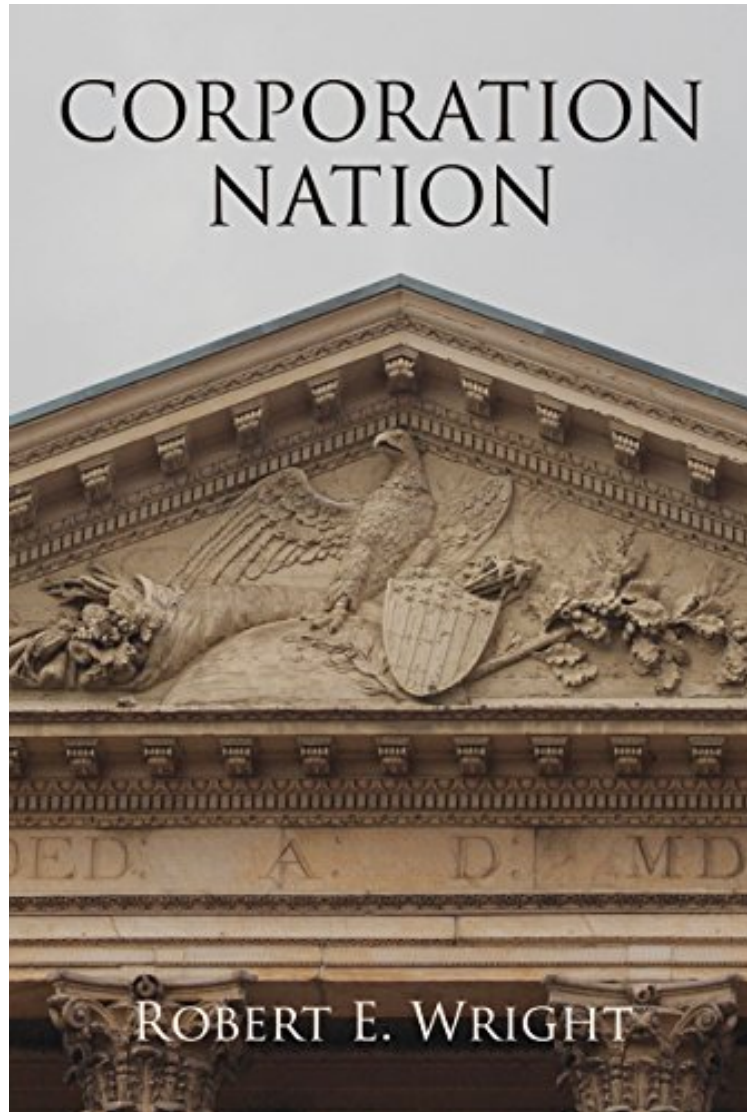


(Download ebook) Corporation Nation (Haney Foundation Series)

## Corporation Nation (Haney Foundation Series)

*Robert E. Wright*

*ebooks | Download PDF | \*ePub | DOC | audiobook*



[Download](#)

[Read Online](#)

#3134169 in eBooks 2013-11-20 2013-11-20 File Name: B00GY0APLE | File size: 32.Mb

**Robert E. Wright : Corporation Nation (Haney Foundation Series)** before purchasing it in order to gage whether or not it would be worth my time, and all praised Corporation Nation (Haney Foundation Series):

3 of 4 people found the following review helpful. Learn From HistoryBy CorpGovNetRobert E. Wright delves into the history of the corporation, addressing central issues such as agency theory, democracy and public interest through the lens of history.Despite protests that corporations were potentially corrupting, U.S. state governments early on combined to charter more corporations per capita than any other nation--including Britain--effectively making the United States a "corporation nation." Robert E. Wright traces the shift in corporate governance from relatively self-governing business republics to the much more regulated entities we are familiar with today.In the nineteenth century,

checks and balances, primarily enforced by shareowners, kept managerial interests aligned with both shareowners and the larger society. As the ownership of typical corporations became more widely dispersed, owners had less and less incentive to monitor. That led to increased managerial malfeasance, more repeated economic crises and increased intervention by government in the way of required disclosures and regulations. Based on historical evidence, Corporation Nation makes a compelling argument for improved internal corporate governance. Most early U.S. corporations sold shares via direct public offering (DPO), similar to IPOs but without the involvement of an investment bank or intermediary, other than a subscription agent. Businesses often relied on prominent backers, "smart money," to assure small investors. Although Wright doesn't mention it, the JOBS Act appears to have some potential to bypass expensive intermediaries. See video clip prepared by/for Cutting Edge Capital (this is not an endorsement of their services). Before the Civil War, stockholders were much more involved in major policy decisions and corporate governance facilitated that involvement. Often corporations capped the number of votes any one shareholder could cast to balance the power of large and small shareholders. But such "prudent man" rules faded out because they were early circumvented. Good governance, even before the Civil War, required stockholders with ample incentives to monitor their investments carefully. Wright argues that "early securities markets were fairly efficient, in part because they allowed insider trading." (my emphasis, p. 165) Yes, securities prices were certainly subject to manipulation attempts, but their calculations were generally founded upon exact knowledge of the business. (I'm not sure I buy Wright's argument here, which might be less problematic if such trades were immediately known. That seems less likely in a pre-computer and mandatory filing age.) Directors typically had a lot of their net worth invested in the companies they governed, so they didn't need additional pay to incentivize them, although conflicts with both potential and real conflicts of interest were not uncommon. Wright discusses a host of problems, many of which ring true today -- unannounced or inconvenient meetings, abuse of proxy votes, and fraudulent accounting, to name a few. It is interesting to read how states began to regulate corporations, especially banks, after the Panic of 1819. In 1829, for example, New York enacted the first banknote-insurance scheme, the Safety Fund. Wright points out that several of the Fund's provisions worked well by aligning the incentives of stockholders and their corporations. However, the insurance aspects increased moral hazard, required more careful supervision by the state and attracted the interest of rogues who set up "rag institutions" that quickly went bust. "The best reforms were those that sought to provide stockholders with the powers and incentives they needed to monitor their own property for themselves," Wright argues. However, with more widely dispersed shareowners, coordination was difficult and by 1910 Woodrow Wilson would write that the "position of the minority stockholder is... extremely unsatisfactory. I do not wonder that he sometimes doubts whether corporate stocks are property at all." Wright argues that well-meaning laws like the Clayton Act and Glass-Steagall actually decreased the balance banks were able to provide as intermediaries and actually increased the weight of managerial dominance at the biggest companies. He provides good analysis of the issues surrounding stock options (only upside, fluctuation not necessarily company specific, short-term, and backdating removed any incentive alignment). What lessons should be drawn from history for application to current issues? Wright is not shy or moderate in his recommendations, which are well aimed at restoring rights to shareholders. Given the right tools, shareholders can protect their own interests and those interests are broader, more closely aligned with those of society, than are the interests of dominant managers. Wright ends with a list of reforms "to make corporations more like republics by giving their citizens (stockholders) the ability to prevent their legislatures (directors) and their managers (executives) from acting like tyrants by engaging in excessive self-dealing." I've seen no better examination of antebellum corporate governance in the U.S. than Corporation Nation and agree with the thrust of Wright's recommendations. One more minor area of disagreement is that Wright places too much faith in institutional investors and not enough in retail investors as when he calls for more "'dissident' directors beholden to institutional investors, not executives." Large, primarily indexed funds, have little incentive to monitor the corporate governance of companies in their portfolios and take an active role in challenging management and boards. Any benefit these large funds could obtain through such actions would equally benefit competitors, while the initiating fund would bear all the costs. There is or could be room for more active monitoring by retail owners. A retail shareowner with \$300,000 invested in a company may be more highly motivated to monitor than a mutual fund with \$10 million invested. Finance professors, retired executives and industry specialists may find activism more interesting and rewarding than golf or another trip to Europe. Anyone with the right subscriptions can mine 'big data.' Social media tools like LinkedIn, Twitter and more specialized sites like The Motley Fool, Stockr.com, and Sharegate.com have potential to be useful tools for announcing and, to the extent allowable by law, coordinating campaigns. With today's tools, individual shareholders don't have to be Carl Ichan to be heard and to make a difference.

From bank bailouts and corporate scandals to the financial panic of 2008 and its lingering effects, corporate governance in America has been wracked with crises. Amid a weakening system of checks and balances in which corporate executives have little incentive to protect shareholder interests, U.S. corporations are growing larger and more irresponsible at the same time. But dependence on corporate profit was crucial to the early republic's growth, success, and security: despite protests that incorporated business was an inefficient and potentially corrupting system,

U.S. state governments chartered more corporations per capita than any other nation—;including Britain—;effectively making the United States a "corporation nation." Drawing on legal and economic history, Robert E. Wright traces the development and decline of corporate institutions in America, connecting today's financial failures to deteriorating corporate law. In the nineteenth century, checks and balances kept managerial interests aligned with those of stockholders, and public opinion grew supportive as corporations raised billions of dollars to finance infrastructure such as transportation networks, financial systems, and manufacturing operations. But many of these checks and balances were dismantled after the Civil War, allowing leeway for the managerial malfeasance that spiraled into economic crisis in the twenty-first century. Bolstered with archival and original data, including the first complete count of American business corporations before the Civil War, *Corporation Nation* makes a compelling argument for improved internal governance and more effective external government regulation.

"The originality of the book derives from Wright's juxtaposition of the modern debate on corporate governance with his own intimate knowledge of 19th century literature and case law and a major new database." -- Les Hannah, *Financial History* (Fall 2013), 38. "Based on historical evidence, *Corporation Nation* makes a compelling argument for improved internal corporate governance." -- James McRitchie, *CorpGov.net* (Jan. 27, 2014). "Wright writes in an informal and engaging style, and weaves many quotations from historical materials into the text: he lets early shareholders and journalists finish many of his sentences. His extensive use of early pamphlets and business records, including many that have not been previously quoted in the literature, enhances the value of the book. An even more valuable contribution of the book is the presentation of new data Wright collected with Richard Sylla of NYU on the annual numbers of corporate charters granted by the American states up to 1860." -- *EH.Net* (December 2014) "Wright's worthwhile book is part economic history, part legal history, and part analysis of the American business corporation as an institution." -- *Journal of American History* (December 2014) "This is an excellent book. It is well researched, with a wide range of contemporary sources consulted, and is well written, the style lively and accessible without compromising academic rigour." -- *Economic History* (February 2015). About the Author Robert E. Wright is Nef Family Chair of Political Economy at Augustana College in Sioux Falls, South Dakota and the author of many books, including *One Nation Under Debt: Hamilton, Jefferson, and the History of What We Owe*, *Fubar* *nomics*, and (with Simon Constable) the *Wall Street Journal Guide to the 50 Economic Indicators That Really Matter*. Excerpt. copy; Reprinted by permission. All rights reserved. Chapter 1 The Corporation Nation Emerges If they were honestly and safely conducted, [corporations] would afford a safe and satisfactory investment for small sums and thus tend to equalize the wealth of the people.—V. H. Lockwood, 1897 The development of the for-profit business corporation over time has never been well understood, even in the nation most responsible for its economic ascendance, the United States. "American-style corporate capitalism," two business scholars recently proclaimed, "is an international juggernaut" (an overwhelmingly destructive force) and perhaps the single most important institutional feature of modern, developed economies the globe over. Yet even leading scholars of the U.S. economy have underestimated the number, ubiquity, and economic importance of early corporations, creating the misapprehension that they were insignificant until after, or perhaps during, the Civil War. Two reporters for the generally astute economics weekly *The Economist* recently wrote a book that called the corporation "yet another quirky . . . invention" of "Victorian Britain." Many contemporaries, however, believed that America, not the Mother Country, was responsible for raising corporations from vehicles of monopoly privilege to a widely used form of business. "In no other age or country," wrote Andrew Allison in 1884, "have private corporations entered so extensively into the business of the country, never so thoroughly into the details of everyday life, as with us." Moreover, while Britain embraced the corporate form before most other nations did, the economies of both America and Britain were significantly corporatized well before Victoria's long reign began in 1837. "By the time that [Supreme Court Chief Justice John] Marshall left the Court in 1836," legal historian Arthur Selwyn Miller noted in 1968, "the corporation . . . had become a key institution in American life." As the new data presented in Chapter 4 show, Miller's intuition was right. In addition to setting the historical record straight, this book seeks to improve the internal governance and external regulation of corporations today. Business leaders as well as policymakers have forgotten the conditions under which corporations thrive and the circumstances in which they are likely to flail or fail. That memory lapse has caused Americans some serious consternation recently—in the form of Enron, Lehman Brothers, Comcast, Fannie Mae, Bernie Madoff, and others too numerous to mention—and, I fear, will cause even more serious trouble in the relatively near future. Until they relearn to govern themselves, corporations will continue to face two major risks: increased government regulation and the withdrawal of investor demand. Either outcome could injure the economy, while the occurrence of both—if investors widely believe that new regulations would burden corporate profits without improving governance—could prove economically devastating. Think dangerous drop in liquidity, withdrawal of foreign portfolio investment, stock market meltdown, and ultimately decreased incentive for entrepreneurs to innovate due to an anemic IPO market. Such a disaster scenario is not unrealistic. Money, it is said, "stays where it is well treated," and currently, it is regularly abused by the nation's regulators and its largest corporations. Currently, the public has more confidence in gas-station attendants than in bankers and more confidence in auto repairmen than in investment

advisers. Corporate governance malfeasance has raised the cost of capital in the past and could do so again. After the Civil War, shady railroad managers frightened "legitimate investment," nearly killing "the goose which lays the golden egg" in the words of one critic. "Worthy stock enterprises," complained another, "languish from public distrust in stock companies." In the late nineteenth century, investment gurus regularly cautioned individuals not to buy common stocks because good information about corporate financials was lacking. Legal reforms aimed to change that; but in the wake of numerous scandals, their success appears doubtful. Despite all the disclosure laws passed since, financial information remains of dubious quality. According to Jonathan Macey, one of the world's leading experts on all things corporate, stockholders must "trust" that corporate executives will treat their money right because "shareholders have . . . virtually no contractual rights to corporate cash flows." Most investors today don't know that, and they overestimate the power of regulators to monitor executives on their behalf. When investors realize that what they get in return for their hard-earned money is at the whim of overpaid corporate executives, not the rule of law, there will be economic hell to pay. "If the confidence of the public in great corporations is destroyed," noted one scholar during the Great Depression, "as it has been already sorely shaken in numerous recent instances of gross lapses from duty, the entire stability of our institutions will be thereby undermined." Disgruntled investors today could also withdraw from the equities markets, some scholars warn. "The fundamental problem of the corporation," noted economists Charles Calomiris and Carlos Ramirez in the mid-1990s, "is to secure funding from people who are not directly in control of the use of those funds." Without safeguards, managers can, and will, bilk investors to the point that "suppliers of funds may not find it worthwhile to transfer their savings to corporations." And because a majority of Americans now own stock, if only indirectly via their retirement accounts and other mutual fund holdings, the economic, political, and social risks of a "capital strike" are greater than ever. Even if such a strike were not widespread enough to result in economic meltdown, any sizable change in investor sentiments away from corporate securities would likely raise the cost of corporate capital and hence slow economic growth.

Before the Civil War, investors in U.S. corporations enjoyed much more security than they do today. Many of the "glaring abuses" and "evils" of modern corporations, a Depression-era corporate critic argued, "are due to the transformation of small, closely held, personal business corporations of the type which existed in the earlier days of the Republic, into nationwide companies whose stock is widely held in many dispersed hands and which too often are characterized by loose, careless management and control." The concomitant erosion of traditional governance checks and balances, this book will show, played perhaps an even larger role in the demise of investor security after the Civil War. Action is necessary because the corporation is too economically important to be allowed to wither. Within a few years of adoption of the Constitution, the corporation was ingrained in almost every aspect of Americans' economic lives, from finance to transportation, as Joshua Gilpin discovered when he set out from Philadelphia "to the Western parts of Pennsylvania" in 1809: "After crossing the Schuylkill permanent Bridge [a corporation], we took the Lancaster turnpike [another corporation]," used money issued by corporate banks, and even slept in a hotel owned by a corporation. In 1835, a pundit noted that the great internal improvements of the period, "the roads, canals, tunnels, are the result of those laws which permit, and those systems of government which do not trammel, the association of wealth." As another corporate booster put it that same year, "almost every instance of valuable public improvement that meets the eye, is to be traced directly or indirectly to the agency of that much-decried monster—Corporation!" Still another, writing two years later, noted that if contemporaries looked in "different directions" they could not "but see their beneficial influences upon the condition of the country." If anything, corporations are even more important to the nation's economic health today.

Miller claimed that history provided "no convincing answers" for why America became the consummate corporation nation before the Civil War (1861-65). This book shows that a generally effective system of internal governance allowed early corporations to raise (what were then) significant sums of equity capital at start up without the aid of investment banks or other intermediaries. Americans did not invent the for-profit business corporation, but they did perfect the form—and far earlier than most believe—in the first half of the nineteenth century, surpassing the British and other precedents (discussed in Chapter 2) quickly and completely, despite the misgivings expressed by corporate critics detailed in Chapter 3. As Chapter 4 shows, by the early nineteenth century, the young nation had chartered more corporations than any other country on earth and sustained its lead throughout the antebellum period. As shown in Chapter 5, corporations proliferated widely throughout the nation, north and south, east and west, because the benefits of creating them generally outweighed the costs. Corporate privileges like the ability to sue and be sued in its own name, perpetual succession, use of a corporate seal, limited liability, entity shielding, share transferability, and relatively clear laws concerning the operations and governance of joint-stock companies allowed corporations to grow much bigger, much faster than they could have as traditional partnerships or sole proprietorships. That, in turn, allowed them to achieve scale economies (lower production costs per unit produced), the most profitable (Coasean) degree of vertical integration, and market power (some degree of control over prices and quantities). As eighteenth-century British political economist Sir James Steuart correctly noted, "by uniting the stocks of several merchants together, an enterprise far beyond the force of any one, becomes practicable to the community." Incorporators had to pay postage, publishing, and other lobbying costs and were not assured of receiving a charter, but the expected direct costs of incorporation were typically minimal, especially after the passage

of general incorporation acts in many states in the 1840s and 1850s. "The difference, in point of delay, trouble and expense, between forming a private corporation under a general law, and obtaining a special charter," a late nineteenth-century jurist claimed, "may be likened to that between modern traveling by railroad and the old fashioned stage coach." But the chartering of more than 22,000 businesses by special act before 1861 suggests that the "stagecoach" approach to incorporation was more an inconvenience than a barrier to entrepreneurs. The indirect costs of incorporation and large sizedash;the so-called agency costs of having numerous agents and employees complete important work tasks on behalf of the ownersmdash;were more substantial but could be mitigated by screening, employee incentives, and other governance principles, which are discussed in Chapter 6. A few early corporations survive to this day, but most eventually exited via bankruptcy, a deliberate winding down of their affairs, or merger (then typically called "amalgamation"). Most failed companies were driven out of business by more efficiently managed competitors, but a few were extinguished by corporate governance failures (various types of fraud), such as those detailed in Chapter 7. As described in Chapter 8, defalcations spawned regulatory responses that more or less prevented the exact repetition of earlier frauds but did little or nothing to prevent new types of expropriation from taking place. Chapter 9 takes up that theme by tracing the history of corporate governance and regulation from the Civil War to the present. The book concludes in Chapter 10 with the suggestion that a new approach to regulation is needed if the number and severity of corporate financial scandals are to be significantly reduced. Returning to the governance principles of our forebears is a good place to start. Restoring internal governance to a semblance of health and improving external regulation will not be easy; nothing of such crucial importance ever is. Retaining investor confidence in corporations is essential to the nation's continued material prosperity. Corporate precocity helped the early U.S. economy to grow and develop more rapidly than any other in the world. "The limited liability corporation," Columbia University president Nicholas Murray Butler argued in the late nineteenth century, "is the greatest single discovery of modern times," a sort of "technology" that unleashed more familiar technologies like steam and electricity. Without corporations, reformer Henry Wood wrote in 1889, "science, invention, art, and production would fail to find wide and general expression, and material, commercial, and even intellectual progress would be turned backwards." If anything, corporations are even more important today. It simply is not true, as some earlier economic historians believed, that the U.S. economy did not "take off" until sometime after 1830. The best available evidence indicates that per-capita incomes began increasing soon after the ratification of the Constitution and have continued unabated, save for the undulations of the business cycle, until the present time. The same goes for industrial production. America grew wealthy because of the solidity of its institutions, not its great expanse, a point that nineteenth-century Americans well understood. "A broad land is not necessary to a great people," one noted in 1845. "An earnest industry, a bold enterprise, a comprehensive wisdom, have made" the nation "what it is, and are able to make it all it could wish to be." Nineteenth-century Americans realized that the business corporation was one of the most important of those growth-inducing institutions. "The surprising influence of these institutions, in promoting the general Improvement of the Country," Massachusetts governor Levi Lincoln proclaimed, "may be witnessed wherever they are situated. Look but to the villages of Lowell and Ware, places where the very wastes of nature, as if by the magic of machinery, have suddenly converted into scenes of busy population, of useful industry, and of wealth." "On a spot where a few years ago there was but two or three houses," aspiring pastor Ephraim Abbot noted in 1812, "there is a village of 64 families and 500 people in some way employed about the factory." "By their [corporations'] aid," a committee of New York legislators noted in 1826, "the spirit of improvement has marched into the wilderness with a rapidity of advance that has astonished the world, and new commercial towns have sprung up amid the haunts of the savage as if by the work of magic, where the wants of trade have been called for and been gratified with new establishments." Corporations, especially commercial banks, were believed to help farmers, a major contingent of the economy throughout the antebellum era, to bring "their lands into good order" and make them "very productive" by allowing them to erect "proper buildings," to use "clover and plaster" to restore tired lands, and to achieve economies of scale in livestock production. Banks and networks of transportation corporations also helped farmers to receive good cash prices for their crops far from major markets. Corporations also lifted overall living standards. Railroads, for example, boasted that they could provide "ready and cheap access" to "beautiful rural district[s]" with their "healthful attractions to all who desire to seek them . . . to enjoy the invigorating air of the country . . . during the summer months." Businessmen could even commute daily by taking "the cars in the evening and retire to some cool retreat in the country . . . returning by an early train the following morning. It is needless to say, that this would be a convenience and a luxury that would be appreciated by a large class of the community." The Staten Island Railroad drew the "wealthy population" of Philadelphia and New York to the island "as a summer resort for sea-bathing" and served as the "center of delightful union between the refined and intelligent families of the two chief cities of this country." The poor also benefited, primarily when they purchased low-cost goods produced by corporations that did not possess undue market power. Manufacturers "reduced the price of cloth to the consumer," a contemporary claimed, "more than two-thirds" without yielding more than 6 percent profit on average. At the same time, nails dropped from fourteen cents to less than five cents per pound, and many other goods also became more affordable. Many low-income individuals also received wages from corporations, but that benefit must be balanced with the fact that

corporations displaced many tradesmen and other small businesspersons. Corporations were not merely a convenient means of improving economic efficiency and living standards; they were often indispensable to those lofty goals because they provided unique ways for people to cooperate. As Butler claimed in 1911: "[C]ooperation . . . has come to stay as an economic fact . . . . It cannot be stopped . . . . This new movement of cooperation has manifested itself . . . in the limited liability corporation." "Perhaps the primary feature of a corporation," another early corporate historian explained, "is that it exists to further certain purposes, particularly purposes which those persons who have associated themselves with it—usually voluntarily, would find it difficult or impossible to achieve merely as individuals." "Large sums have in many instances been raised for carrying on private business, as well as improvements of great public utility," an anonymous author pointed out in 1829, "which could never probably have been carried through successfully without corporations." "Extensive experience," another wrote in 1852, "as well as observation, establishes the fact, that combinations may accomplish what individual cannot; what one may fail to accomplish for himself, the many may accomplish for each other." In the early nineteenth century, private capital would go where even governments feared to tread. "The undertaking was deemed so hazardous that the State declined adventuring in it" was then a common refrain in corporate histories and charter petitions. With the exception of the large state canal systems, most of which ended disastrously, governments allowed pioneering entrepreneurs, such as investors in the Schuylkill Navigation Company, to bear the risk of spending too much on too little. "This, however," noted a contemporary, "is the history of every new business, large or small." But people will invest only in enterprises that promise them a fair return, something many corporations today have trouble doing because of the shoddy ways in which they are governed. Pundits often claim that Americans do not save enough, but they rarely trace the cause to an underlying distrust of corporations—or rather, the individuals charged with managing them. As argued in the final chapter of this book, business and policy leaders can improve corporate governance by understanding and building upon past governance arrangements and thus reinvigorate a sagging U.S. economy.