How the American Corporation Evolved Over Two Centuries[1]

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What we think we know is shaped by statements that we hear over and over until we become convinced that they must be true. Of the American business corporation, we often hear the following statements. The corporation is a legal person, with rights and obligations like those possessed by other persons such as us. Unlike us, the corporation has perpetual life. Its owner-shareholders have limited liability. Each share is entitled to one vote in the governance process that elects directors and makes other shareholder decisions. The purpose of the corporation is to produce and market goods and services in such a way as to maximize profits and *share price*, or what is often termed *shareholder value* or *shareholder wealth*.

These truisms embody purposes that are thought to benefit us as individuals, as well as our economy, polity, and society. Legal personhood and perpetual life allow the corporation to make contracts and avoid having to reorganize whenever an owner dies. Limited liability encourages us to pool our capital in corporations that can achieve economies of large-scale production and distribution in ways impossible for sole proprietorships and partnerships; the corporate shareholder knows that he or she cannot lose more than the amount invested even if the corporation fails with debts greater than its assets. One share, one vote strikes us as just a fair and equitable way to govern corporations. Maximizing profits and shareholder value is good for shareholders but also strikes many people as good for society because it indicates that the corporation has deployed its assets to create the

1 This essay is a revision of a paper presented on 16 November 2013 at a symposium on American corporations. I thank Professors William Baumol and Ralph Gomory and the other presenters, Lynn Stout and Edward Wolff, for their comments on that presentation.

most value and thereby contribute to economic growth and rising living standards over time.

One of the uses of history in general, and of economic history in particular, is to remind us that what we believe—what we take for granted today—was not always the case. The institutions and organizations of our modern economy were not given to us by stone tablets delivered from on high, or even delivered to posterity in the form of declarations and constitutions written by great statesman long ago. Rather, they are the result of an evolving historical process. Here, I briefly survey that process over more than two centuries of U.S. history to show how we arrived at our current corporate forms. Since there are currently many doubts about whether the interests of our corporations are aligned with those of American society, we might be interested to know that corporations in the past were often quite different from what they are now. Armed with that knowledge, we can consider how corporations can further evolve in ways that better align their operations with larger societal goals.

I will give more attention to the earlier eras of corporate development. My fellow panelists in this symposium will focus more on recent and current developments.

Early U.S. Corporations: 1790s–1860s

Although the United States borrowed many of its economic and financial institutions—taxes, forms of money, banks and central banks, securities markets, and so on—from earlier, mostly European models, it led the world in developing the modern corporation as a form of competitive business enterprise. In Europe, up to middle of the nineteenth century, the typical corporation was a privileged monopoly created by rulers in return for favors promised by the company, and few such entities existed. Early America was not so different. It appears that only seven business corporations were created in the Thirteen Colonies, and another twenty eight up to 1790.

Contrast those numbers with the United States after 1790. Recent research reveals that in the period from 1790–1860, U.S. state legislatures chartered more than 22,000 corporations by individual acts of their legislatures, and an estimated 7,000–8,000 more under general incorporation laws enacted mostly from the 1840s on.[2] Impressive as that is when contrasted with the Old World, it was just a start. By 1910, an estimated 450,000 corporations existed in the world, and 270,000 of them (60% of the total) were American. In recent years,

2 Wright and Sylla 2011; Sylla and Wright 2013; Wright 2014.

around 6 million American corporations file tax returns. A fellow economic historian has described the United States as the world's first "corporation nation."[3] It seems an apt description of our country.

Most of the pre-1860s corporations were small by today's standards, although even today, since only about 10,000 of our 6 million corporations are listed and publicly traded in securities markets, it is clear that most corporations are still rather small. The largest of the early corporations were banks and insurance companies, joined later in the antebellum era by railroads and manufacturers.

The largest of all the early U.S. corporations were the two Banks of the United States (BUSs) chartered by Congress. The first BUS, the brainchild of Alexander Hamilton in 1790, was particularly influential because many features of its charter were copied in many later bank and some non-bank charters.[4] In terms of our current beliefs about corporations, it is instructive to look at that charter. The first BUS was definitely a legal person with rights and also responsibilities, one of which was to be regularly inspected by the Secretary of the Treasury. The U.S. government subscribed for 20% of its stock, and Hamilton argued that it would be a profitable investment for the government. That conveyed a message to the states that they, too, could charter other corporations and benefit from doing so, which is one reason corporations began to proliferate in the 1790s.

BUS shareholders had strictly limited liability, which seems to have been the default option in most early corporate charters. But limited liability was far from universal in such charters. Some states chartered corporations and specified unlimited shareholder liability, or no limited liability until authorized capital was fully paid in, or unlimited liability for directors who exceeded corporate authority as specified in charters. Over time, strictly limited liability became the norm for all corporations, but double liability was a feature of national bank charters and many state bank charters into the 20th century.

Unlike our modern corporations, neither the first or second BUSs had perpetual life. Each was chartered for 20 years. In fact, largely for political reasons, each failed to have its charter renewed when it came up for renewal. Most of the early charters granted in special acts of state legislatures had such term limits, but charters were usually renewed for corporations that survived and requested renewals. These term limits allowed the legislature to monitor corporations and make sure they had lived up to the terms of their charters, and to alter charter terms at renewal time if that seemed to be in the public interest.

3 Wright 2011; Wright 2014.

4 Bodenhorn 2011.

Legislative charters often specified that corporations, especially banks, reserve some shares for the state, and the dividends from those investments were dedicated to state School Funds, Literary Funds, and other special purposes. Banking corporations were also required by their charters to perform certain duties, often unrelated to their business purpose, that were deemed to be in the public interest. To obtain the charter, a corporation had to accept these responsibilities. Some examples follow:

- Massachusetts funded a large portion of the state budget in its early decades from a tax on bank capital. It also required banks to lend 10% of their capital stock to citizens of the state engaged in agriculture and manufacturing.[5]
- Between 1818 and 1854, Connecticut banks were charged bonuses and were directed to pay them to various institutions, among them Yale University and the Connecticut Retreat for the Insane. The state also required some banks in their corporate charters to purchase stock in canal and railroad companies.[6]
- In New York, Aaron Burr's Manhattan Company charter in 1799 promised to supply New York City with fresh water, although it went on to engage mostly in banking. When the state chartered the City Bank (today's Citibank) in 1812, it was required to pay $100,000 into the state's common school fund. The larger Bank of America chartered the same year had to pay $400,000 into that fund, and another $100,000 into a state roads and navigation fund.[7]
- Pennsylvania in 1814 and 1824 acts chartering banks required the banks to make loans at 6% interest and equal to 20% of their paid-in capital to farmers, mechanics, and manufacturers in their districts.[8]
- Maryland reserved the right to purchase shares in every bank it chartered. For charter renewals in 1813 and 1822, Baltimore banks were required to establish a turnpike company, invest in its stock, and even manage it. Several Maryland bank charters expired in 1815, and renewal conditions included a tax on bank capital for the benefit of the state's Free School Fund and a directive that the banks subscribe to shares in the Cumberland Turnpike Road.[9]
- Virginia invested in the banks it chartered and held most of the stock in a Literary Fund that financed local schools and a Fund for Internal Improvements that financed canals.[10]

5 Sylla, Legler, and Wallis 1987; Fenstermaker 1965.

6 Sylla, Legler, and Wallis 1987; Fenstermaker 1965.

7 Fenstermaker 1965.

8 Fenstermaker 1965, p. 18.

9 Sylla, Legler, and Wallis 1987; Fenstermaker 1965.

10 Sylla, Legler, and Wallis 1987.

- South Carolina established a wholly state-owned Bank of the State of South Carolina in 1812; the bank's profits were paid into a sinking fund, and in 1824, the state made the bank responsible for paying the interest and principal payments due on the state's debt.[11]
- Georgia in 1836 required the Ocmidgee Bank to pay a charter bonus of $25 thousand to the Georgia Female College at Macon.[12]
- Louisiana in 1836 required the Merchants' Bank of the state to pay $1,000 annually to a male orphan asylum.[13] The state's Exchange and Improvement banks were required to build and operate hotels. The Commercial Bank of New Orleans (shades of Aaron Burr) had to build a water works system for the city. And the New Orleans Light and Banking Company was tasked with installing gas lights in the city.

These examples indicate that corporate social responsibility could have a clearer and more definite meaning in the early decades of U.S. history than it appears to have now.

What about voting rights in early U.S. corporations? Was one vote per share considered to be either natural or the norm? Hardly, and it may come as a surprise to those who think one vote per share to be natural that no less an authority than Alexander Hamilton deemed it an "improper rule," but so too, he reasoned, was a "democratic" rule of one vote per shareholder. In his 1790 "Report on a National Bank," Hamilton wrote:

> A vote for each share renders a combination between a few principal stockholders, to monopolize 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 that they should have, and which, perhaps, their security and that of the bank require. A prudent mean is to be preferred.

By a "prudent mean," Hamilton meant a staggered voting system in which holders of one or two shares would have one vote, and that "no person, copartnership, or body politic shall be entitled to a greater number than thirty votes."[14]

Hamilton did not want large shareholders in corporations to conspire in ways that might deprive minority shareholders of their rights or take their property. But he also did not want small shareholders to deprive larger ones of their due, which a "democratic" rule

11 Ibid.

12 Fenstermaker 1965.

13 Ibid.

14 Hamilton, 1963, pp. 328, 335. Hamilton's original "Report on a National Bank" is dated December 1790.

would do. Because of Hamilton's enormous influence on early U.S. legislation, his prudent-mean voting scheme was written for about half a century into many corporate charters granted by states. After that, one vote per share, which some have termed a "plutocratic" (as opposed to "democratic") rule increasingly became the norm, so much so that for a long time, it has been considered only natural.

If the early U.S. corporate system had so many features that might seem to require corporations to be more responsible to society in comparison with our current system, we might reasonably ask why it was gradually abandoned. The answer is that chartering corporations by special acts of state legislatures was a system susceptible to corruption. Incumbent corporations would bribe or otherwise induce legislators and legislatures to prevent new corporations from entering and competing with them. And corporate wannabes would use the same techniques to gain charters.

The solution to these problems after they became increasingly evident was the general incorporation statute. Virtually all corporations today, and almost all of them since the mid-19th century, are formed under such statutes, which make the granting of corporate charters a routine function of the executive branch of state governments instead of creating corporations by special acts of the legislative branch. Under a general incorporation law, any group of incorporators meeting the specifications of the law could obtain a corporate charter. Access to the corporate form thus became more open, and the cozy, crony-capitalistic relationships between legislators, political parties, and corporations were left behind, at least for a time. This, on net, was a gain. But one of the losses that accompanied the change was reduced political and social control over the creation of corporations and corporate governance.

Gilded Age, Robber Barons, Progressive Era, and the Roaring '20s

Most American corporations remained relatively small after 1860, but the period from then into the early twentieth century marked the advent of more and more large corporations that operated across the nation and even across national borders. Railroads were the earliest examples of large, capital-intensive corporations, particularly as they consolidated into railway systems that spanned much of the North American continent. Railroads made possible the mass distribution of goods produced and marketed by large industrial corporations, taking advantage of mass-production technologies.

These corporations—exemplified by the Pennsylvania, New York

Central, Union Pacific and Great Northern railroads, and by industrials Standard Oil, American Tobacco, U.S. Steel, DuPont, Swift, AT&T, Ford, General Motors, and Sears Roebuck—were something new and, to many Americans, threatening. Their numbers were tiny in relation to the hundreds of thousands of smaller, more traditional corporations, but they accounted for a large and growing share of the country's output. Their principal owners, often dubbed *robber barons*, wielded great power and amassed wealth previously unimaginable. These owners shared economic power with a new class of professional managers that, despite having limited ownership stakes, effectively controlled the giant enterprises. The implications of this separation of ownership and control were explored in a famous book published in 1932, *The Modern Corporation and Private Property*, by law professor Adolph Berle and economist Gardner Means.[15]

Society reacted to the threatening nature of the concentration of corporate wealth and power, especially in the so-called Progressive Era from 1900–1920, with antitrust laws and government regulation at both the state and federal levels. On the whole, however, the effects of these developments were limited because large corporations had the means to hire the country's best lawyers to fend off the attacks of trust busters and "capture" governmental regulators.

From the Great Depression to Globalization: 1930s–1970s

What really checked the growing power of large corporations was the Great Depression of the 1930s. It did so by putting big business and big finance under a cloud, which led to Franklin D. Roosevelt's New Deal in 1933. The New Deal engineered a large expansion of government in the American economy and a concentration of governmental power at the federal level. The Roosevelt administration used its political mandate to rein in the powers of big business and big finance with a host of new regulations and programs designed to shift economic power away from big business and toward government and labor. This leveled a playing field that previously had been tilted in favor of big business.

World War II and the Cold War helped to restore some of the prestige big business lost in the Great Depression. But it did so mostly because it prompted large corporations and big finance to cooperate —to become a partner—with a more powerful federal government and a more powerful labor movement in the war efforts. The two decades after World War II for Americans were ones of marked prosperity; a

15 Berle and Means 1932.

widely shared prosperity featuring steeply progressive taxes on incomes; rising middle-class living standards; new highs in stock prices for the first time in a generation; and cooperative relationships of corporations, labor, and government. The interests of each seemed to be well aligned. What was good for General Motors, as its CEO Charles Wilson famously said in the 1950s, was good for the country, and that included labor, the government, and other stakeholders in corporate America.

In retrospect, the two prosperous postwar decades were the result of special circumstances that would not last. The United States was the only belligerent to emerge from World War II relatively unscathed. All the others had to rebuild their economies, and that took some time. By the 1960s, they were back to normal, often with more of the latest and most efficient technologies that American corporations had shunned because their investments in older technologies had survived the war intact. Whereas U.S. business had the vast American economy and even a good bit of the world economy to itself during the two prosperous decades, it suddenly faced stiff competition from other countries.

By the 1970s, rising inflation and oil-price shocks were further eroding U.S. competitiveness. The Federal Reserve thought it could revive a slowing economy by printing more money to reduce interest rates and stimulate investment and job creation. But the results turned out to be inflation, rising interest rates, and rising unemployment. A new word entered the lexicon to describe it—*stagflation*. All of these developments were bad for General Motors, its various stakeholders, and the country.

As far as corporations were concerned, new solutions to their problems gained traction with academics and other critics of a bad situation that admittedly deserved to be criticized. One of them was to attack most of the regulations that had arrived with the New Deal and were sometimes extended after it. Regulation was transformed from a solution to a problem; deregulation was the new solution.

Another academic solution to the problems faced by corporations three to four decades ago was to jettison the stakeholder view of corporate decision making that had grown up in the prosperous decades and replace it with a new view that the purpose of the corporation was to maximize shareholder value.[16] In this view, corporate executives making decisions in the interests of stakeholders other than the owner-shareholders were acting wrongly.

If maximizing profits and shareholder value required shuttering plants in parts of the country where labor unions were strong and

16 For an early and classic statement of this view, see Friedman (1970).

shifting production to right-to-work states where unions were weak or nonexistent, so be it. Corporate profits and the Sun Belt gained; if that created a Rust Belt, so be it. In time, this would be generalized; if shuttering old plants in the United States and opening new ones in other countries increased corporate profits, why not do it?

But what if corporate managers brought up on older stakeholder views of the corporate purpose resisted the new thinking? A solution to that problem might be to replace those managers with new ones brought up on the shareholder-value maximizing thinking increasingly taught in business schools. An even better solution was to incentivize managers by offering them stock options. That, it was argued, would align the managers' interests with those of the stockholders.

This is the point to which the evolution of the American corporation had arrived some 30–40 years ago. Maximizing shareholder value has pretty much dominated corporate goals during the years from then to now. A recent manifestation of this way of thinking that has attracted media attention is the ploy of some U.S.-domiciled corporations to relocate their "home" country to another country, often by purchasing or merging with a corporation located in the other county. A prime motivation for executing this ploy is to save on corporate tax payments because the country of relocation invariably has lower corporate tax rates than the United States.

Such relocations to save on taxes would seem to violate one of the basic tenets of the theory that corporations should maximize profits and shareholder value. In arguing against the stakeholder view of the corporation, Milton Friedman contended that corporate managers should not be making social decisions, such as donating corporate dollars belonging to the shareholders to community or other "public" purposes. Funding such projects was a proper activity for governments but not a proper activity for corporations. An implication of the argument is that if governments rather than corporations are to be responsible for the funding of such projects, corporations ought to have the responsibility of paying the taxes imposed by governments to do so.[17] When American corporations cut their tax payments by relocating their domiciles to other nations with lower corporate tax rates, they, in effect, are playing a game of "Heads I win, tails you lose."

The question before us is whether we are in better shape as a country because of the triumph of shareholder value maximization. That can be discussed in an informed way once it is realized that earlier in American history, corporate social responsibility meant something quite different.

17 See Avi-Yonah (2014) for an elaboration of this view.

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