Why Has There Been So Little Blockholding in America?

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Abstract

A hundred years ago American corporate control looked "normal": large financial intermediaries and plutocratic families were controlling blockholders in the economy's large and growing Chandlerian enterprises. By fifty years ago, the United States had become truly exceptional: blockholding had become rare, and managers largely autonomous. Roe (1994) argues that the political ethos of America was too hostile to the exercise of financier power for blockholding intermediaries to survive. La Porta *et al.* (1999) paint a picture of blockholding around the world as a response to weak protection of minority shareholders, which suggests that American shareholders been able to afford diversification because of the powerful and effective Delaware's Chancery. We invoke Historians' Standard Tactical Maneuver Number Three, and say that the situation is more complicated. Yes, America's deep equity markets amplified the benefits of diversification. Yes, the Delaware Chancery protects minority shareholder rights. Yes, there is a powerful Populist-Progressive current in American politics. But key historical accidents played as large a role as the forces adduced by Roe and La Porta *et al.* in creating this form of American exceptionalism.

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I. Introduction

A century ago European academics like Werner Sombart worried why there was no socialism in the United States. Today we academics worry why there is so little blockholding in the United States, for in corporate control – as in so many other things – the United States is exceptional. 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 corporations the exert control over stock exchange listed corporations. In the United States by and large parent companies do not have listed subsidiaries. Some 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 does not. In the United Kingdom ownership is diffused and institutional shareholders are powerful. In the United States they are not.[2] In most countries the market for corporate control is a market for blocks. In the United States it is not. In most countries the market for corporate control in widely held corporation follows the U.K. model – tender offers go rapidly to a shareholder vote with the board condemned to passivity. In the United States active boards bargain with bidders, (de)motivated by fiduciary duties, stock options and severance pay packages.

[2] Institutional investors in the United Kingdom often operate behind the scenes and their influence is hard to measure (see Coffee and Black 1994), but their power has become highly visible in the advisory votes on executive remuneration during the 2003 annual meeting season. The 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. Indeed, the latest confirmation how little influence U.S. shareholders have on crucial governance decisions is the demand of the Council of Institutional Investors' to give shareholders a voice in the selection of corporate directors (CII Press Release, 22 May 2003; see www.cii.org), outside a fully fledged proxy fight.

America's peculiarity is made even more striking by the fact that it is the result of the past century. A century ago 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.[3] 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*[4]*,* in 1904. Moody looked forward to a future in which Americans would have delegated control over the commanding heights of their economy to an alliance of one family group and one financial intermediary: the family of the Rockefellers, and the investment banking partnership of J.P. Morgan and Company. Moody wrote his book to persuade American investors and politicians that this personalized oligarchic financial capitalism of controlling blocks held by Rockefellers and other plutocrats would be good. 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 proved ephemeral. Sixty years later John Kenneth Galbraith marveled at the speed with which American capitalism had become impersonal:

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[3] Mark Roe (1994) concurs with DeLong (1991) that the evidence does indicate that the sources of capital to finance large-scale industry and tranasportation "were concentrated at the turn of the century."

[4] See John Moody (1904).

> "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."[5]

For Americans at the mid-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.[6] At the end of

[5] John Kenneth Galbraith (1967).

[6] 1932, of course, sees the publication of Adolf Berle and Gardiner Means (1932), *The Modern Corporation and Private Property*. There are interesting differences between the arguments of Means by himself, and that of Berle and Means, or at least our perceptions of the latters' 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" he concludes "as primarily the result of the heavy surtaxes of the war period, a non-recurring 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.

1929 only 11% 200 of the largest corporations in the United States were still controlled by large blockholders, while 44% were controlled by incumbents with much reduced ownership interest. In another 44% of cases management was alleged to have taken over control, and to have established itself as a self-perpetuating body that resembles the Catholic Church where "the Pope selects the Cardinals and the College of the Cardinals in turn select the succeeding Pope" (Means 1931, pg. 87, footnote 7).[7]

And today? La Porta, Lopez-de-Silanes, and Shleifer (1999) find the United States exceptional in the limited influence and small size of its major block shareholders.[8] This lack of blockholders has important and powerful consequences for American corporate

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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, 96) 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 wrestle control from the former owners – who could have stayed in control had they taken steps to set up devices to do so.

[7] In corporations "[C]ontrol 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 sub-divided, the management can thus become a self-perpetuating body even though its share in the ownership is negligible." (Means 1931, pg. 87). This basic mechanism is largely unchanged and Yermack (1999) recently found evidence that U.S. CEOs continue in the Catholic 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."

[88] They rationalize the pattern of blockholding 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 – and they do – find more blockholding 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 blockholding. It is true that the risk that in the United States the risk that small shareholders will be expropriated by managers or large blockholders is small. (No legal examples, and only Adelphia and Enron as illegal examples come readily to mind). But (legal) expropriation is only one danger to shareholder wealth. Managerial groupthink generated over time as managers choose like-minded sycophants to be their successors is another. Legal protections cannot guard against this source of reduction in shareholder value, which may be a more important spur to blockholding and shareholder voice.

governance. Mark Roe begins his 1994 *Strong Managers, Weak Owners* with an anecdote about how at the start of the 1990s the General Motors Corporation paid no attention at all to the views of two of its largest shareholders on how it should select its CEO – a degree of managerial autonomy that is hard to imagine being the rule in almost any other industrial economy.[9] Becht, Bolton, and Roell (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 blockholders 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. America is way to one side of the point of balance – at least, if the experience of other industrial economies is any guide – and 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.[10]

Mark Roe (1994) believes that America evolved its exceptional form of non-blockholding and its exceptional forms of corporate control due to "politics." Ever since the Age of Andrew Jackson 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

[9] Roe (1994), p. xiii.

[10] The success of the American economy over the course of the twentieth century does make one less certain about judgments of large-scale century-long failure in America's markets for corporate control. However, few dispute the importance of getting financial systems right as a precondition for successful economic development. See Rousseau and Sylla (2001).

block and bargain with the next potential seller. But suppose that there is only one monopolist? Then you are not free, but are controlled. In Roe's interpretation, those seeking to limit and curb financial concentration and control – whether small rural bankers, corporate managers, or others – struck this deep chord in Americans' 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 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 two 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 blockholders can function. The blockholder can be a financial institution that aggregates the small shareholdings of a great deal of individuals into a block. The blockholder can be a plutocratic family that wishes as a matter of family policy to retain effective control. It is true that the desire for diversification militates against long-run family blocks. 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 the fortune- and control-holding families of other countries have built institutions to partially resolve this dilemma: through pyramids of holding companies and special super-voting 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?

Thus we have to fill in two gaps in the story of Roe (1994). We do so in five stages. After this first, introductory section, in section II 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 III 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 1917-1918 to the writings

in popular magazines of share-ownership advocates like Edgar L. Smith 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 – then elsewhere. It also discusses the attempts by blockholders to find durable institutional instruments through which to exercise control, and the government's pursuit of such blockholders 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 IV looks back from the end of the 1930s: no more "money trust," few blockholders, and the approach of managerial capitalism. Section V 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 blockholding impossible*; or *America's continental size made its firms enormous, and blockholding 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 blockholding*; 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 messy: a historian's rather than an economist's. The populist-progressive political tradition in America exerted pressure against finance capitalism, but the populist-progressives were not the main current: recall that for more than half a century before 1948, the only way a Democrat got into the presidency was in (a) 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 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 "politics" 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 voting 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 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.

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

Finance Capitalism, American Style

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. Moreover, "trusts" were by and large good things: economies of scale meant that big business – large hierarchical Chandlerian[11] corporations – were efficient, productive, and delivered goods to consumers at low cost. It was true that trusts came with elements of monopoly 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

[11] See Chandler (1977).

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.[12] 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.[13]

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[12] 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 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?).

[13] 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-IPO investors in Morgan's International Mercantile Marine and in the Rockefellers's Amalgamated Copper lost their shirts, and even investors in Morgan's United States 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

For our purposes here, 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:

> …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... 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... indirect influence is of great importance in many other industrial consolidations... (p. 490)

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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…" Althoug h 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..."

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 it 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.[14] 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 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 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...

[14] 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.

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 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.[15] 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

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[15] See DeLong (1991).

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 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.[16]

Thus, if we can take John Moody as a reliable observer,[17] American corporate control at the start of the twentieth century appears to have looked remarkably "normal," where

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[16] See DeLong (1991): "The investment bankers' price for continuing to finance the company was that its next president should be… Theodore N. Vail…. 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."

[17] 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, 151-2). 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 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 non-problem 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

"normal" is understood as "like other countries." Immensely wealthy families with powerful voting blocks. Stock locked up in voting trusts whose trustees closely scrutinize managers. Large financial institutions that see it as their business to choose and un-choose corporate managers, and that by-and-large respect each others' relative spheres of industrial influence. This is a story that we have heard many times in this conference so far. It applied in America as well as elsewhere. As Charles Mellen, President of the New York, New Haven, and Harford 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."[18]

But then it fell apart.

The Progressive Political Attack

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.[19] Theodore

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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.

[18] See Pound and Moore (1931), p. 273.

[19] See Hofstadter ().

Roosevelt tried first to coopt 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."[20] And, Brandeis added, this fear was a very unhealthy thing: "I believe the effect of your position is toward paralysis rather than expansion."[21]

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 blockholders 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 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 interest to their own private

[20] 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 too… that it would be as much as their financial life was worth to try to poke their fingers in." See Lamont (1913).

[21] See Lamont (1913).

profit – for they themselves were both principals as blockholders 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 policyholders (in his role as vice-president of New York Life) with an interest in buying at a low price, and could act accordingly.[22]

From the Progressives' point of view, this was mendacious nonsense. Louis Brandeis (1914) 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[23] – 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

[22] Pujo Committee (1913b).

[23] See Vanderlip and Sparkes (1935).

> 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 family 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?[24] 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 blockholder unpleasant.

The Early History of Standard Oil

The early history of Rockefeller's Standard Oil is a good illustration of the cat-and-mouse game played between Gilded Age industrialists on the one hand and Populists and Progressives on the other. It shows the influence of legal innovations and antitrust regulation on the evolution of ownership and corporate organization in the pre-WWI period. And up until the very eve of WWI itself, it seemed as though the plutocratic families and the blockholders were holding their own.

[24] See Delong (1991), p. 212. It does look like the McCormicks and the Deerings were a little bit naïve. 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, United States Steel.

Standard Oil's origins came in a partnership set up by John D. Rockefeller and the English engineer Sam Andrews in Cleveland in 1865: "Rockefeller & Andrews".[25] In 1867 they were joined by Henry Flagler, who brought with him access to financing from wealthy Cleveland businessman Stephen V. Harkness.[26] William Rockefeller, John D.'s brother, provided a valued Wall Street connection as well. But how were they to bring in outside investors without ceding control? They managed. In 1870 the Standard Oil Company (Ohio) was incorporated, with Rockefeller family members holding 50% of the shares—John D. Rockefeller 26.7%, William Rockefeller 13.3%, William Rockefeller's brother-in-law, Oliver B. Jennings another 10 percent. Flagler, Harkness, and Sam Andrews each held 13.3% as well.[27]

Under Ohio corporation law the Standard Oil Company (Ohio) could not own stock in other corporations, and could not legally operate outside the state. But the reality was that Standard Oil's headquarters were in New York by the mid-1870s: 26 Broadway. The legal solution to this, formally set up in 1879, was to place the shares of Standard Oil (Ohio) into a trust. Three middle-management employees of Standard Oil (Ohio) were chosen 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 shareholder of Standard Oil Ohio, in proportion to

[25] 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, pg. 85). Rockefeller, the junior partner, essentially eliminated the three Clarks from the partnership that continued as "Rockefeller & Andrews" (Chernow 1998, pg. 87-88).
[26] Harkness had made his money with liquor deals, but this did not seem to disturb puritan Rockefeller (Chernow 1998, pg. 106).
[27] Chernow (1998 pg. 133) states that the remaining 10% were "divided among the former partners of Rockefeller, Andrews and Flagler", which seems to imply that the partnership had other partners.

their holdings.[28] The number of shareholders had grown to thirty-seven, but the Rockefeller family still held a 30% block. And John D. Rockefeller still owned a quarter.[29]

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: an agreement that was widely regarded as a legal masterpiece, and was extremely influential in setting the mold for other companies' organizational forms.[30] The shares of all Standard Oil companies operating in all states were placed in a single trust with nine trustees. These nine trustees held central control over all Standard Oil companies, but formally they owned no stock: the Trust owned the stock. Dividends were distributed to the holders of the trust certificates in proportion of 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. Moreover, the trustees were appointed for staggered terms.[31] Dodd had managed to design a takeover-proof holding company operating an interstate business out of New York. It conformed to the letter of the law, but not the spirit.

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[28] For a facsimile of the 1879 trust agreement see Stevens (1913).

[29] 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 Andrew's stake (Chernow 1998, 181).

[30] 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.

[31] The 1882 trust agreement is also reproduced in Stevens (1913).

Regulators responded. In 1889 several states passed antitrust laws. In 1890 Congress passed the Sherman Act, marking the beginning of an ongoing struggle between Standard Oil on the one hand and antitrust reformers and enforcers on the other.[32]

The first (apparent) setback for Standard Oil came on March 2, 1892, when the Supreme Court of Ohio ruled that the Standard Oil trust agreement violated the law. On March 10,1892, the Standard Oil Trust announced that it would dissolve. Trust certificates were exchanged in proportional amounts for shares in each of the constituent companies. This dissolution allows us to see that the nine trustees jointly held more than 50% of the trust certificates. And, once again John D. Rockefeller alone owned a quarter.[33]

Between 1888 and 1893 the state of New Jersey reformed its corporate law to explicitly allowing New Jersey corporations to own stock in corporations operating in other states of the Union. New incorporations in New Jersey shot up. New Jersey state revenues from corporations shot up as well. New Jersey became known as "the home of the trusts" –for which read "holding company" (Stoke 1930). In 1898 Standard Oil dropped the "community of interest" organization (by which every owner owned a pro-rata share in each of the operating companies) and organized itself into Standard Oil of New Jersey, a holding company that owned the stock of the Standard Oil companies operating in the other States.

[32] See Thorelli (1955) for a detailed account of the political history leading up to the passage of the Act.

The pattern is clear. S.C.T. Dodd and his lawyers were—with the assistance of the New Jersey legislature—organizing new legal instruments to accomplish their purposes as rapidly as Populists and Progressives could move against the old legal vehicles: Trust was replaced by "community of interest", holding company, and outright fusion (Bonbright and Means 1932, pp. 68-72).

But 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 was in violation of the antitrust laws.[34] The landmark ruling breaking up Standard Oil into its constituent companies came that same year.

But even after the breakup of Standard Oil, John D. Rockefeller still held a quarter of each company. But he would not live forever, and few if any in subsequent generations would share his taste for control rather than diversification.

[33] 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, page 226).
[34] See Stevens (1913) for a facsimile of the Court's decision.

III. The Coming of Shareholder Diversification

1911 saw the Supreme Court order the breakup of Standard Oil. 1912 saw the Pujo Committee investigate the "Money Trust." 1914 saw Louis Brandeis inveigh against the power of the "Money Trust" in an attempt to make it one of the key issues for Wilson administration policy activism. 1932 saw Adolf Berle and Gardiner Means publish their *The Modern Corporation and Private Property,* trying to think through the consequences of a world in which blockholders were few and shareholders many and without means of communication and organization. 1933 saw the Glass-Steagall Act that separated off commercial from investment banking. 1938 saw the Public Utility Company Holding Act that eliminated any possibility of a pyramidal utility empire. 1948 saw the federal government shy away from attempting to break up General Motors, but nevertheless pursue the smaller task of getting rid of General Motors's large remaining blockholder: DuPont, out of a fear that DuPont's large block in GM restrained trade by depriving DuPont's competitors of the ability to compete for the business of the largest purchaser of intermediate products the world had ever seen.

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 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. La Porta *et al.* (1999) point out that blockholding flourishes where protections of minority shareholders are weak. But more is

going on. We take a worm's-eye look at the decline of potential control blocks in the years between the start and the middle of the twentieth century by considering four case studies: Standard Oil, General Motors, Samuel Insull's utility empire, and legal restrictions on holding companies.

In Standard Oil (New Jersey), after the mandated antitrust breakup of the original monopoly, it is clear that the forces stressed by Roe (1994) played little if any role in a process by which the minimum number of shareholders needed for a 50% control block rose from 7 in 1912 to more than 600 by 1950. Large investors' desires for diversification and the thickness of the American market which allowed diversification to take place at little price penalty played the predominant roles in the dispersion of ownership, and in the shift of control from the Rockefeller family itself (and its close associates) to the self-replacing oligarchy of managers. In General Motors, it was the details of antitrust law that played the principal role: DuPont's blockholding was ruled illegal by a Supreme Court carrying out a Populist-Progressive mandate against the wielding of market power crystalized in the antitrust law: here the forces stressed by Roe (1994) rule. In the case of Samuel Insull and his utility empire, however, neither explanation has purchase. Insull's highly-leveraged utility pyramid combined managerial efficiency, leading-edge technology, and clever financial engineering that combined shareholder equity with massive amounts of low-cost debt secured by the enormous and valuable capital stocks of American utilities. But then came the Great Depression. Degrees of leverage that seemed wholly reasonable in the 1920s led Insull's empire to bankruptcy in the Great Depression, led to Insull's flight, recapture, and trial. Although Insull himself was acquitted, the

lesson drawn – a lesson that would not have been drawn without the Great Depression – was that such control pyramids had no place in America. Insull's failure poisoned the well for any future imitators.

The use of holding companies… [TO BE ADDED LATER]

Standard Oil

Consider Standard Oil. Before the court-ordered breakup of the monopoly in 1911, there was no doubt as to who controlled Standard Oil: John D. Rockefeller. The rule was that John D. Rockefeller owned one-quarter of the voting shares of whatever business entity – operating company, trust, holding company – was the locus of power and authority first in Cleveland and then at 26 Broadway.

Antitrust was very important in setting the process of Standard Oil share dispersion in motion. It was not lack of family capital, but the active working of the government that led to John D. Rockefeller, Sr.'s withdrawal from the oil business. The Rockefellers had escaped antitrust regulation through clever legal maneuvering and restructuring for many years. But antitrust caught up in 1911.

In the post-1911 period, after the court-mandated breakup of the Standard Oil monopoly, the flagship of the Rockefeller fortune was Standard Oil of New Jersey (now ExxonMobil). In 1912 John D. Rockefeller senior still owned a quarter of Standard Oil

(New Jersey). 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). However, over the subsequent generation and a half, ownership of Standard Oil (New Jersey) became remarkably dispersed – yet not because of additional government action of any kind.

We have data year by year from 1912 to 1950 on the number of shares and shareholders, and on the number of shareholders owning more than one thousand shares and on the cumulative holdings of such "large" shareholders of Standard Oil (New Yersey).[35] 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% 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[36]: that the share S of stock shares held by the top share B of shareholders at

[35] From Gibb and Knowlton (19??).

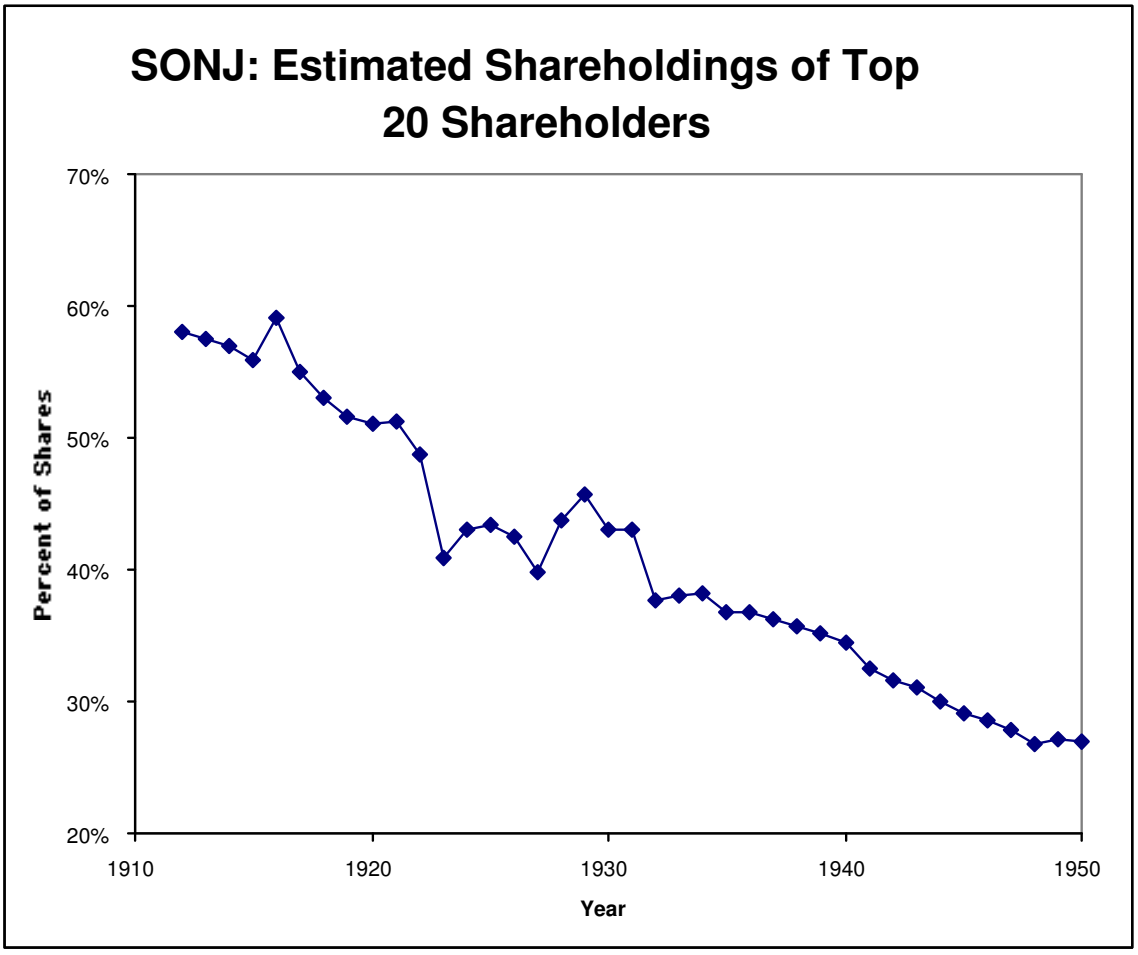
[36] See Krugman (1996), Piketty and Saez (2001). Krugman advances various arguments for what kinds of circumstances and generating processes might lead one might expect a power-law relation to hold. Piketty and Saez estimate power-law distributions for top income fractions.

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.[37]

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 1000 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 20 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 fifty percent of the company's stock.

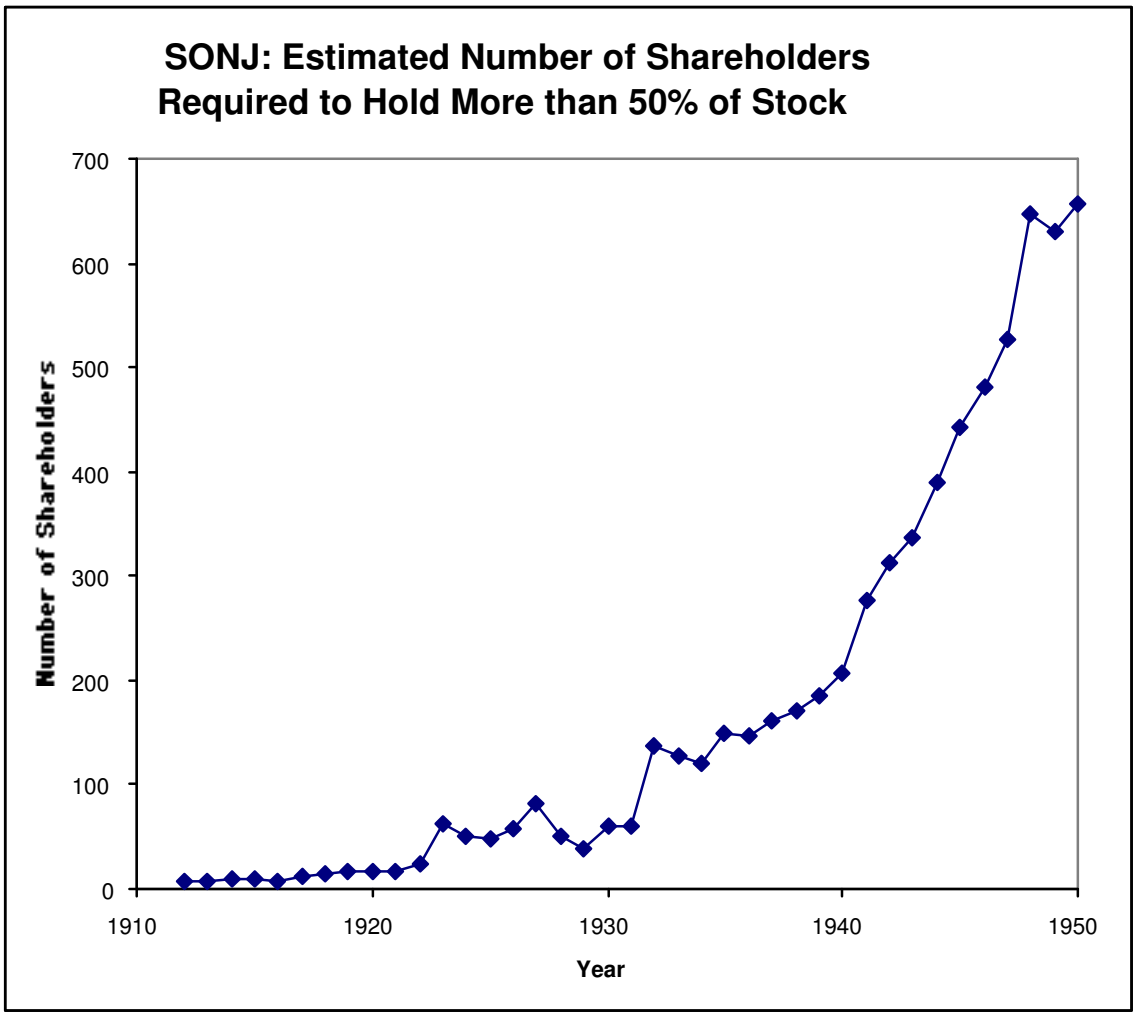
The erosion of concentration across the one and a half generations from 1912 to 1950 is impressive. In 1912 our rough estimate is that the largest 20 shareholders of Standard Oil (New Jersey) owned roughly 58% of the company's shares. By the year 1930 our rough estimate is that that year's 20 largest shareholders owned roughly 43% of shares. By 1950 our rough estimate is that year's 20 largest shareholders were down to 27% of shares. Twenty individuals and institutions that own 58% of a company can easily organize to have a powerful voice. That voice is much less powerful—their chances of winning a proxy fight against an entrenched Berle-Means management is much less—if their holdings amount to only 27% of shares.

[37] 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 five-fold multiplication in 1923.



It is possible to turn the question around. What is the smallest coalition of shareholders that could be assembled to vote fifty 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 multi-year 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 fifty percent of the outstanding shares of Standard Oil of New Jersey.



These conclusions are not very vulnerable to the heroic assumption of a power-law distribution with coefficient A = 1.43. At the most basic level, the underlying facts are these: In 1912 105 shareholders – 1.8% of all Standard Oil of New Jersey shareholders – owned 75 percent of Standard Oil of New Jersey stock. In 1950 2142 shareholders – 0.9% 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 2142 "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 post-1912 dispersion of Standard Oil (New Jersey) shareholdings. Roe's factors played little role in 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 is remarkably powerful in its effects.

General Motors

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.[38] The earlier national banks and the later members of the Federal Reserve system could not own shares of stock.[39] The Armstrong investigation of 1905-1906 knocked out insurance companies as possible attractive locuses for the exercise of supervision, monitoring, and control.[40] As mutual funds developed, they were regulated in such a way as to make 5% 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 passive investors rather than active blockholders.[41] 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 Act, and the Bank Holding Company Act – should not be seen as fragmenting the banking

[38] See White (1982).

[39] 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 Affailiate" was identical to that of the bank itself, there was little hazard.

[40] See Roe (1994), chapter 7.

[41] 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" but rather managerial fear of pension-fund socialism a la Drucker (1976).

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."

We can see the forces stressed by Roe at work in important individual cases. Where there were substantial blockholdings, forces set in motion by Populist-Progressive hostility to economic power conspired to cut them down to size. Consider the investment that DuPont (the chemical corporation) made in General Motors. 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 General Motors's president in 1920. In the 1920s DuPont's General Motors stockholdings amounted to 1/3 of General Motors' 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 General Motors the dominant automobile company in America – and in the world.[42]

Come the late 1940s the federal government began thinking about whether it wanted to try to dissolve General Motors in order to increase competition in the automobile

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[42] See Sloan (19??).

industry. In the end the government decided not to pursue a breakup of General Motors. 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."[43] The fact of influence coupled 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.

Samuel Insull

[TO COME LATER]

Holding Companies

[TO COME LATER]

[43] See Harbeson (1958).

Conclusion

Powerful as Roe's (1994) arguments are, they are not complete. The forces that Roe sees as important in breaking up blockholding in America have little or nothing to do with the dispersion of the shareholdings of Standard Oil. It was not the case that the scale of America was too large for a family to hold a control block in Standard Oil: one family did. The dispersion of Standard Oil's shareholdings fits the picture painted by La Porta *et al.* (1999) much better: large shareholders in Standard Oil wanted to diversify, the depth of the market made diversification straightforward, and there are no signs of any significant worry that the end of blockholding put shareholders' wealth at risk by leaving their cash flows vulnerable to erosion under a greedy or incompetent self-replacing oligarchy of managers.

Powerful as La Porta *et al.*'s arguments are, they are also not complete. DuPont sold off its control block in General Motors not because it valued diversification and trusted the Delaware Chancery to protect the value of its cash flows, but because a Supreme Court interpreting Populist-Progressive antitrust laws told it to do so: ruled that DuPont's block was an illegal restraint of trade. Here we can see the forces that Roe stresses at work at their most powerful. The resonant chord struck in American politics by the argument that it was unfair for financiers to order managers around (rather than just to bid for their business in the market) shaped America's institutions in a way hostile to blockholding.

And even the combination of Roe and La Porta *et al.* still leaves out large chunks of the picture. In spite of the effectiveness of the Delaware Chancery, in spite of the benefits of

diversification, in spite of minority shareholder protections, in spite of a legal system hostile to blockholding, Samuel Insull in the late-1920s was well on the way to constructing a continent-spanning utility pyramid. But the combination of the Great Depression and the high leverage inherent in his pyramidal structure busted Insull, and poisoned the well for any subsequent imitators

IV. The View from the End of the 1930s

If managerial capitalism as Galbraith knew it was not complete at the end of the 1930s, it was well along. Data from the Temporary National Economic Committee [TO BE ADDED]

V. Conclusion

Looking at the evolution of corporate control during the 1980s and 1990s, we are struck not by how much has changed from the 1950-1980 heyday of managerial capitalism, but by how little. Discussions of how taking companies private would realign the interests of owners and managers by recreating financier control appear to have been overstated. Hopes that managerial incentive contracts would realign the interests of managers with dispersed shareholders also appear to have been largely hopes alone. The major difference appears to lie in the vulnerability of firms to hostile takeovers – and in the

willingness of the Delaware Chancery to at least hint that it will regard Boards of Directors that take steps to sacrifice large amounts of shareholder value as in breach of their fiduciary duties. But the magnitudes of required takeover premiums suggest that this functions at best as a very loose form of market discipline in America today.

It is a fact that America's odd system of corporate control – essentially a corner solution, apparently sacrificing all the benefits of control blocks in order to squeeze out the last bit of benefit from diversification – has been accompanied by extraordinary economic success during the century. During the 1990s, when the Internet boom seemed unstoppable and the U.S. stock market at its most bullish, it became fashionable to regard the United States's rather odd system as a model worth imitating. It became fashionable to predict that corporate governance around the world would soon mirror the U.S. model: That is, private executives would receive high-power incentive pay in the form of stock options, and they would be kept in check chiefly by shareholder-friendly laws, lawyers, and institutional investors, as well as by the specter of mergers or takeovers resulting from low stock prices. Conversely, labor unions, major-bank shareholders, and rich-family financiers – key influences in other countries – would be less important.

Some signs supported this "convergence to the U.S. pattern" view. Managers in other countries looked enviously at the magnitude of the capital flowing through U.S. (and British) 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.

It is in this context, we believe, that our story of the historical development of the U.S. pattern of non-blockholding is of general interest. Roe (1994) argued that the American system makes sense as a result of the Populist-Progressive current in American politics – and thus that it is a justified economic model only if the Populist-Progressivist belief that the exercise of economic power induces stagnation, fear, and corruption is well founded.[44] La Porta *et al.*'s (1999) picture of blockholding around the world as a response to a failure to protect minority shareholders can be read to suggest that America's institutional financial underpinning must be very good in order to induce such an absence of blockholding.[45] Still other points of view advanced are that America is simply too big large for family pyramid-style capitalism, and that America's stock market is so deep and liquid as to make diversification irresistible. We find that all of these arguments are substantially true, and that they are all powerful factors in the evolution of the American pattern of corporate control. Yet we also find them all – even acting together – insufficient. A big role remains for chance, luck, and that sequence of bizarre events that is American history.

[44] A belief that Roe (1994) regards as unlikely to be true.

[45] We do not think that this is necessarily a correct reading. That La Porta *et al.* (1999) argue that fear of expropriation is not a motive for blockholding in America does not imply that America is at an optimum financial structure as far as blockholding is concerned.

Yes, America's deep equity markets amplified the benefits of diversification. Yes, the Delaware Chancery protects minority shareholder rights well – but that is not the only important reason that potential large shareholders might sacrifice diversification for oversight and control. Yes, there is a powerful Populist-Progressive current in American politics – but if Mark Hanna could defeat them and prevent the free coinage of silver, if Taft and Hartley could defeat them and start union density on its long more than half-century decline, if Reagan could defeat them and reverse the confiscatory notional tax rates on high incomes, why should the Populist-Progressive current have been so strong in corporate control, which is at bottom a power struggle between (rich) stockholders and (powerful) financial institutions on the one hand and (rich and powerful) managers of large corporations on the other?

McKinley's assassination meant that Theodore Roosevelt appointed judges who ruled on the breakup of Standard Oil. Theodore Roosevelt's splitting of the Republican Party in 1912 was the only reason for Woodrow Wilson's presidency and its brand of progressivism. The whipsaw created by the celebrity culture of Wall Street in the 1920s coupled with the magnitude of the Great Crash meant that leverage was tied to financial disaster for a generation, and greatly limited the possibility of pyramids. The Great Depression played a key role in Franklin Roosevelt's election, in strengthening the Populist-Progressivist current, and in the reinvigoration of American antitrust. In large part, America's current system is an historical *accident.*

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 looking across countries we see a stunning international variety in the solutions. Moreover, no one system seems durably and obviously superior. Consider the flavors of corporate governance. In Germany, two key influences over managers are its union movement – through raw organizational strength and its codetermination laws, which require that unions be represented on large corporations' boards– and the "universal" banks such as Deutsche Bank. Elsewhere, families play a key role: In Sweden, the Wallenberg family sits atop a pyramid of holding companies that can control an astonishingly large proportion of industry management. In Italy, it is the Agnellis. It is hard to understand how such variation can be the optimal response to differences in economic structure. It is also hard to argue that any one system is clearly superior: all appear to have advantages and disadvantages, and all appear to owe as much to politics and chance as to some Coasian process of groping towards optimal forms of contract.

We see the costs of changing corporate governance structures as high, our ignorance about the value of such structures as great, the likelihood of gains uncertain, and economists' opinions subject to waves of fashion. Two decades ago the hot argument was for the superiority of Japan's system. Nobody suggests that anybody else should move toward Japan's system today.

However, we do see 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. 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 and are likely to continue to drive toward a trend toward a greater role for the stock market. The forces that played such a role in shifting Standard Oil (New Jersey) from family to managerial capitalism are likely to be in powerful operation all across the world economy's industrial core.

But even if firms with many shareholders become more prevalent, they need not all be governed alike. 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. It is even compatible with the ready assignment by dispersed shareholders of proxy rights to large financial intermediaries.[46]

Our conclusion, therefore, is Historians' Standard Tactical Maneuver Number Three: it's more complicated than that. The political logic that blockholding does not resonate with the Populist-Progressive current in American politics is certainly powerful, but Populists

[46] Which creates a who-will-guard-the-guardians problem. How can a financial institution that is itself a Berle-Means corporation be reliably tasked with protecting dispersed shareholders of other Berle-Means corporations?

and Progressives care much more about the role of unions or the free coinage of silver at a ratio of 16:1 or the progressivity of income taxes or national health insurance or the funding of the social-insurance system than about the details of corporate control – which is, after all, a fight over power and wealth between (rich) large shareholders and (powerful) financial intermediaries on the one hand and (rich and powerful) corporate managerial oligarchs on the other. It is unclear why Populist-Progressives thought they had a dog in this particular fight.

The economic logic that diversification is cheap in the thick market of the United States is accurate and powerful, but clearly insufficient to drive United States blockholding to its current near-corner solution low levels – and so is the institutional logic that the Delaware Chancery effectively protects minority shareholders. We need to acknowledge that these political and economic currents are insufficient to generate what we see. A large part of the logic is that there is no logic: there is simply contingency and the bizarre process of history:

> I returned and saw under the sun, that the race is not to the swift, nor the battle to the strong, neither yet bread to the wise, nor yet riches to men of understanding, nor yet favor to men of skill; but time and chance happeneth to them all.

PIECES THAT HAVE NOT YET FOUND A PLACE:

The same was true for pyramids : in particular Section 7 of the Clayton Act, and related measures in the railroad and utility field (Du Pont, Van Sweringen, Insull)

A third force was "frenzied finance" : promoters buying blocks from founders, merging bits and pieces and throwing the stock of the resulting amalgamations (or holdings) onto the market. In some cases with JP Morgan watching over the management of the widely held giants. Often not, in particular after the money trust had been crushed. Meade's "Trust Finance" is full of example. Rogers and William Rockefeller in the Amalgamated Copper case.

Litigation : miniority shareholders bringing suits against blockholders is already mentioned in Ripley (1915) and Bonbright/Means have a whole appendix on the subject. We need to explore this in future drafts.

why are American dynasties so prone to giving wealth they have amassed to the arts, education and charitable causes? A particular type of US private benefits that serves as a substitute (is allowed?) for the private benefits of control enjoyed by dynasties elsewhere? Bill Gates putting his wealth into a foundation, securing eternal gratitude of WW medical research before the (EU) antitrust authorities get him?

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