had managed to create a takeover-proof holding company operating an interstate business out of New York, an arrangement that conformed with the letter of the law, but not the spirit.

1892–98: "Community of Interest"

The regulators responded. In 1889 several states passed antitrust laws, and in 1890 Congress passed the Federal Sherman Antitrust Act, marking the beginning of an ongoing struggle between Standard Oil, antitrust reformers, and antitrust enforcers at the federal and the state level.[23] The first (apparent) setback came on 2 March 1892, when the Supreme Court of Ohio ruled that the Standard Oil trust agreement violated the law, and on 10 March 1992 the Standard Oil trust announced that it would dissolve, exchanging trust certificates in proportional amounts of shares in each of the constituent companies. This gives us the next opportunity for observing that the nine trustees jointly held more than 50 percent of the trust certificates. John D. Rockefeller alone held a 26.4 percent stake, allowing him and his associates to exert majority control in all Standard Oil companies.[24]

1898–1911: New Jersey Holding Company

Between 1888 and 1893 the state of New Jersey reformed its corporate law, explicitly allowing New Jersey corporations to own stock in corporations in other states of the Union. As a result, new incorporations (and state income from fees) shot up, and New Jersey became known as "the home of the trusts" (read, holding company; Stoke 1930). Standard Oil followed suit in 1898, and the "community of interest" was replaced by the Standard Oil of New Jersey, turning itself into a New Jersey holding company and owning the stock of the Standard Oil companies in the other states.

Standard Oil was no exception. With regulation and active attorneys depriving the trusts of their original legal instrument, they turned to the legal instruments that were still available: the "community of interest," the hold-

22. The 1882 trust agreement is also reproduced in Stevens (1913).

23. See Thorelli (1955) for a detailed account of the political history leading up to the passage of the act.

24. Curiously, it took a considerable amount of time before the other certificate holders performed the exchange. In this period, the trustees continued to control the old trust and voted almost all the exchanged shares in the constituent companies (Hidy and Hidy 1955, p. 226).

ing company, and outright fusion. The holding company was used as often as outright fusion, including well-known names like Eastman Kodak, U.S. Steel, and the E. I. du Pont de Nemours Powder Company (Bonbright and Means 1932, pp. 68–72).

But again, the enforcers caught up. In 1904 the Supreme Court culled the J. P. Morgan–led merger of the great transatlantic railroads through the Northern Securities Holding company (Ripley 1915), casting serious doubts on the effectiveness of the holding company as a vehicle for circumventing antitrust regulation in the context of horizontal combinations. Worse, in 1911 the Supreme Court ruled that the American Tobacco Company, which had been created through outright fusion, was also in violation of the antitrust laws.[25] The landmark ruling breaking up Standard Oil into its constituent companies was pronounced in the same year, marking the de facto end of Rockefeller rule over the oil industry.

Thus, if we can take John Moody as a reliable observer,[26] American corporate control at the start of the twentieth century appears to have looked remarkably "normal," where "normal" is understood as "like other coun-

25. See Stevens (1913) for a facsimile of the court's decision.

26. We believe that we can take Moody as a reliable observer. While historians like Fritz Redlich (1951) take Moody and others (like C. W. Barron, as reported in Pound and Moore 1931, or Frank Vanderlip, as reported in Vanderlip and Sparkes 1935) at face value, some other historians of American finance do not. Financial historian Vincent Carosso (1970) argue that Pujo Committee Chief Counsel Louis Untermyer could only claim there was a "money trust" by redefining it as a "loose, elastic" term meaning not a formal organization of any kind but an "understanding," and that even so investment bankers could not exercise "control" because they were always less numerous than the non–Wall Street directors (pp. 139, 151–52). Huertas and Cleveland's history of Citibank (1987) argues that the investment banking market at the start of the twentieth century was a contestable one: that had a railroad executive like C. W. Mellen wished to use other partnerships than J. P. Morgan and Company to float securities for his railroad's expansion, he would have found no obstacles to doing so. Had other firms wished to compete with J. P. Morgan for, say, the underwriting of U.S. Steel, they would have found it possible to do so. But profits are small in contestable markets, and the underwriting profits from U.S. Steel were as large a share of their economy then as $30 billion would be for us now (DeLong 1991).

There is, however, no doubt that there are other issues than concern for the public interest in many Progressives' attacks on the money trust. Perhaps Louis Brandeis was more—or as—interested in protecting the property of his Boston railroad financier clients and allies from competition from Morgan-financed railroads as he was in advancing the public interest. Certainly Samuel Untermyer had found cooperation with the "Money Trust" more advantageous than criticism of it. Huertas and Cleveland (1987) write that Untermyer was an "aspiring politician" for whom the Pujo media spotlight was a wonderful opportunity. He thus changed his position 180 degrees, for in 1910 Untermyer had dismissed monopolization as a nonproblem in American industry and had attacked demagogues who hoped to use it as an issue. Huertas and Cleveland cite Kolko (1963, p. 359).

The situation seems to us analogous to that of the late Roman Republic's parties of *optimates* and *populares.* Just as Untermyer changed sides, and just as Progressive Money Trust–hating congressman Charles Lindbergh's son Charles, the aviator, was to marry Morgan partner Dwight Morrow's daughter Anne, so Rome's feuding elite patrician factions fought viciously over political control between time-outs for marriages and realignments. But this does not mean that there were not real issues involved in *optimates'* and *populares'* disputes over land settlement policy for veterans and imperial expansion.

tries." Immensely wealthy families with powerful voting blocks. Stock locked up in "trusts" (voting trusts, holding companies, amalgamated corporations) whose trustees and boards closely scrutinize managers. Large financial institutions that see it as their business to choose and unchoose corporate managers, and that by and large respect each other's relative spheres of industrial influence. As Charles Mellen, president of the New York, New Haven, and Hartford Railroad, put it in a private conversation with journalist C. W. Barron, he was a thrall of J. P. Morgan and company: "I wear the Morgan collar, but I am proud of it."[27]

But then it began to fall apart.

As Mark Roe (1994) details, the American "money trust" was subjected to a powerful political attack in the first two decades of the twentieth century. A Democratic Party anchored in the west and south with leaders like William Jennings Bryan and Woodrow Wilson fought hard to claim the banner of "Progressivism" for its own and to reduce the illegitimate power over the nation's economy wielded by the bankers, financiers, and industrialists of that strange and un-American city that was New York.[28] Theodore Roosevelt tried first to co-opt that Progressive movement and then to split the Republican Party by joining the attack against America's "malefactors of great wealth."

The Progressive critique focused on two sets of issues. The first was the simple existence of *economic power*—a situation in which someone's economic future depended on their pleasing one particular gatekeeper. In the view of Progressive leader Louis Brandeis, this dammed entrepreneurship and initiative. Who would dare to cross or to question the judgment of a Morgan or a Rockefeller? As Brandeis told Morgan lieutenant Thomas Lamont at a private meeting in 1913, "You may not realize it, but you are feared."[29] And, Brandeis added, this fear was a very unhealthy thing: "I believe the effect of your position is toward paralysis rather than expansion."[30]

Second, the Progressives' belief in fair play was outraged by the fact that the Rockefeller, Morgan, and allied groups at the top of America's finance capitalist pyramid turned conflict of interest into a lifestyle. Investment bankers and insider block holders were principals themselves, were the bosses of corporate managers who had fiduciary duties to try to sell off securities at as high a price as possible, and also were the bosses of or exercised substantial control over the managers of financial intermediaries

27. See Pound and Moore (1931, p. 273).

28. See Hofstadter (1964).

29. As Brandeis said he had discovered from his own personal experience with the financing of the New York, New Haven, and Hartford Railroad: "I went to some of the leading Boston bankers. . . . I said . . . 'Won't you please act . . . [?] Their reply . . . was that they would not dare to . . . that it would be as much as their financial life was worth to try to poke their fingers in." See Lamont (1913).

30. See Lamont (1913).

who had the exact opposite interest. They thus had the freedom to sacrifice the interests of one set of principals to another, or to sacrifice both of the other sets of interests to their own private profit—for they themselves were both principals as block holders and middlemen as the key intermediaries in large-scale transactions. Few moments in the history of congressional investigations are more eye-opening than George W. Perkins, partner in J. P. Morgan and company and vice president of New York Life, arguing to Arsene Pujo's congressional investigative committee and its chief counsel Samuel Untermyer that there was no conflict of interest: that even though Morgan was selling the securities and New York Life was buying them, he knew at every moment whether he was a principal (in his role as partner of Morgan) with an interest in selling at a high price or an agent of the policy holders (in his role as vice president of New York Life) with an interest in buying at a low price, and could act accordingly (Pujo Committee 1913b).

From the Progressives' point of view, this was mendacious nonsense. Louis Brandeis (1913) invoked the authority of Jesus Christ to condemn it as he pushed for financial reforms that would (p. 56) "give full legal sanction to the fundamental law that 'No man can serve two masters'. . . . No rule of law has been more rigorously applied than that which prohibits a trustee from occupying inconsistent positions. . . . A director . . . is . . . a trustee." National City Bank President Frank Vanderlip[31]—one of the "insiders" of the Money Trust—reminisced about the times:

> I opposed underwriting fees because I felt that they were too high. As a [Union Pacific] director . . . my obligation . . . ran to the stockholders . . . not to Harriman. I have in mind recollections of occasions when it was pointed out to me, in a hurt tone, that the City Bank was sharing in those underwriting profits that I thought were too fat. (pp. 204–5)

Conflict of interest and malfeasance cannot be the whole story. If so, why would both the McCormick and the Deering families have been so anxious to let Morgan partner George W. Perkins be an honest broker and set the respective prices at which their interests were to be combined into International Harvester?[32] Nevertheless, Progressivism was strong enough and powerful enough in the first two decades of the twentieth century to make life as a finance capitalist intermediary or block holder unpleasant.

Even before 1900, there was at least one family that had decided that the political pressure and the lack of diversification were together too large risks to run. As Carosso (1970) recounts the story, in 1879 William Vanderbilt decided that he wanted to sell off the control block in the New York

31. See Vanderlip and Sparkes (1935).

32. See DeLong (1991), p. 212. It does look like the McCormicks and the Deerings were a little bit naive. Carstensen (1989) makes a convincing case that George W. Perkins did attempt a (small) sacrifice of International Harvester's interests to enrich the House of Morgan's main project at the time, U.S. Steel.

Railroad that he had inherited from his father, the Commodore. Hoyt (1967) quotes William Vanderbilt as saying, "We get kicked and cuffed by Congressional committees, legislatures and the public and I feel inclined to have others take some of it, instead of taking it all myself."

How do you sell off a control block in one of the leading enterprises of the age, when nothing like it had been attempted before? Junius Spencer Morgan and his son, John Pierpont Morgan, had a plan. The principal market for the shares was to be England, where J. S. Morgan lived and did most of his business. English investors would be offered a share in a well-run railroad that had good track and a clear line from the port of New York all the way to Chicago. How could English investors be sure that the railroad line would continue to be well run? When J. S. Morgan sold them their shares, they would sign the proxies over to his son J. P. Morgan, who lived in the United States, would represent them on the New York Railroad's board, and would vote their proxies. A combination of (a) political pressure and (b) the promise of a wide and diversified market that would purchase the control block at a good price together induced this first step toward Berle-Means-style finance fifty years before they wrote this book.

There is more to the story. For the Progressive movement led not just to smoke or noise but to one definitive major government intervention in the commanding heights of the economy: the antitrust suit against and then the breakup of Standard Oil.

11.3 The Coming of Shareholder Diversification

In 1911, the Supreme Court ordered the breakup of Standard Oil. In 1912 the Pujo Committee investigated the "Money Trust." In 1914 Louis Brandeis inveighed against the power of the "Money Trust" in an attempt to make it one of the key issues for Wilson administration policy activism. In 1914 the passage of the Clayton Act also took place, with its section 7 prohibiting corporations from holding controlling stakes in competing corporations. In 1932 Adolf Berle and Gardiner Means published their book *The Modern Corporation and Private Property,* trying to think through the consequences of a world in which block holders were few and shareholders many and without means of communication and organization. In 1933 the Glass-Steagall Act separated commercial from investment banking. In 1935 the Public Utility Company Holding Act eliminated any possibility of a pyramidal utility empire. In 1948 the federal government shied away from attempting to break up GM but nevertheless pursued the smaller task of getting rid of GM's large remaining block holder: DuPont. Mark Roe (1994) tells this process of fragmentation as the triumph of politics: Populists, Progressives, and their heirs, striking a deep chord in their attacks on the personal exercise of economic power in America, pursue stockholders through the law and through institutions, in the

Table 11.3 **Large Standard Oil shareholders, 1911**

Name of shareholder	% holding
Rockefeller, J. D., Sr.	24.9
C. W. Harkness	4.4
Payne	4.1
Flagler	1.5
Rockefeller, William	0.8
Archbold	0.6
Pratt	0.5
Jennings	0.4

Source: Hidy and Hidy (1955).

process eliminating every way that dispersed owners can organize the monitor and supervise entrenched managers. And, indeed, practically all of what Roe writes is accurate and insightful.

11.3.1 Standard Oil

But more is going on. Consider the flagship company of the post-1911 Rockefeller fortune: Standard Oil of New Jersey (now Exxon). In 1912 John D. Rockefeller senior alone owned a quarter of Standard Oil (New Jersey), as table 11.3 shows. The top 1.5 percent of shareholders owned 72 percent of the company's shares. The Rockefellers and their allies both *owned* and *controlled* Standard Oil (New Jersey). Yet over the subsequent generation and a half, ownership of Standard Oil (New Jersey) became remarkably dispersed.

We have data year by year from 1912 to 1950 on the number of shares and shareholders, on the number of shareholders owning more than one thousand shares, and on the cumulative holdings of such "large" shareholders of Standard Oil (New Jersey).[33] Unfortunately, "1,000 shares" does not mean the same thing in 1912 as it does in 1950. In 1912 1,000 shares is 0.1 percent of the company, a one one-thousandth stake. In 1950 1,000 shares is only one thirty-thousandth of the company's capital stock. There are only 5,832 holders of Standard Oil (New Jersey) stock in 1912. By 1950 there are 222,064, more than 35 times as many.

With this limited data, even putting them on a roughly comparable basis requires heroic assumptions. We make them. We make the heroic assumption that the distribution of the upper tail of shareholdings of Standard Oil (New Jersey) follows a power-law distribution:[34] that the share *S*

33. From Gibb and Knowlton (1976).

34. See Krugman (1996) and Piketty and Saez (2001). Krugman advances various arguments for what kinds of circumstances and generating processes might lead one to expect a power-law relation to hold. Piketty and Saez estimate power-law distributions for top income fractions.

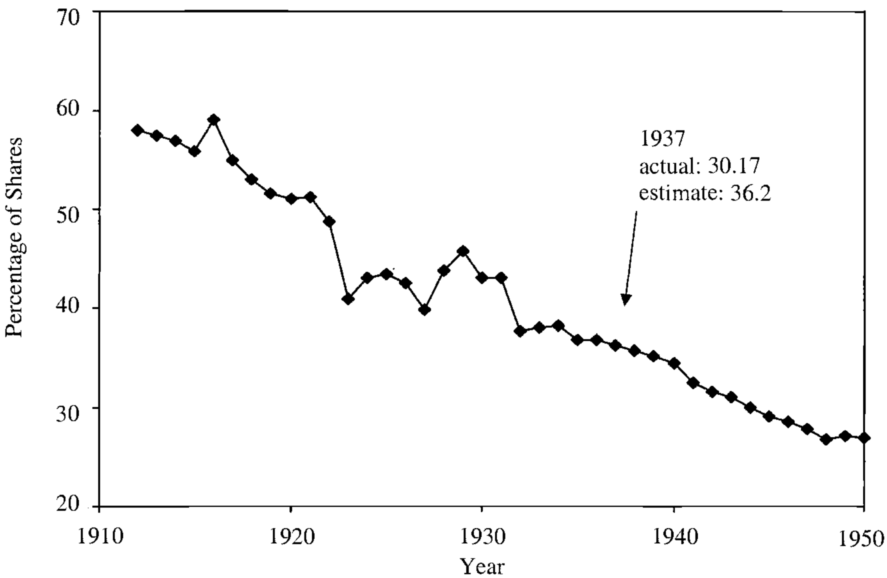

Fig. 11.1 Standard Oil of New Jersey: Estimated shareholdings of top twenty shareholders

Source: Authors' calculations from data from Gibb and Knowlton (1976).

of stock shares held by the top share B of shareholders at any moment in time follows the equation $S = A(B^p)$. We use our data to obtain a log least-squares estimated value of 1.43 for A.[35]

Given this estimated value for A, we generate an estimate of p for each year to fit that year's data point on the percent of shareholders with more than 1,000 shares and the percent of shares that such shareholders own. Thus—if the power-law assumption holds—we put our data on Standard Oil on a consistent basis. The most interesting ways to present the data are two: first, year-by-year estimates of the rough share of Standard Oil owned by the top twenty shareholders; second, year-by-year rough estimates of the smallest number of Standard Oil shareholders you would need to assemble in order to control more than 50 percent of the company's stock. Figures 11.1 and 11.2 present our results.

Figure 11.1 shows that the erosion of concentration across the one and a half generations from 1912 to 1950 is impressive. It also shows that our estimate is surprisingly accurate for the year we can observe the actual percentage holding of the largest twenty owners (from the Temporary Na-

35. With a t-statistic of 5.43. The identifying variance in this regression is dominated by the two splits of Standard Oil of New Jersey in this time period: a tripling of the number of issued shares in 1921 and a further fivefold multiplication in 1923.

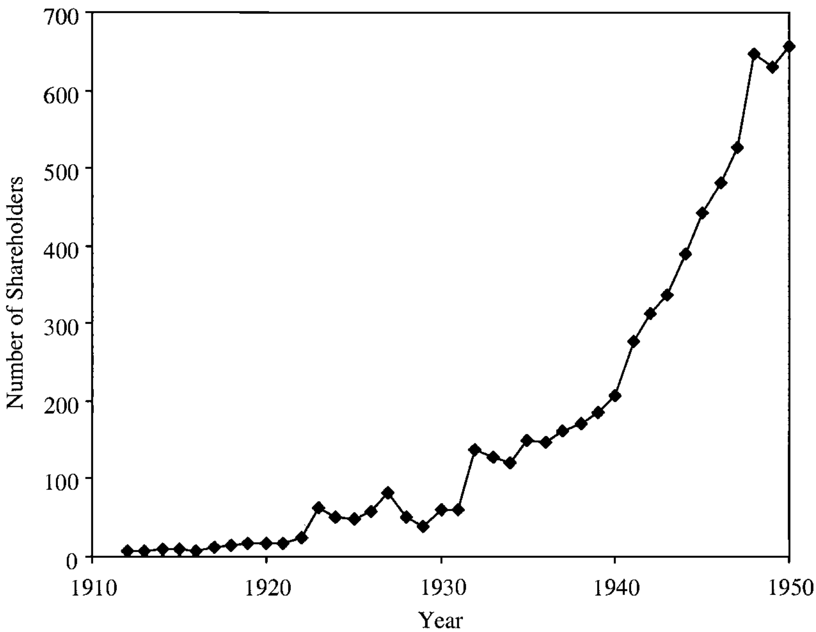

Fig. 11.2 Standard Oil of New Jersey: Estimated number of shareholders required to hold more than 50 percent of stock

Source: Authors' calculations from data from Gibb and Knowlton (1976).

tional Economic Committee study). Our estimate is 36.2 percent; the actual concentration was 30.2 percent.

It is possible to turn the question around. What is the smallest coalition of shareholders that could be assembled to vote 50 percent of the stock of Standard Oil of New Jersey? In 1912 our rough power-law-derived estimate is eight: the largest eight shareholders own more than half of Standard Oil of New Jersey. By 1920 a fair amount of dispersion has taken place: our estimate is that you need the eighteen rather than the eight largest shareholders to make up a majority.

Further diversification by major owners leads to an estimate of between forty and eighty by the late 1920s, and then the turmoil of the multiyear crash and stock market declines of the Great Depression carries the number up to 150 by the mid-1930s. By 1950, or so our power-law-derived estimates tell us, you would need to assemble the six hundred largest shareholders to control 50 percent of the outstanding shares of Standard Oil of New Jersey.

These estimates are, of course, vulnerable to the heroic assumption of a power-law distribution for shareholdings. At the most basic level, the underlying facts are these: In 1912 105 shareholders—1.8 percent of all

Standard Oil of New Jersey shareholders—owned 75 percent of Standard Oil of New Jersey stock. In 1950 2,142 shareholders—0.9 percent of a vastly expanded number of Standard Oil of New Jersey shareholders—together owned 62 percent of Standard Oil of New Jersey stock. In 1950 you would have had to assemble not a majority but a considerable fraction of those 2,142 "large" shareholders to assemble a majority of shares. In 1912 you could have assembled a majority of shares by simply picking the biggest holders from the 105. The assumption that the upper tail of shareholdings follows a power-law distribution aids our comprehension of the shape of the process of share dispersion, and is probably not far from the truth. It does not generate the fact of dispersion.

Note that none of the "political" factors stressed by Roe (1994) were at work in this dispersion of Standard Oil (New Jersey) shareholdings, and the resulting increase in the likely power of established managers and decrease in the power of owners over decisions about corporate direction and managerial succession. Incumbent shareholders sold off their shares, seeing the value of diversification in reducing the expected cost of the idiosyncratic risk borne by holding large blocks as worth more than the loss of the ability to easily assemble a controlling voice at annual meetings should one want to challenge or replace management. And over the course of a generation and a half this process of diversification proved to be remarkably powerful in its effects.

11.3.2 Politics

The effects of the drift away from control and toward diversification that we have seen at work were, of course, reinforced by the workings of the political factors stressed by Roe (1994). In striking contrast to banking elsewhere, American banking *was* fragmented—by the inability to branch across state lines, and often by the inability to branch at all.[36] The earlier national banks and the later members of the Federal Reserve system could not own shares of stock.[37] The Armstrong investigation of 1905–6 knocked out insurance companies as possible attractive locuses for the exercise of supervision, monitoring, and control.[38] As mutual funds developed, they were regulated in such a way as to make 5 percent block ownership or the possession of a seat on a board the cause of substantial restrictions in liquidity. As pension funds developed, they too were encouraged to become

36. See White (1982).

37. It is important not to overstate the power of the pre-1933 restrictions on American banks. Banks could not branch across state lines, but the importance of New York meant that they hardly needed to: the National City Bank of James Stillman and Frank Vanderlip and the First National Bank of George F. Baker were doing fine as nationwide financial intermediaries from their Manhattan bases. Banks could not own equities, but their "security affiliates" could—and as long as the ownership and management of a bank's security affiliate was identical to that of the bank itself, there was little hazard.

38. See Roe (1994), chapter 7.

passive investors rather than active block holders.[39] Attempts by banks to navigate around the restrictions imposed on them to become truly large and powerful financial intermediaries were prevented by a series of legal restrictions. As Roe (1994) puts it (p. 101),

> The modern banking laws—McFadden, Glass-Steagall, the FDIC [Federal Deposit Insurance Corporation] Act, and the Bank Holding Company Act—should not be seen as fragmenting the banking system . . . [but as] stop[ping] the . . . finesse . . . of [previous] laws. . . . Glass-Steagall stopped another finesse of the rules, but it should not be seen as shattering a truly powerful, stockholding intermediary. . . . [T]he United States declin[ed] to build and refine a system of powerful intermediaries that could have come to counterbalance managerial power in large public firms.

11.3.3 General Motors

But there is more to it than that. Where there were substantial block holdings, circumstances conspired to cut them down to size. Consider the investment that DuPont (the chemical corporation) made in GM. After the end of World War I a former DuPont treasurer, John J. Raskob, persuaded the DuPont company to invest $25 million in GM as a way of creating a possible automotive market for DuPont's artificial fabric, paint, and plastic products. The relationship grew remarkably close: Pierre S. du Pont became GM's president in 1920. In the 1920s DuPont's GM stockholdings amounted to one-third of GM's outstanding stock. And DuPont and GM worked together in the 1920s to develop coolants and gasoline additives. More important, however, the DuPont interests backed the restructuring plan of Alfred P. Sloan that made GM the dominant automobile company in America—and in the world.[40]

Come the late 1940s the federal government began thinking about whether it wanted to try to dissolve GM in order to increase competition in the automobile industry. In the end the government decided not to pursue a breakup of GM. However, the close links between the DuPont chemical company and GM produced by the large DuPont holdings did come under scrutiny. And in *U.S. v. DuPont* the Supreme Court held in 1957 that DuPont's GM shareholdings were indeed a violation of the previously almost-unused section 7 of the Clayton Antitrust Act. The court ruled that DuPont's acquisition of GM shares was motivated by a desire to obtain "an illegal preference over its competitors in the sale to General Motors of its products, and a further illegal preference in the development of chemical discoveries made by General Motors."[41] The fact of influence coupled

39. See Roe (1994), chapter 9. Here, however, Roe argues that the decisive factor was less likely to be Populist-Progressivist fear of "malefactors of great wealth" than managerial fear of pension-fund socialism à la Drucker (1976).

40. See Sloan (1964).

41. See Harbeson (1958).

with the fact that at least some of GM's purchases of DuPont's products were motivated by a desire by GM to keep its owner happy was enough to call for divestiture. The days when GM had a single large, active shareholder powerful enough to monitor and overawe management had come to an end.

11.4 The View from the End of the 1930s

It was actually[42] Gardiner Means (1931) who wrote that

> It is apparent that, with the increasing dispersion of stock ownership in the largest corporations, a new condition has developed with regard to their control. . . . No longer are the individuals in control of most of these corporations the dominant owners. Rather, there are no dominant owners, and control is maintained in large measure separate from ownership.

Empirically, this insight was based on an analysis of the growth in the number of stockholders between 1900 and 1928 (Means 1930, updating Warshow 1924) and the distribution of ownership blocks among the largest 200 U.S. corporations at the end of 1929 (Means 1931).[43]

Means (and, a year later, Berle and Means) was certainly right in seeing a substantial diffusion of shareownership. Figure 11.3 shows the number of shareholders in America's three largest corporations. By the end of the 1920s AT&T had nearly half a million shareholders. The Pennsylvania Railroad had 150,000. Table 11.4 reports Means's numbers on the growth of shareholding for a broader range of companies. The pattern is the same: wide diversification is well under way.

Means attempted a fivefold classification of "the separation of power over corporate resources and ownership interests therein." The spectrum ran from (a) almost complete ownership through (b) majority control, (c) control through a legal device (a pyramid, nonvoting preferred or common stock, voting trusts), (d) minority control through a stock interest, down to (e) management control.[44]

The key to control with little (or no) ownership was the rules governing board elections. In Germany votes attached to bearer shares typically fell into the hands of depository banks; in the United States proxy voting by

42. Nevertheless, almost every modern article on corporate ownership cites Berle and Means (1932).

43. A shortened version of Means (1930) became chapter 1 of book I in Berle and Means (1932); Means (1931) became chapter 5. Chapter 3 of book I is a shortened version of Means (1931b). More generally, it appears that Means was responsible for book I and Berle for book II.

44. Management control arises when "ownership is so widely distributed that no individual or small group has even a minority interest large enough to dominate the affairs of the company" (p. 83).

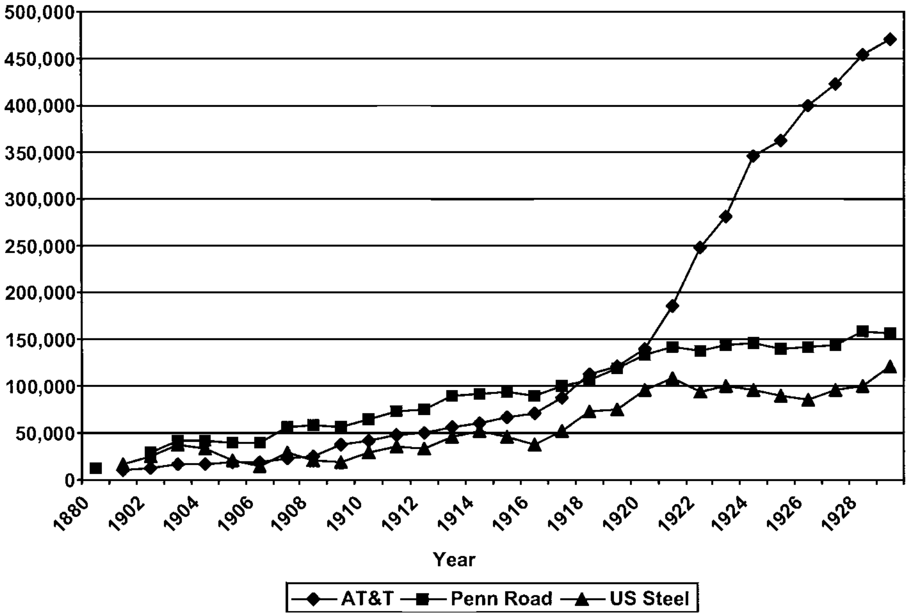

Fig. 11.3 Number of shareholders in the three largest U.S. corporations—AT&T, the Pennsylvania Railroad, and U.S. Steel

Source: Authors' calculations from data from Means (1930).

mail and record ownership put these votes de facto into the hands of the incumbent board of directors:

> Ordinarily, at an election, the shareholder has three alternatives. He can refrain from voting, he can attend the annual meeting and personally vote his stock [or appoint a personal proxy to attend], or he can sign a proxy transferring his power to certain individuals selected by the management of the corporations, the proxy committee. . . . [C]ontrol will tend to be in the hands of those who select the proxy committee by whom, in turn, the election of directors for the ensuing period may be made. Since this committee is appointed by the existing management, the latter can virtually dictate their own successors.

It is no coincidence that the proxy process was a major concern of the drafters of 1933 Securities and Exchange Act[45] and continues to be so to this day.[46]

45. Thomas Corcoran, one of Felix Frankfurter's "Happy Hot Dogs" brought in from Harvard to draft the 1933 Securities and Exchange Act, shared this view: "Proxies, as solicitations are now, are a joke. The persons who control the machinery for sending out proxies, with practically no interest in the corporation, can simply keep other people from organizing [and] get enough proxies to run the Company" (Seligman 1982, p. 87).

46. The 1933 act contained specific provisions on the proxy voting process, but to date these provisions have not changed the nature of U.S. board elections in a fundamental way: "Share-

Table 11.4 Growth in number of shareholders, 1900–28

Name of company	1900	1910	1913	1917	1920	1923	1928	Growth (%)
Industrial								
Union Bag and Paper	1,950	2,250	2,800	1,592	1,856	2,263	1,278	–34.5
General Asphalt	2,089	2,294	2,184	2,112	1,879	2,383	1,537	–26.4
Gt. North. Iron Ore	3,762	4,419	4,685	4,855	6,747	9,313	7,456	98.2
Am. Sugar Refin.	10,816	19,551	18,149	19,758	22,311	26,781	22,376	106.9
Am. Car and Foundry	7,747	9,912	10,402	9,223	13,229	16,090	17,152	121.4
U.S. Steel Corporation	54,016	94,934	123,891	131,210	176,310	179,090	154,243	185.6
United Shoe Machy	4,500	7,400	8,366	6,547	8,762	10,935	18,051	301.1
Am. Smelt. and Refin.	3,398	9,464	10,459	12,244	15,237	18,583	15,040	342.6
U.S. Rubber	3,000	3,500	12,846	17,419	20,866	34,024	26,057	768.6
International Paper	2,245	4,096	3,929	4,509	3,903	4,522	23,767	958.7
Am. Locomotive	1,700	8,198	8,578	8,490	9,957	10,596	19,369	1,039.4
Swift and Co.	3,400	18,000	20,000	20,000	35,000	46,000	47,000	1,282.4
Stand. Oil of N.J.	3,832	5,847	6,104	7,351	8,074	51,070	62,317	1,526.2
General Electric	2,900	9,486	12,271	12,950	17,338	36,008	51,883	1,689.1
DuPont Powder	809	2,050	2,697	6,593	11,624	14,141	21,248	2,526.5
United Fruit	971	6,181	7,641	9,653	11,849	20,469	26,219	2,600.2
Proctor & Gamble	1,098	1,606	1,881	2,448	9,157	11,392	37,000	3,269.8
Total Industrial	108,233	209,188	256,883	276,954	374,099	493,660	551,993	410.0
Utilities								
Brooklyn Union Gas	1,313	1,593	1,646	1,834	1,985	1,879	2,841	116.4
Western Union	9,134	12,731	12,790	20,434	23,911	26,276	26,234	187.2
Commonwealth Edison	1,255	1,780	2,045	4,582	11,580	34,526	40,000	3,087.3
Am. Tel. & Tel.	7,535	40,381	55,983	86,699	139,448	281,149	454,596	5,933.1
Total Utilities	19,237	56,485	72,464	113,549	176,924	343,830	523,671	2,622.2
Railroads								
Reading	6,388	5,781	6,624	8,397	9,701	11,687	9,844	54.1
N.Y.N.H. & Hartford	9,521	17,573	26,240	25,343	25,272	24,983	27,267	186.4
Illinois Central	7,025	9,790	10,776	10,302	12,870	19,470	21,147	201.0
Pennsylvania	51,543	65,283	88,586	100,038	133,068	144,228	157,650	205.9
Union Pacific	14,256	20,282	26,761	33,875	47,339	51,022	47,933	236.2
Chicago and Northwestern	4,907	8,023	11,111	13,735	19,383	21,555	16,948	245.4
Del. Lack. and Western	1,896	1,699	1,959	2,615	3,276	6,650	7,957	319.7
Atlantic Coast Line	702	2,278	2,727	3,404	4,422	5,162	4,213	500.1
Chesapeake and Ohio	1,145	2,268	6,281	6,103	8,111	13,010	6,885	501.3
Great Northern	1,690	16,298	19,540	26,716	40,195	44,523	43,741	2,488.2
Total Railroads	99,073	149,275	200,605	230,528	303,637	342,290	343,585	246.8

Source: Means (1930, table II) and authors' calculations.
Note: Growth column shows growth between 1900 and 1928.

Figures 11.4 and 11.5 show Means's classification of corporate control for large corporations at the end of the 1920s for both "immediate" and

holders typically are provided proxies allowing a vote only on company-nominated candidates, and disclosure in company proxy material is limited to those candidates. Also, most companies use plurality rather than majority voting for director elections, so candidates are elected regardless of whether a minimum percentage of shareholders approve. Therefore, company nominees are nearly always elected to the board, regardless of the number of shareholders who object to their candidacy" (from Securities and Exchange Commission [SEC] chairman William Donaldson's introductory remarks at the 8 October 2003 open meeting on the SEC's proxy access proposal). On the SEC's 2003 reform proposals see also Bebchuk (2003, 2004).

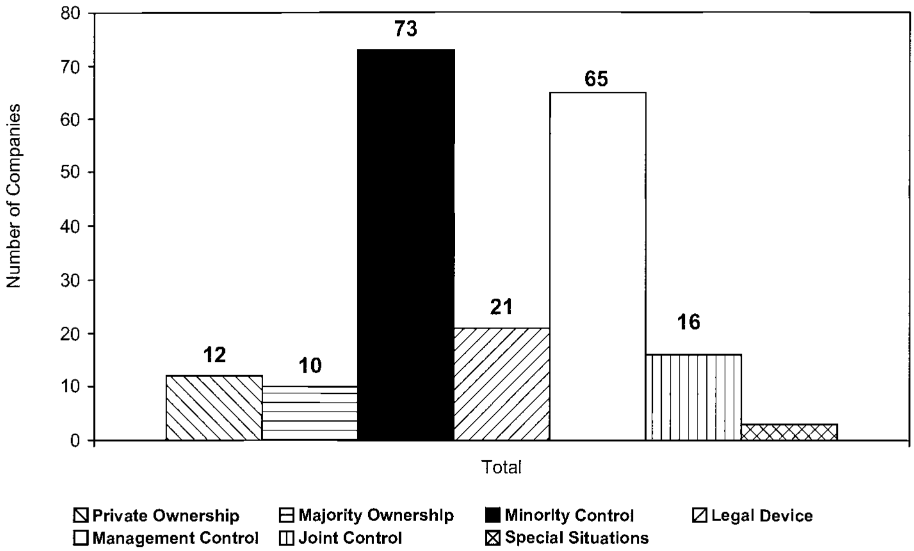

Fig. 11.4 Immediate corporate control in the 200 largest American corporations in 1930

Source: Means (1931).

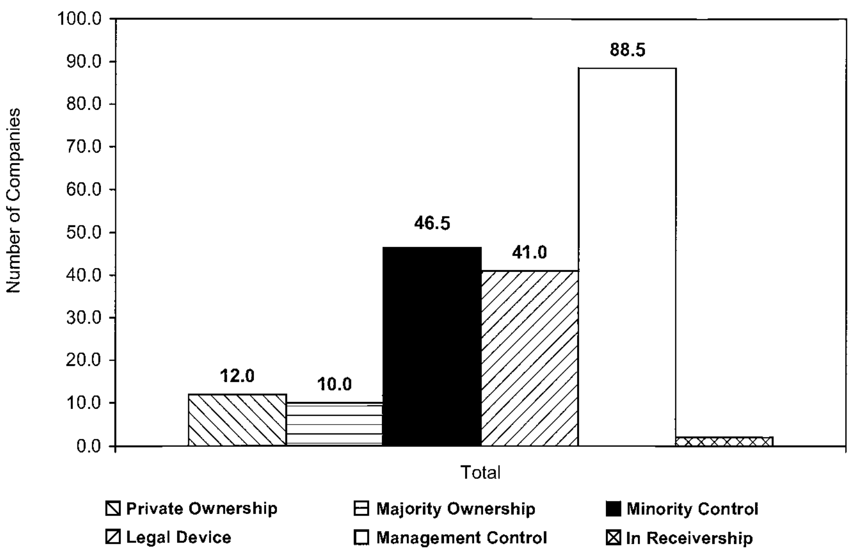

Fig. 11.5 Ultimate corporate control in the 200 largest American corporations in 1930

Source: Means (1931).

"ultimate" control, tracing control to the company that had ultimate control over corporate assets. In terms of ultimate control, management control had become the dominant force in corporate control in America.

From our perspective, Means's assessment of corporate control at the end of 1929 is not satisfactory. First of all, conceptually, his classification does not distinguish between control by a CEO-as-president who dominates a board of "yes men," and family control with little ownership that is exerted via a family dominated, self-appointing board.[47] Two, the data in Means (1931) and Berle and Means (1932) do not allow us to make the distinction between family control through ownership, family control through boards, and management control. Three, the data compiled by Means (1931a) were not complete and not entirely reliable.

To investigate family control, we turn to the earliest comprehensive and reliable cross section of blockholder control in the largest 200 U.S. corporations—the Temporary National Economic Committee's (TNEC) "Investigation of Concentration of Economic Power."[48] The TNEC report was laboriously compiled from SEC filings and questionnaire surveys by SEC staff and was considered to permit one, "for the first time, to determine with some precision the magnitude of the largest holdings in each of a wide group of giant corporations" (Gordon 1945, p. 31).[49] The TNEC (1940) report reflects the general ownership situation around the end of 1937 and, for each of the largest 200 corporations, listed and nonlisted, contains information on record ownership, beneficial ownership, share classes, and the names and holdings of directors. More important, the TNEC volume contains a control classification that is more suitable to our investigation than Means (1931). The TNEC classification is also based on the size of the largest block of voting shares, but it also considers the distribution of other blocks and the presence of shareholders on the boards.[50]

47. The same is true for the other separation categories. A voting trust could be controlled by a family and the company run by a family member or a professional manager, or the trust could be controlled by a professional manager outright.

48. The TNEC has not been intensively used. Two exceptions are Gordon (1945), who made extensive use of the TNEC data to investigate managerial ownership and, more particularly, ownership by "control groups"; and Leech (1987), who studied potential block holder coalitions using power indices.

49. Holderness, Kroszner, and Sheehan (1999) use an even earlier cross section compiled from section 16 reports of insider holdings for 31 December 1935 covering more than 1,500 publicly listed corporations, but not nonlisted companies. The SEC report contains data on direct ownership and beneficial ownership of individual officers and directors, but it does not contain information on the holdings of outside block holders and, hence, corporate control. In the 1930s the data were used extensively by Gordon (1936, 1938). Comparing the SEC's 1935 and the TNEC (1940) data, Gordon (1945, p. 25) considers the TNEC (1940) data more reliable, but Holderness, Kroszner, and Sheehan (1999, p. 447) show that a comparison of insider ownership for the 169 firms in both samples gives very similar results.

50. The basic TNEC classification distinguishes between four control groups: majority control, predominant minority (30–50 percent of voting stock), substantial minority (10–30 percent), and substantial minority control (less than 10 percent of voting stock). The remaining cases are prudently classified as "companies without apparent dominant stock interest."

Table 11.5 American corporate control in 1938

Control group	Manufacturing	Railroads	Utilities	Other	All Companies
Single family group	28	1	5	9	43
Two or more family groups	23	2	3	8	34
Family and corporate groups	5	0	0	1	6
Single corporate group	4	8	25	5	42
Two or more corporate groups	2	3	8	1	14
No dominant stockholding group	34	15	4	8	81
50–100%	10	6	20	4	42
30–50%	17	7	7	8	37
10–30%	28	1	12	9	47
Under 10%	9	0	2	3	13
No block	34	15	4	8	61
Total	96	29	45	30	200
	Manufacturing (%)	Railroads (%)	Utilities (%)	Other (%)	All Companies (%)
Single family group	29.2	3.4	11.1	30.0	21.5
Two or more family groups	24.0	6.9	6.7	20.0	17.0
Family and corporate groups	5.2	0.0	0.0	3.3	3.0
Single corporate group	4.2	27.6	55.6	16.7	21.0
Two or more corporate groups	2.1	10.3	17.8	3.3	7.0
No dominant stockholding group	35.4	51.7	8.9	26.7	30.5
50–100%	10.4	20.7	44.4	13.3	21.0
30–50%	17.7	24.1	15.6	20.0	18.5
10–30%	27.1	3.4	26.7	30.0	23.5
Under 10%	9.4	0.0	4.4	10.0	6.5
No block	35.4	51.7	8.9	26.7	30.5
Total	100.0	100.0	100.0	100.0	100.0

Source: TNEC data and authors' calculations.

Table 11.5 reports the distribution of control in terms of numbers of companies and as percentages of total assets. Figure 11.6 reports the size of the largest share block for the TNEC companies, and figure 11.7 characterizes the type of the potential control share block. Note the important differences, shown in figure 11.8, between utility companies and others: utility companies had the most diversified ownership by far, and attempts to gather utilities into a more centralized control structure were defeated by the combination of finance and politics—the Morgan-led raid and carveup of Samuel Insull's utility empire, and then the Public Utility Holding Company Act of 1938. Utility companies also explain much of Means's (1931) original result. Pyramiding was a phenomenon that was largely confined to the utilities sector. The utilities sector was also the sector where the companies at the top of the pyramids were widely held.

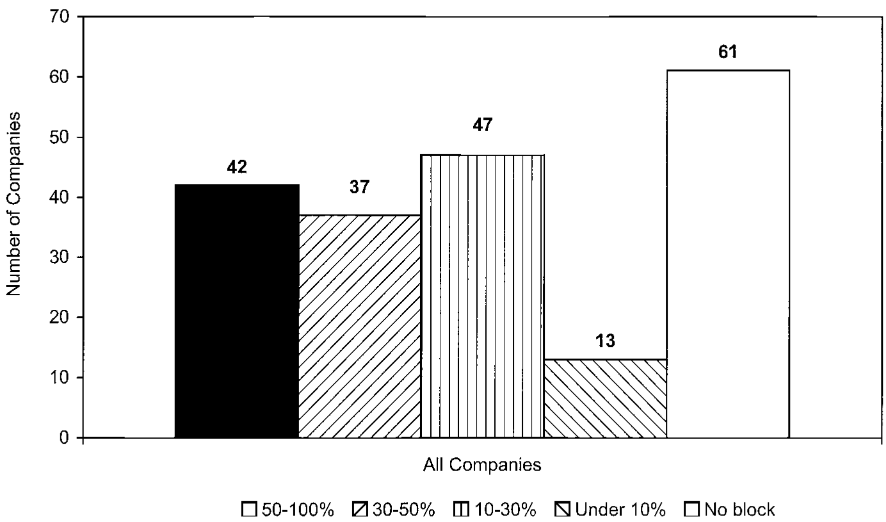

Fig. 11.6 The size of direct stakes in 1938

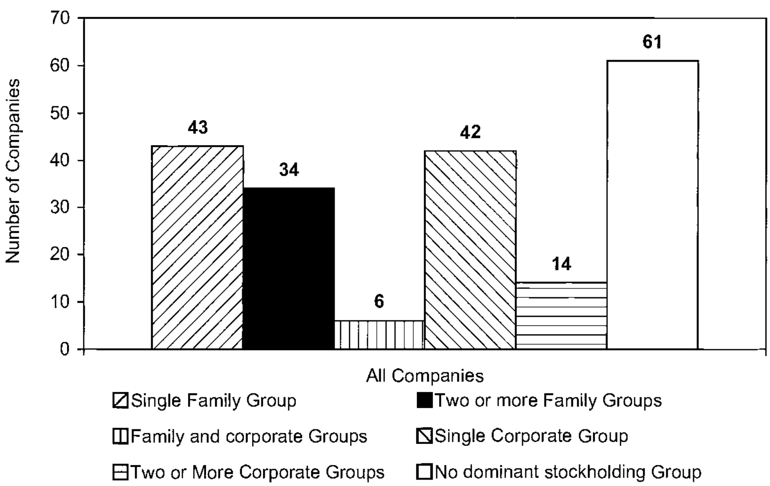

Fig. 11.7 Control groups in 1938

Hence, it was the special type of pyramiding in the utilities sector that led the marked increase in dispersion when considering "ultimate" ownership.

The TNEC (1940) list of the largest 200 corporations includes companies that are subsidiaries of other companies on the list (complex and pyramidal holdings). Gordon (1945) argued that this induced an upward bias into ownership concentration statistics and excluded the twenty-four sub-

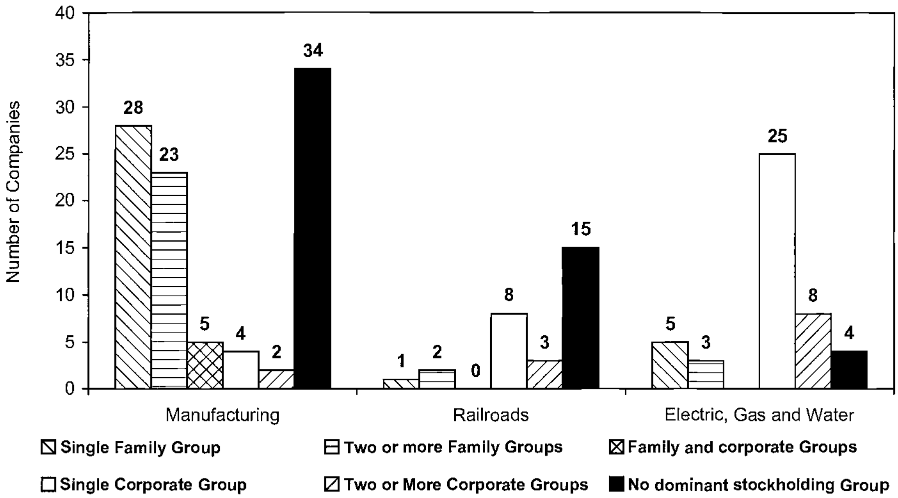

Fig. 11.8 The special place of utilities in 1938

sidiaries from the sample (twenty-one companies with majority ownership by a corporation and three leased lines).

11.4.1 Where did the founders go?

The TNEC sample gives us the data that we need to answer our key question: where did all the founders go? In the TNEC 1938 cross section, 96 of the largest 200 U.S. corporations were in the manufacturing sector, and 34 (35.4 percent) of those had no dominant block holder. The largest investors were Dutch institutional investors[51] and the Sun Life Assurance Company of Canada, holding small blocks under 5 percent. We have traced the origins of the thirty-four industrial companies without a dominant ownership interest back in time. The results suggest that the origin of the "modern corporation" in 1939 is found in the first horizontal merger wave, trust promotion, and antitrust measures.

Tables 11.6, 11.7, and 11.8 show the links between the TNEC cross section of manufacturing corporations without a dominant block holder, and John Moody's original list of trusts in 1904. In twenty cases there is a direct link through the company name. In three cases the companies changed their names: Atlantic Refining and Continental Oil had been part of the

51. See De Jong and Röell (chap. 8 in this volume) for a history of ownership and control in the Netherlands. The major Dutch investors were Hubrecht van Harencarspel Maatschappij, Broes and Gosman Maatschappij, Nederlandsch Administratieen Trustkantoor, Wertheim and Gompertz Westendorp Maatschappij, Administratiekantoor van Binnen en Buitsenlandsche Fondsen. Broekmans Administratiekantoor, and Niew-Amsterdamch Administratiekantoor (TNEC 1940, pp. 1502–4).

Table 11.6 **TNEC industrial corporations without dominant ownership interest, and with trust origins**

Name of company	Name and page in Moody/comment	Incorporation date	State
Allis-Chalmers Manufacturing Co.	Allis-Chalmers Company (p. 454)	1901	NJ
American Car & Foundry Co.	American Car & Foundry Co. (p. 455)	1899	NJ
American Radiator & Standard Sanitary Corporation	American Radiator Company (p. 456)	1899	NJ
American Smelting & Refining Co. (ASARCO)	American Smelting and Refining Company (and affiliated companies) (Greater Trust; p. 45)	1891	NJ
American Sugar Refining Co.	American Sugar Refining Company (and affiliated companies) (Greater Trust)	1891	NJ
American Tobacco Co.	Consolidated Tobacco Company (and affiliated companies) (Greater Trust; p. 69)	1901	NJ
American Woolen Co.	American Woolen Company (p. 457; p. 236)	1899	NJ
Anaconda Copper Mining Co.	Amalgamated Copper Company (Greater Trust)	1899	NJ
Armour and Co.	Armour, Swift, National Packing, Cudahy (and affiliated interests) (p. 457)	1868	NJ
Atlantic Refining Co.	Standard Oil Company (Standard Oil, Greater Trust)	1899	NJ
Bethlehem Steel Corporation (Delaware)	United States Shipbuilding Company (p. 344; part of ship-building trust)	1902	NJ
Borden Co.	Borden's Condensed Milk Company (p. 458)	1899	NJ
California Packing Corporation	California Fruit Canner's Association	1900	CA
Continental Oil Co.	Standard Oil Company (Conoco, Standard Oil)	1911	
Corn Products Refining Co.	Corn Products Company (p. 459)	1902	NJ
Eastman Kodak Co.	Eastman Kodak Company (p. 460)	1901	NJ
General Electric Co.	General Electric Company (p. 460)	1892	NY
Pullman Inc.	Pullman Company (p. 464)	1897	IL
Pure Oil Co.	Pure Oil Company (p. 464)	1895	NJ
Union Carbide & Carbon Corporation	Union Carbide Company (p. 465)	1898	VA
Union Oil of California (UNOCAL)	Not in Moody. Independent oil company.	1890	
United Fruit Co.	United Fruit Company (p. 465)	1899	NJ
United States Steel Corporation	United States Steel Corporation (Greater Trust)	1901	NJ
United States Smelting, Refining & Mining Co.		1899	
Westinghouse Electric Manufacturing Co.	Westinghouse Companies (p. 466)	1899	IL

Sources: TNEC (1940, pp. 1502–4) and Moody (1907, pp. 453–78).

Table 11.7 **TNEC industrial corporations without dominant ownership interest, and without clear trust origins**

Name of company	Comment	Incorporation date	State
American Rolling Mill Co. (ARMCO)		1901	
B. F. Goodrich Co.		1870	
Continental Can Co. Inc.	Incorporated after horizontal merger wave	1913	
Goodyear Tire & Rubber Co.	Went into receivership in 1921, with creditors taking over control, forcing out founders and dispersing ownership	1898	OH
Kennecott Copper Corporation	Consolidation of Guggenheim and other interests	1914	
Mid-Continent Petroleum Corporation	No information found		
National Distillers Products Corporation	No information found		
Texas Corporation (Texaco)	Independent oil company	1902	
Wilson & Co. Inc.	Meat packing company		

Sources: TNEC (1940, pp. 1502–4) and Moody (1907, pp. 453–78); Allen (1949) for Goodyear.

Standard Oil Trust, which was broken up in 1911; the Anaconda Mining Company was a previously acquired subsidiary of the Amalgamated Copper Company; in 1901 Bethlehem Steel was part of the United States Shipbuilding Trust—although its rapid expansion came afterward. For ten companies no direct trust origin could be established. Nevertheless, it is striking that two-thirds of the manufacturing corporations without large blocks in the late 1930s had been part of Moody's finance-capitalist corps a generation earlier.

Why did trust formation lead to widely held ownership? Looking at the history of the twenty-four widely held manufacturing companies with trust origins, we identify three principal reasons.

1. The original dominant shareholders were bought out by trust promoters who sought to cash in and reduce leverage by floating the combination on the stock exchange. The most prominent example is U.S. Steel, with J. P. Morgan buying out Andrew Carnegie.

2. Trust promoters who kept dominant ownership positions in the trusts were forced to relinquish control by antitrust action. The outstanding example is the Standard Oil of New Jersey holding company, which was dissolved in 1911. Although the Rockefellers were given equal ownership blocks in the individual postbreakup companies, it was clear that further antitrust action would have resulted had they sought to influence or

Table 11.8 Moody's greater industrial trusts, as of 1 January 1904

Name of company	Incorporation date	State	Number of plants acquired or controlled	Total capitalization, stocks and bonds outstanding	Status 1939
Amalgamated Copper Co.	1899	NJ	11	175,000,000	Among 200 largest
American Smelting and Refining Co.	1899	NJ	121	201,550,400	Among 200 largest
American Sugar Refining Co.	1891	NJ	(about) 55	145,000,000	Among 200 largest
Consolidated Tobacco Co.	1901	NJ	(about) 150	502,915,700	Among 200 largest
International Mercantile Marine Co.	1902	NJ	6	170,786,000	Defunct
Standard Oil Co.	1899	NJ	(about) 400	97,500,000	Broken up
United States Steel Co.	1901	NJ	(about) 785	1,370,000,000	Among 200 largest

Sources: Moody (1907, p. 453); TNEC, and companies' histories.

coordinate the activities of these companies in a major way. Antitrust action against influential owners was also important in some other cases, in particular when families held blocks in related businesses. The classic example is a 23 percent block the Du Pont family acquired in General Motors via the E. I. du Pont de Nemours chemical company in 1917–19. Du Pont was forced to sell the block as a result of civil action brought by the government under the Clayton Act of 1914.[52]

3. The original owners and/or the trust promoters sold their ownership stakes but sought to keep control of the trusts by dominating the boards through family-affiliated directors. An outstanding example of the former is ASARCO, where the Guggenheims had carved out a near 50 percent ownership stake they sold after a few years, while retaining board control (at least for a while). A prime example of the latter is, again, U.S. Steel, where four J. P. Morgan partners came to sit on the board of the newly formed trust (Chernow 1990). This mechanism was also important in some of the widely held companies without clear trust origins, like B. F. Goodrich (David Goodrich was chairman), Wilson and Co. (Edward Foss Wilson was president and director; Thomas E. Wilson chairman of the board) and Kennecott Copper (three members of the Guggenheim family were members of the board).

In all of the thirty-four companies without dominant ownership, the separation of ownership and control emphasized by Means (1931) and Berle and Means (1932) was complete by the late 1930s.

Why did the original owners and the trust promoters sell their control blocks in the first place? One reason—stressed by Dewing (1919)—was that the American stock market gave them an opportunity to sell the stock for more than it was worth. "Physicians, teachers, dentists, and clergymen" constituted "the happy hunting ground" of the "sucker list," where people were persuaded to buy "highly speculative and worthless securities" by "devious and dubious" methods. A second reason was the very success of Morgan and his peers—George F. Baker, James Stillman, Frank Vanderlip, and company—not at swindling the investing public but at persuading the investing public, through a good track record, that they would not be swindled. As DeLong (1991) calculated, large industrial combinations promoted and organized by J. P. Morgan were by and large quite good investments. Giving founders peace of mind through special or preferred stock, merging competitors, maintaining a presence on the board of directors, and putting the weight of the Morgan name behind the newly diversified enterprise all raised the price that founding families could get for their con-

52. The 23 percent block was bought in 1917–19, the federal government took civil action under section 15 of the Clayton Act to enjoin violations of section 7 of that act in 1949, the case was initially dismissed by the district court but upheld by the Supreme Court in 1957, and the block was sold in 1961.

trol blocks. Moreover, this strategy appeared to involve no inevitable loss of control—or so it looked for a while, until the Morgan partners and the founders died or rotated off the board and were replaced by managerial picks.

Thus Vanderbilt and Carnegie were bought out by attractive offers for their shares they could not refuse; Havemeyer, Rockefeller, and Du Pont were forced out by government antitrust policy; the Guggenheims diversified while attempting to keep control of the board. And sooner or later many of them turned to philanthropy. The fact that America was not supposed to be a land of aristocracy, combined with Teddy Roosevelt's crack about "malefactors of great wealth," stung. So Rockefeller endowed the University of Chicago and Rockefeller University. Carnegie built 3,000 libraries, bought 4,100 church organs, and built Carnegie Hall, the Carnegie Institute, and the Peace Palace at the Hague. And he said, "He who dies rich dies disgraced." As the founding families turned their interests elsewhere, control slipped bit by bit into the hands of the managers.

The process continued, and families continued to fade, after World War II. Consider Coca-Cola. In 1919 the Woodruff family buys the company. In 1923 George Woodruff becomes CEO. In 1938 Woodruffs own 39 percent of the stock, directly and indirectly, chair the board, and have one additional director seat. Today? Berkshire-Hathaway and the SunTrust bank are the only 5 percent shareholders. No Woodruff sits on the board of directors.

11.5 Conclusion

Thus the story we have to tell turns out not to be a neat one. America is indeed exceptional. But the causes of its exceptionalism are not at all simple. Mark Roe is right: politics mattered a lot. Antitrust policy, the campaigns against the "money trust" and the "power trust," muckraking, and populism meant that to be concentrated was to be a target. Why not (a) avoid being a target and (b) pick up the benefits of diversification, even if the cost is some extra slack between the interests of owners and the actions of managers?

But other things mattered too, and probably mattered more. The turn of the American upper class of the Gilded Age to philanthropy, for example, was clearly important. And so—possibly—was the role played by inheritance taxes. The sophistication of American investment banking and the large size of the pool of potential stock owners appear to have made it possible for founding families to divest themselves of their control blocks without paying a substantial price penalty. How important were the legal shareholder protections emphasized by La Porta and company in creating this opportunity to sell out with only a small (or no) discount, and how important were other factors? We wish that we knew.

We do know that the ability of trust promoters and investment bankers to place large amounts of stock with ever wider circles of investors was an important driver of ownership dispersion. We also found anecdotal evidence that "frenzied finance," the belief that one can get rich quickly by investing in a bull market, contributed to this ability—just as it did during the Internet boom and the mergers and acquisitions wave of the late 1990s.

Also important was the fact that few if any among the founding families thought that they were giving up control to salaried managers. They believed that they would be able to maintain their dominance over the boards of what they still saw as their own companies indefinitely. Perhaps they expected the diversified shareholders to follow their lead and vote for them in board elections? The illusion that control could be maintained even without a controlling block proved a durable one, but it was an illusion. At the end of the 1920s even John D. Rockefeller himself found it an enormous struggle to fire the president of Standard Oil of Indiana.

The basic problems of corporate governance—how to make managers accountable to investors, protect small investors from large ones, provide managers with the right incentives, and manage conflicts of interest—are common, but there is "stunning international variety" in the solutions. Moreover, no one system seems durably and obviously superior, not even that of the United States, as is clear in the wake of the Enron scandal and the alleged rigging of corporate elections by Hewlett-Packard management.

The costs of changing corporate governance structures are high, the likelihood of gains uncertain, and claims of the U.S. system's macroeconomic advantages are as likely to last as did the claims two decades ago for the superiority of Japan's system. Political differences, organizational inertia, and the absence of clear, durable superiority in efficiency will preserve a wide divergence of models.

It is probably right to believe that diversity in corporate control will persist. But in one aspect—the number of shareholders per firm—some convergence among listed companies is likely. Firms with a broad shareholder base have an easier time tapping pension fund money via the New York and London markets. An aging population, particularly in Europe, and the consequent need to convert at least part of pay-as-you-go pension plans into capitalized ones have driven a trend toward a greater role for the stock market. Stock index providers are increasingly "punishing" companies with large block holders by limiting the weight in the index to the size and value of the "free float."

But even if firms with many shareholders become more prevalent, they need not all be governed alike. Such widely distributed ownership is compatible with dispersed voting rights and contestable board control, as in the United Kingdom. But it is just as compatible with uncontestable board control nominally exercised in the interest of shareholders—as in the

United States, with their poison pills and entrenched directors, or as with the Netherlands' priority shareholders, who possess the sole right to nominate directors for election to corporate boards.

In their ideal world, institutional investors and professors would probably root for convergence with the U.K. model—not the U.S. one. There are reasons to believe everybody will be disclosing on which side of the road they are driving under International Accounting and Disclosure Standards, but it is unlikely they will all end up driving on the left.

Appendix

Dual-Class Shares

Dual-class share capitalizations with differential voting rights are powerful instruments for securing voting control of corporations with relatively proportionally less and often little ownership. The most widely used arrangement involves the combination of voting and nonvoting shares, with voting ratios—the ratio of votes to the capital that must be invested to secure them—that depend on the relative amounts of shares issued.[53] Dual-class structures with voting ratios of 1:10 are common in Denmark (Neumann 2003), Norway (Bohren and Odegaard 2001), and Sweden (Högfeldt 2004; Agnblad et al. 2001).[54] In the Netherlands (and in the United Kingdom) it is possible to issue priority (or deferred) shares that have special rights vested in them—for example, the sole right to make binding nominations for board election. It is also possible to list voting trust certificates without voting rights (De Jong et al. 2001).

The United States today is not exceptional in its rules. The law of many states allows corporations to issue shares with no voting rights, limited voting rights, contingent voting rights, or multiple voting rights. In practice, U.S. corporations are more indulgent than their U.K. peers, but they show more restraint than corporate Canada. There were 100 dual-class firms in the United States with at least one class listed in 1994, rising steadily to 215

53. Under German law up to 50 percent of par value can be issued as nonvoting stock. In theory, owning all the voting stock gives 100 percent of the voting rights with 50 percent ownership of the total equity. Today the only German company that is known to attain the maximum 1:2 voting ratio using this arrangement is Porsche AG (Becht and Mayer 2001). In the United Kingdom there are no limits on the ratio of nonvoting to voting stock. Although such capitalizations are very rare today, and have been rare historically (Frank, Mayer, and Rossi 2004), in the case of DMGT plc a 4 percent ownership stake can secure 67 percent of the voting rights (Becht 2003).

54. In the Nordic countries today voting ratios are limited to 1:10 by law. Historically, voting ratios of 1:1000 or higher were used. In Sweden the equity base of Ericsson is a grandfathered survivor of this era.

in 2001. The most common voting ratio is 1:10, but in some cases it can be higher (Gompers, Ishii, and Metrick 2004, table 3).[55] Well-known examples of dual-class share companies include Berkshire Hathaway, Viacom, Comcast, the Ford Motor Company, Wrigley, and Hershey Foods, among others.

However, historically, the United States has been exceptional in the virtual absence of dual-class share capitalizations of *common stock* with differential voting rights. This absence has been attributed to the restrictions imposed by the New York Stock Exchange's listing rules, which discouraged deviations from "one-share-one-vote" and other practices that would violate what the New York Stock Exchange (NYSE) considered appropriate standards in "corporate democracy, responsibility, integrity and accountability to shareholders" (Seligman 1986, p. 689). Until 1985 the relevant section of the NYSE's listing manual clearly stated that "since 1926, The New York Stock Exchange has refused to list non-voting *common stock*" (NYSE 1983, 313.00[A]; cited in Seligman 1986, p. 690). The NYSE was also "of the view that any allocation of voting power under normal conditions to classes of stock other than common stock should be in reasonable relationship to the equity interests of such classes" (NYSE 1983, 313.00[D]). The NYSE also believed that preferred stockholders should have the right to appoint at least two directors when dividend payments were not met in six consecutive quarters (NYSE 1983, 313.00[E]).[56] More

55. The authors identify dual-class companies by combining data from three different databases: the Securities Data Company (SDC), the Center for Research in Security Prices (CRSP), and the Investor Responsibility Research Center (IRRC).

56. More generally the NYSE was critical of all devices that propel voting rights beyond ownership, refusing to list voting trust certificates, classes of shares with unusual voting provisions, and shares of companies that give out irrevocable proxies or have voting pool arrangements. It is not entirely clear when the additional provisions cited were put into the listings manual. For a detailed description of the NYSE's stance on this issue in 1983 see Seligman (1986, pp. 689–90). The AMEX and NASDAQ were not as choosy, and Seligman (1986) argues that this was the reason the NYSE abandoned its restrictive policy in 1985–86. The current provisions of section 313 of the listing rules read as follows:

(B) *Non-Voting Common Stock.* The Exchange's voting rights policy permits the listing of the voting common stock of a company which also has outstanding a non-voting common stock as well as the listing of non-voting common stock. However, certain safeguards must be provided to holders of a listed non-voting common stock:

(1) Any class of non-voting common stock that is listed on the Exchange must meet all original listing standards. The rights of the holders of the non-voting common stock should, except for voting rights, be substantially the same as those of the holders of the company's voting common stock.

(2) The requirement that listed companies publish at least once a year and submit to shareholders an annual report (Para. 203.01) applies equally to holders of voting common stock and to holders of listed non-voting common stock.

(3) In addition, although the holders of shares of listed non-voting common stock are not entitled to vote generally on matters submitted for shareholder action, holders of any listed non-voting common stock must receive all communications, including proxy material, sent generally to the holders of the voting securities of the listed company.

fundamentally, we would like to know why the NYSE took such a firm stance against families and promoters who sought to retain voting control by issuing common stock without voting rights. But before we turn to this question, we first explore how widely used nonvoting shares actually were before 1926.

The capital stock of U.S. corporations is traditionally divided into preferred stock and common stock.[57] Although there were not general rules, preferred stock generally had "a prior lien on assets, a prior lien on earnings and the right to cumulative dividends" (Dewing 1934, p. 137). Nonvoting preferred stock was issued with full voting rights, no voting rights, or contingent voting rights, only acquiring voting rights when certain conditions were met (or not), for example, if dividends were not paid.[58] Classified common stock only came into use from 1917 onward (Dewing 1934, p. 195). Class B was subordinated to Class A in receiving noncumulative dividends, if the management so decided, while Class B retained full voting control (Dewing 1934, pp. 196–97).[59] Empirically, the 200 largest U.S. corporations in 1937–39 (TNEC 1940) had issued 404 different types of stock: 208 common stock issues and 196 preferred stock issues. Among the preferred stock issued, 61 issues had contingent voting and only 21 were nonvoting.[60] Among common stock issues, we found only 8 nonvoting common stock issues, and only three times was it used to secure corporate control.[61] Both findings are consistent with the literature: "as in the case of the preferred stocks [there were] only relatively few industrial shares which were entirely non-voting" (Stevens 1926, p. 360). Why then was nonvoting *common stock* so controversial, and why did the older and more frequent nonvoting preferred not cause the same controversy? To answer this ques-

(C) *Preferred Stock, Minimum Voting Rights Required.* Preferred stock, voting as a class, should have the right to elect a minimum of two directors upon default of the equivalent of six quarterly dividends. The right to elect directors should accrue regardless of whether defaulted dividends occurred in consecutive periods.

(NYSE Listing Manual, 313.00 Voting Rights, last modified 10/01/1998)

57. Dewing (1934, p. 138) also discusses "guaranteed stock," which was issued by promoters in consolidations and claims that are similar to unsecured debt.

58. The rights of each stock were defined in the corporation's charter and bylaws, written on the stock certificate, and the variety of documented flavors is astonishing.

59. For Dewing (1934, p. 198), "from all angles [a class common stock] appears as a kind of weakened preferred stock; it is another attempt to lure the investor into accepting lessened security in the hope of a speculative profit."

60. Own calculations based on TNEC (1940, pp. 206–30). Stevens (1926) found sixteen issues of completely nonvoting preferred among 350 corporations. Dewing (1934) reports similar results for a cross section of 1,048 preference stock issues between 1925 and 1930.

61. In practice, nonvoting stock can be an important tool for securing family and/or incumbent control, but it is equally important to understand the rules of corporate elections. In this respect, U.S. corporate law provided for potential variety: voting could be by shares or class; with equal or unequal voting rights; with simple majority voting, supermajority voting, or cumulative voting (for directors); conditional or unconditional. Stevens (1938) showed that the general assessment is not changed by these considerations—nonvoting stock was not an important tool of corporate control.

tion a small excursion into the pre-1926 history of thinking behind the capital structure of U.S. corporations is required. Starting with the horizontal combinations we have stressed in earlier parts of this paper, capitalization, in particular "overcapitalization" ("stock watering") was a subject for leading corporate finance textbooks (Mead 1926; Dewing 1918, 1934), muckrakers (Lawson 1906), outraged professors (Ripley 1927), the financial press, politicians, and regulators.[62] Are securities issued against anything but the equivalent of the replacement value of tangible assets "water"? What securities can and should be issued against "goodwill"? When does goodwill become water? How much free cash-flow should investors put in the hands of the promoters and the management? How should one value intangible assets?

The issue is well illustrated by the F. W. Woolworth initial public offering highlighted in Graham and Dodd (1934).[63] The asset side of the company's balance sheet was divided in tangible assets and "goodwill." The latter was valued at $50,000,000. On the liabilities side there were 500,000 shares of common stock with a par value of $100 each offsetting the goodwill, and preferred stock offsetting the value of the tangible assets. The goodwill was written down to $1 by 1925, out of earnings and profits. The presence and degree of stock watering depended on the valuation of the tangible assets, the intangible assets, and which type of security was issued against which asset class.[64]

For traditionalists like Ripley, who had built a reputation as the leading scholar of railroad finance, some of the "modern" techniques of corporate finance were getting out of hand. The increased use of Class A common stock without voting rights was the peak of an unacceptable development. Investors were giving up all their control rights and creating a "birthright for pottage" (Ripley 1927, p. 78). In Ripley's, Mead's, Stevens's, and Dewing's view assets were claims on cash flow with (contingent) control rights. Without having knowledge of the insights of modern contract theory, they argued that claims on certain asset classes should be matched with certain (contingent) control rights for bond- and shareholders. Ripley's opposition to dual-class common share issues was motivated by his beliefs of what

62. The term "watered stock" referred "definitely and explicitly to the large issues of common stock brought into existence at the time of promotion against which existed no property value except 'goodwill'" (Dewing 1934, p. 84). An alternative definition stated that "stock watering may be defined as the issuance of full-paid stock in an amount exceeding the value of the assets against which the stock has been issued" (Dodd 1930).

63. The "stock watering" debate is rooted in more fundamental debate over par-value versus non-par-value stock: "This whole discussion of the significance of no-par stock rests on the presumption that the stockholder is interested primarily in the rights to earnings. And a corollary of this is that he is not interested in the original cost of the property which is creating the earnings. If this is so, then the term *watered stock* loses all its significance" (Dewing 1934, p. 84).

64. The market value of the common stock was $20,000,000 in 1911 and $354,182,000 in 1937, divided into 9,703,610 shares (TNEC 1940, p. 230).

a "sound" capitalization should look like. Under traditional railway finance, common stock was issued against goodwill, and its value was crucially dependent on the quality of management. Hence common stockholders demanded, and were given, voting rights. Depriving common stockholders of the right to appoint the board, and hence participate in the selection of management, at least in theory, was considered an outrage.

It was against this background that Ripley (1927) declared that the rise of Class A (nonvoting) common stock issues in 1924–25 would make these twelve months "go down in history—like the Year of the Plague, or the Year of the Big Wind—as the Year of the Split Common Stock and the Vanishing Stockholder." Ripley's view, forcefully expressed in an address to the Academy of Political Science (28 October 1925), caused a remarkable echo. It was published in the *Nation* and the *Atlantic Monthly* and amplified in the *New York Times.* The public and official mood was such that, with few exceptions, between 1926 and 1986 the NYSE did not list nonvoting common stock issues (Seligman 1986, pp. 695–97).

The nonvoting stock episode lends support to Roe's (1994) "fragmented finance" view. Ripley's (1927) main line of attack was directed again the investment banking houses that were the motors behind the undesirable developments in American corporate financed he condemned so forcefully in "Main Street and Wall Street." However, to be entirely sure about what motivated the NYSE's decision, more clinical research is required.[65]

References

Barca, Fabrizio, and Marco Becht, eds. 2001. The Control of Corporate Europe. *The control of corporate Europe.* Oxford: Oxford University Press.

Bebchuk, Lucian Arye. 2003. Symposium on corporate elections. Harvard Law and Economics Discussion Paper no. 448. November. http://ssrn.com/abstract=471640.

Bebchuk, Lucian Arye, and Jesse M. Fried. 2003. Executive compensation as an agency problem. *Journal of Economic Perspectives* 17:71–92.

Becht, Marco, Patrick Bolton, and Ailsa A. Röell. 2002. Corporate governance and control. ECGI Finance Working Paper no. 02/2002. European Corporate Governance Institute. http://ssrn.com/abstract=343461.

Berle, Adolf, and Gardiner Means. 1932. *The modern corporation and private property.* New York: Macmillan.

Black, Bernard S. 1998. Shareholder activism and corporate governance in the U.S. In *The New Palgrave Dictionary of Economics and the Law,* ed. Peter Newman. London: Macmillan.

Black, Bernard S., and John C. Coffee, Jr. 1994. Hail Britannia? Institutional investor behavior under limited regulation. *Michigan Law Review* 92:1997–2087.

65. This being said, Seligman (1986) does provide numerous references that firmly point in the direction of a populist backlash against bankers and "their" nonvoting shares.

Bonbright, J. C., and G. C. Means. 1932. *The holding company: Its public significance and its regulation.* New York: McGraw-Hill.
Bork, Robert. 1978. *The antitrust paradox.* New York: Free Press.
Brandeis, Louis. 1913. *Other people's money—and how the bankers use it.* New York: Stokes.
Burrough, Bryan, and John Helyar. 1990. *Barbarians at the gate: The fall of RJR-Nabisco.* New York: Harper Collins.
Carosso, Vincent. 1970. *Investment banking in America.* Cambridge, MA: Harvard University Press.
Carosso, Vincent P., and Rose C. Carosso. 1987. *The Morgans: Private international bankers, 1854–1913.* Cambridge, MA: Harvard University Press.
Carstensen, Fred. 1989. A dishonest man is at least prudent: George W. Perkins and the International Harvester Steel properties. Storrs, CT: University of Connecticut.
Chandler, Alfred. 1977. *The visible hand: The managerial revolution in American business.* Cambridge: Harvard University Press.
Chernow, Ronald. 1990. *The house of Morgan.* Boston: Atlantic Monthly Press.
Davis, Stephen. 2004. Culture shift shakes corporate America. *Financial Times,* March 14.
DeLong, J. Bradford. 1991. Did J. P. Morgan's men add value? A historical perspective on financial capitalism. In *Inside the business enterprise,* ed. Peter Temin. Chicago: University of Chicago Press.
Dewing, Arthur S. 1919. The financial policy of corporations. New York: Ronald Press.
Dodd, S. C. T. 1893. The present legal status of trusts. *Harvard Law Review* (November).
Donaldson, William H. 2003. Introductory remarks at the October 8 open meeting: Proxy access proposal. U.S. Securities and Exchange Commission. Washington, D.C., October 8.
Douglas, William O., and James Allen. 1940. *Democracy and finance: The addresses and public statements of William O. Douglas as member and chairman of the Securities and Exchange Commission.* New Haven, CT: Yale University Press.
Drucker, Peter. 1976. *The unseen revolution: How pension fund Socialism came to America.* New York: W. W. Norton.
Dunlavy, C. A. 1998. Corporate governance in late 19th century Europe and the U.S.: The case of shareholder voting rights. In *Comparative corporate governance: The state of the art and emerging research,* ed. K. J. Hopt, H. Kanda, M. J. Roe, E. Wymeersch, and S. Prigge. Oxford: Oxford University Press.
Galbraith, John Kenneth. 1967. *The new industrial state.* New York: Houghton Mifflin.
Garraty, John. 1960. *Right-hand man: The life of George W. Perkins.* New York: Harper and Brothers.
Gerschenkron, Alexander. 1962. *Economic backwardness in historical perspective.* Cambridge: Harvard University Press.
Gibb, George, and Evelyn Knowlton. 1976. *History of the Standard Oil Company.* New York: Harper.
Gillan, Stuart, and Laura Starks. 1998. A survey of shareholder activism: Motivation and empirical evidence. *Contemporary Finance Digest* 2:10–34.
Harbeson, Robert W. 1958. The Clayton Act: Sleeping giant of antitrust? *American Economic Review* 48 (1): 92–104.
Hawley, Ellis Wayne. 1966. *The New Deal and the problem of monopoly: A study in economic ambivalence.* Princeton, NJ: Princeton University Press.

Hofstadter, Richard. 1964. The paranoid style in American politics. *Harper's Magazine.*

Holderness, Clifford G., Randall S. Kroszner, and Dennis P. Sheehan. 1999. Were the good old days that good? Changes in managerial stock ownership since the Great Depression. *Journal of Finance* 54:435–69.

Holmstrom, Bengt, and Steven N. Kaplan. 2001. Corporate governance and merger activity in the United States: Making sense of the 1980s and 1990s. *Journal of Economic Perspectives* 15:121–44.

Hoyt, Edwin Palmer. 1967. *The Guggenheims and the American dream.* New York: Funk & Wagnalls.

Huertas, Thomas, and Harold Cleveland. 1987. *Citibank.* Cambridge, MA: Harvard University Press.

Karpoff, Jonathan M. 1998. The impact of shareholder activism on target companies: A survey of empirical findings. University of Washington School of Business.

Krugman, Paul. 1996. *The self-organizing economy.* Cambridge, MA: Blackwell.

La Porta, Rafael, Florencio López-de-Silanes, and Andrei Shleifer. 1999. Corporate ownership around the world. *Journal of Finance* 54 (2): 471–517.

Lamont, Thomas. 1913. *The Brandeis talk.* Thomas W. Lamont Papers, Box 84. Boston: Harvard Graduate School of Business.

Lawson, Thomas. 1905. *Frenzied finance: The crime of Amalgamated.* New York: Greenwood.

Leech, Dennis. 1987. Ownership concentration and control in large U.S. corporations in the 1930s: An analysis of the TNEC sample. *Journal of Industrial Economics* 35:333–42.

Means, Gardiner C. 1930. The diffusion of stock ownership in the U.S. *Quarterly Journal of Economics* 44:561–600.

———. 1931. The separation of ownership and control in American industry. *Quarterly Journal of Economics* 46:68–100.

Moeller, Sara B., Frederik Paul Schlingemann, and Rene M. Stulz. Wealth destruction on a massive scale? A study of acquiring-firm returns in the recent merger wave. *Journal of Finance,* Forthcoming http://ssrn.com/abstract=571064.

Moody, John. 1904. *The truth about the trusts.* New York: Moody.

Paine, Albert. 1921. *Theodore N. Vail: A biography.* New York: N.p.g.

Piketty, Thomas, and Emmanuel Saez. 2001. Income inequality in the United States, 1913–1998. University of California at Berkeley, Department of Economics.

Pound, Arthur, and Samuel Moore, eds. 1931. *More they told Barron.* New York: Harper and Brothers.

Pujo Committee. U.S. Congress. House. Committee on Banking and Currency. 1913a. *Minority Report of the Committee . . . to Investigate the Concentration of Control of Money and Credit.* Washington, DC: Government Printing Office.

———. 1913b. *Money Trust Investigation.* Washington, DC: Government Printing Office.

Redlich, Fritz. 1951. *The molding of American banking.* New York: Hafner.

Reed, William J. 2001. The Pareto, Zipf, and other power laws. *Economics Letters* 74:15–19.

Ripley, William Z. 1915. *The railroads: Finance and organization.* New York: Longmans Green.

Roe, Mark. 1994. *Strong managers, weak owners: The political roots of American corporate finance.* Princeton, NJ: Princeton University Press.

Romano. 2001. Less is more: Making institutional investor activism a valuable mechanism for corporate governance. *Yale Journal of Regulation* 175–250.

Seligman, Joel. 1982. *The transformation of Wall Street: A history of the SEC.* Boston: Houghton Mifflin.
Shleifer, Andrei, and Lawrence Summers. 1988. Breach of trust in hostile takeovers. In *Corporate takeovers,* ed. Alan Auerbach. Chicago: University of Chicago Press.
Shleifer, Andrei, and Robert Vishny. 1986. Large shareholders and corporate control. *Journal of Political Economy* 94 (2): 461–88.
———. 1997. A survey of corporate governance. *Journal of Finance* 52:737–80.
Smith, Edgar L. 1924. *Common stocks as long-term investments.* New York: Macmillan.
Smith, George, and Richard Sylla. 1993. The transformation of financial capitalism: An essay on the history of American capital markets.
Sloan, Alfred P. 1964. *My Years with General Motors.*
Sombart, Werner. 1904. *Why is there no Socialism in the United States?* New York: M. E. Sharpe.
Stevens, William, ed. 1913. *Industrial combinations and trusts.* New York: Macmillan.
Stoke, Harold W. 1930. Economic influences upon the corporation laws of New Jersey. *The Journal of Political Economy* 38 (5): 551–79.
Sylla, Richard. 1992. The progressive era and the political economy of big government. *Critical Review* 5.
Tarbell, I. M. 1904. *The history of the Standard Oil Company.* New York: McClure Phillips & Co.
Temporary National Economic Committee (TNEC). 1940. *The distribution of ownership in the 200 largest nonfinancial corporations.* Washington, DC: Government Printing Office.
Thorelli, H. B. 1955. The Federal antitrust policy: Origination of an American tradition. Baltimore, MD: Johns Hopkins Press.
Untermyer, Samuel. 1915. Speculation on the stock exchanges. *American Economic Review* 5 (1): 24–68.
Vanderlip, Frank, and Boyden Sparkes. 1935. *From farm-boy to financier.* New York: Appleton Century.
Warshow, H. T. 1924. The distribution of corporate ownership in the U.S. *Quarterly Journal of Economics* 39:15–38.
White, Eugene. 1982. The political economy of banking regulation. *Journal of Economic History* 42.
White, Eugene. 1989. *Regulation, taxes, and the financing of American business 1860–1960.* New Brunswick, NJ: Rutgers University.
Willis, Parker, and John Bogen. 1929. *Investment banking.* New York: Harper and Row.

Comment Richard Sylla

Two recent essays place the history of the American business corporation in a comparative context. One is the chapter here, "Why Has There Been So Little Blockholding in America?" by Becht and DeLong. The other is a synopsis and two draft chapters of a forthcoming book by Colleen Dun-

Richard Sylla is Henry Kaufman Professor of the History of Financial Institutions and Markets, professor of economics at the Stern School of Business at New York University, and a research associate of the National Bureau of Economic Research.

lavy, *Shareholder Democracy: The Forgotten History* (Dunlavy 2004, forthcoming). Each essay argues that the United States developed patterns and practices of corporate governance that were exceptional rather than typical of the patterns and practices of other nations.

Becht and DeLong contend that around 1900 the United States was not exceptional—corporate control, they say, was "relatively 'normal'"—because families and large financial institutions held controlling blocks of stock in corporations, as in other industrialized economies, and could ride herd on corporate managers. During the next three to four decades, however, they argue that the United States became exceptional as wealthy families sold off their controlling blocks to numerous smaller investors and as large financial institutions retreated from, or were forced to retreat from, exercising monitoring and control functions over corporate management. Thus was born the "Berle-Means corporation" with its widely dispersed stockholdings giving rise to a separation of ownership from control, and leaving management firmly in control. Since this did not happen to nearly the same extent in other countries, where families and/or financial institutions continued to retain greater control over management, the United States became an exception to the usual pattern of corporate control.

Colleen Dunlavy, in contrast to Becht and DeLong, contends that around 1900 the United States was already exceptional in having "plutocratic" voting rights as the norm for corporate shareholders. By that she means that shareholder voting rights in U.S. corporations typically were one share, one vote, giving large shareholders much more say in corporate affairs than small shareholders. In other countries, such as Great Britain, France, and Germany, shareholder voting rights were more "democratic" in limiting the power of large shareholders, the block holders of Becht and DeLong, to control corporate affairs. Earlier in history, the voting rights of shareholders had been more democratic in the United States as well. But they took a "plutocratic turn" toward one share, one vote in the middle decades of the nineteenth century. Dunlavy explores several explanations for the U.S. plutocratic turn, tentatively settling on one holding that the competition for capital was more intense in the United States than in the leading European economies.[1] By adopting plutocratic voting rights for shareholders, American corporations could gain advantages in the competition for capital, and so they did.

1. Dunlavy's tentative explanation is plausible. The United States was growing more rapidly than the European countries, and unlike them it was importing both people and capital. The European states were exporting people and capital, often to the United States. These considerations, as well as higher interest rates and bond yields in the United States than in Europe, suggest that at the margin, competition for capital was greater in America. But all of these considerations likely applied before the plutocratic turn in shareholder voting. Why did the competition for capital in the United States become more intense in the middle decades? Was it from the demand side, perhaps related to the advent of railroads? Or was it possibly from the supply side, perhaps from a decline of capital inflow after the state debt defaults and repudiations of the early 1840s? Or both?

Was corporate governance in the United States around 1900 like that in Europe, as Becht and DeLong say? Or was it not, as Dunlavy contends? Differences in the two positions perhaps are not as great as they might seem. Becht and DeLong look forward from 1900 into the twentieth century and explore the change from finance capitalism to managerial capitalism. Dunlavy in a sense looks backward from 1900, beginning her study a century or so earlier and exploring the transition from "democratic" shareholder capitalism to "plutocratic" shareholder capitalism in the United States, and its persistence in Europe. She agrees with Becht and DeLong that after 1900 managerial capitalism displaced shareholder capitalism in the United States. She also indicates that in the twentieth century shareholder voting rights in Europe followed the American lead and became more plutocratic. This perhaps explains why Becht and DeLong do not find it necessary to say much about cross-national differences in voting rights, and why almost everyone now considers one share, one vote as normal or natural in corporate governance.

But one share, one vote was hardly the norm in the early history of corporations. Pure democracy in voting for directors and on other corporate matters would imply one shareholder, one vote, regardless of whether the shareholder held one or a thousand shares. That would seem odd by current norms, but it was not so odd two centuries ago. Then it seemed to be the Anglo-American common-law presumption if no other voting rights scheme was specified in a corporate charter. More often than not in Britain, France, Germany, and the United States, some other voting rights scheme was specified. And more often than not, it was not one share, one vote. It was another scheme—somewhere between one shareholder, one vote and one share, one vote—that limited the influence of large shareholders in corporate governance. Dunlavy calls such schemes "a prudent mean," a term borrowed from Alexander Hamilton, who used it to describe the shareholder voting scheme he proposed in 1790 for the Bank of the United States, and which became a part of the bank's charter as drafted by Hamilton and adopted by Congress in 1791.

Picking up on Dunlavy's lead, I looked into the origins of Hamilton's idea of prudent-mean voting rights, his rationale for it, and its influence on early U.S. corporate charters. These matters are of some historical importance. Although the United States did not invent the idea of the business corporation, from the 1790s to the 1850s it developed the corporation as a form of competitive enterprise to a far greater extent than did European nations. U.S. federalism played a large role because corporate chartering was almost entirely a function of U.S. state governments, of which there were many, rather than centralized at the national level as in Europe.

The prudent-mean concept of shareholder voting rights appears to have originated with Hamilton, although more study of previous and contemporary business charters would be necessary in order to determine whether his formulation of it was a new idea or reflected customary practices. Before there were any U.S. banks and while he was still a colonel in the Continental Army, Hamilton in three letters to American leaders in 1779–81 had proposed a national bank to help finance the war effort. Two of those letters outlined bank charters but did not take up the matters of corporate governance such as shareholder voting rights. One of the letters was to Robert Morris in spring 1781, and Morris, Congress's newly appointed superintendent of finance, was simultaneously preparing his own proposal for the charter of the Bank of North America. The fifth article of Morris's plan proposed the voting scheme that we now regard as normal, namely "that every Holder of a share . . . may have as many Votes as he holds shares" (Morris 1973, pp. 68–69). Congress approved Morris's plan, and the Bank of North America, the first modern bank in the United States, opened for business at the start of 1782.

Two years later in New York, Hamilton—by then a lawyer—helped found the Bank of New York, wrote its constitution, and served as one its original thirteen directors. Article 5 of Hamilton's 1784 Constitution of the Bank of New York stated: "that every holder of one or more shares, to the number of four, shall have one vote for each share. A subscriber of six shares shall have five votes; eight shares, six votes; and ten shares, seven votes; and one vote for every five shares above ten" (Domett 1884, p. 12).[2] No rationale is given for this voting scheme, but since it differed from that of Morris's bank, with which Hamilton was familiar, and since the Bank of New York was the second—or third, the Bank of Massachusetts with the Morris scheme of one share, one vote appearing nearly simultaneously—the idea of limiting the voting rights of large shareholders in a banking corporation must have been Hamilton's. The Bank of New York commenced operating under Hamilton's constitution, and it applied to the state legislature for a charter of incorporation several times before one was finally granted in 1791. The 1791 charter retained Hamilton's voting scheme and "was substantially the model upon which all the bank charters granted in the State of New York were framed prior to 1825" (Domett 1884, p. 35).[3]

For the rationale of Hamilton's restriction on the power of large shareholders, we have to turn to his 1790 proposal, made as secretary of the treasury, for a Bank of the United States. In the *Report on a National Bank,* Hamilton gives a number of reasons why the Bank of North America that Congress in 1781 (and subsequently several states) had chartered would not do as a national bank. Among them is this:

> A further consideration in favour of a change, is the improper rule, by which the right of voting for Directors is regulated in the plan, upon which the Bank of North America was originally constituted, namely a

2. The entire constitution is on pp. 11–15 of Domett (1884).
3. The 1791 New York charter is contained in an appendix to Domett, pp. 127–34.

> vote for each share, and the want of a rule in the last charter [granted by Pennsylvania]; unless the silence of it, on that point, may signify that every Stockholder is to have an equal and a single vote, which would be a rule in a different extreme not less erroneous. It is of importance that a rule should be established, on this head, as it is one of those things, which ought not to be left to discretion; and it is consequently, of equal importance, that the rule should be a proper one.
>
> A vote for each share renders a combination, between a few principal Stockholders, to monopolise the power and benefits of the Bank too easy. An equal vote to each Stockholder, however great or small his interest in the institution, allows not that degree of weight to large stockholders, which it is reasonable they should have, and which perhaps their security and that of the bank require. A prudent mean is to be preferred. (Hamilton 1963, p. 328)

Later in the *Report,* when he outlines a constitution or charter for the Bank of the United States, Hamilton in article 11 makes his prudent mean idea more concrete:

> The number of votes, to which each Stockholder shall be entitled, shall be according to the number of shares he shall hold in the proportions following, that is to say, for one share and no more than two shares one vote; for every two shares, above two and not exceeding ten, one vote; for every four shares above ten and not exceeding thirty, one vote; for every six shares above thirty and not exceeding sixty, one vote; for every eight shares above sixty and not exceeding one hundred, one vote; and for every ten shares above one hundred, one vote; but no person, copartnership, or body politic, shall be entitled to a greater number than thirty votes. (Hamilton 1963, p. 335)

It is interesting to speculate, in the manner of Becht and DeLong, on how many shareholders with such a voting scheme would be needed to constitute a majority block for control. The Bank of the United States was a large corporation, capitalized at $10 million in twenty-five thousand shares of $400 each, par value. The U.S. government subscribed for five thousand shares, leaving twenty thousand shares in the hands of private shareholders. At one extreme, if each of the private shareholders held one share, there would be twenty thousand private votes plus thirty votes for the federal government. A controlling block without the government would then be 10,016 individuals and shares.

At the other extreme, if all private shareholders held 200 shares, the number of shares that allowed the maximum of 30 votes, there would be 100 private shareholders and 3,030 votes counting the 30 votes of the government. A private controlling block would then be 51 private shareholders. This number is in the range that Becht and DeLong estimate as the number of large shareholders that it would have taken to control Standard Oil of New Jersey in the late 1920s, after its share ownership had undergone considerable deconcentration since the heyday of John D. Rockefeller. One might almost say that Alexander Hamilton, with or without realizing it, had invented the Berle-Means corporation fourteen decades before those authors rediscovered it. But that would not quite be correct, for Hamilton also wrote into the Bank of the United States charter that the secretary of the treasury on behalf of the federal government could require the bank to report to him on its condition as often as once a week. So the bank's management was rather continually monitored by its largest shareholder-regulator.

Colleen Dunlavy finds in Hamilton's statement that an equal vote to each stockholder "allows not that degree of weight to large stockholders, which it is reasonable they should have, and which perhaps their security and that of the bank require" the germ of her explanation of why the plutocratic turn toward one share, one vote came to the United States in the middle decades of the nineteenth century. As the competition for capital heated up, corporations wanting to survive and thrive had to give more weight and security to large shareholders. Before that happened, Hamilton's prudent-mean notion of shareholder voting rights was more democratic, less plutocratic. Since his charters were emulated widely, they became influential in early U.S. banking and corporate development.

I conclude that we need to know a lot more about the history of the corporation, a subject that seems curiously neglected given its importance in modern economic history. Becht and DeLong suggest that we might leave managerial capitalism behind and return to the "initial" conditions around 1900, when families and finance capitalists controlled corporations: "It is not clear that the next generation of the Gates family will have as little influence on American corporate control as the current generation of the Rockefeller family does. It is not clear that the large American financial institutions of the twenty-first century . . . will have as little influence on American corporate control as the firms of the mid-twentieth century did." But these are not the only alternatives to managerial capitalism. Taking a longer view of the history of the corporation, it seems evident that there were other, even earlier initial conditions that might also be considered as models for corporate control and governance. They extend back at least to the late eighteenth century, when the competitive business corporation first emerged in the United States, and to the early practices of other countries as well.

References

Domett, Henry W. 1884. *A history of the Bank of New York, 1784–1884.* 3rd ed. Cambridge, MA: Riverside Press.

Dunlavy, Colleen. 2004. The plutocratic turn in 19th-century shareholder voting rights: Why the U.S. but not Britain, France, or Germany? Paper presented at seminar at Harvard University Charles Warren Center for Studies in American History. 19 April, Cambridge, Massachusetts.

———. Forthcoming. *Shareholder democracy: The forgotten history.* Cambridge, MA: Harvard University Press.

Hamilton, Alexander. 1963. *The papers of Alexander Hamilton.* Vol. 7. Ed. Harold C. Syrett. New York: Columbia University Press.

Morris, Robert. 1973. *The papers of Robert Morris, 1781–1784*. Vol. 1. Ed. E. James Ferguson. Pittsburgh: University of Pittsburgh Press.