Why Has There Been So Little Blockholding in America?

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Abstract

At the start of the twentieth century, corporate control in the United States looked relatively "normal." There were no visible large differences between corporate control in the U.S. and corporate control in a typical industrial economy. Large financial intermediaries and plutocratic families held large blocks of shares in the economy's large and growing Chandlerian enterprises. Such large blockholders played key roles in monitoring, choosing, and replacing managers and setting corporate direction.

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Innovations in railway finance, the horizontal merger wave, trust finance, and antitrust changed all of this. Trust promoters bought out founders and floated corporate securities to an ever broader range of investors and speculators. Investor protection took the form of J.P. Morgan and his men, who charged handsomely for monitoring services, until they were forced to withdraw from corporate boards. In less than thirty years, corporate America moved from the “Gilded Age” of Andrew Carnegie to the age of the professional manager.

But not all families sold out, or were forced out. The separation of ownership and control was more gradual. Families kept a grip—albeit not a firm grip—on their corporations through relatively small ownership stakes and board positions.

Introduction

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

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

The pattern found in the United Kingdom is in some ways closest to the United States. In the United Kingdom, like the United States, ownership is diffused. Yet in the United Kingdom institutional shareholders are powerful. In the United States they are not.[2] In

[2] Institutional investors in the United Kingdom often operate behind the scenes. Thus their influence is relatively hard to measure (see Black and Coffee, 1994). Their power did become highly visible in the advisory votes on executive remuneration during the 2003 annual meeting season. By contrast relative impotence of institutional investors in the United States is well documented; see Black (1998), Gillan and

most countries the market for corporate control follows the U.K. model—tender offers are rapidly put to a shareholder vote, with the board condemned to passivity. In the United States active boards bargain with bidders, motivated by fiduciary duties, stock options, severance pay packages, and other considerations.[3]

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

Starks (1998), Karpoff (1998), and Romano 2001 for recent surveys. Outside a fully fledged proxy fight, shareholders in U.S. corporations have little say in the selection of corporate directors (Bebchuk, 2003; Posen, 2003). Forcing the long-standing Chairman/CEO of Walt Disney, Michael Eisner, to relinquish his Chairman position—after years of below average performance and above average remuneration—has been hailed as a major victory for institutional shareholders (*Financial Times*, March 14, 2004).

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

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

Moody wrote his book to persuade American investors and politicians that the future he saw was a good thing. In Moody's view, the personalized oligarchic financial capitalism of controlling blocks held by Rockefellers and other plutocrats would be a profitable, effective, and productive organization of American finance. And, indeed, American capitalism at the start of the twentieth century was one in which *family* was very important.

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

> Seventy years ago the corporation was the instrument of its owners and a projection of their personalities. The names of those principals – Carnegie, Rockefeller, Harriman, Mellon, Guggenheim, Ford – were known across

> the land. … The men who now head the great corporations are unknown … [and] own no appreciable share of the enterprise…. They are selected not by the shareholders but, in the common case, by a Board of Directors which narcissistically they selected themselves.[4]

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

John D. Rockefeller and his immediate associates *controlled* Standard Oil, and much else, in 1900. But by 1930 Gardiner Means (1930, 1931) is looking at a world in which ownership is greatly dispersed, and is trying to think through the consequences of a financial world in which it is nearly impossible to assemble a block of shareholder votes large enough to credibly threaten the incumbents who have control.[5]

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[4] John Kenneth Galbraith (1967).

[5] 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 perception of the latter's arguments. The "Berle and Means Corporation" is controlled by its professional managers, an arrangement that arises from an inevitable (and—in Berle and Means—undesirable) "separation of ownership and control" in the giant corporation. Means (1930) documents a "remarkable diffusion of ownership from 1917 to 1921" he

At the end of 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 Means saw as resembling more than anything else the organizational structure of the Catholic Church, where "the Pope selects the Cardinals and the College of the Cardinals in turn select the succeeding Pope" (Means 1931, pg. 87, footnote 7).[6]

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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. 592), a situation not unlike those found in some other countries of the world where powerful families exert a degree of power disproportionate to their ownership. Means (1931) characterizes "control as something apart from ownership on one hand and from management on the other". The real puzzle of the U.S. corporation then is how and why professional managers managed to wrestle control from the former owners—who could have stayed in control had they taken steps to set up devices to do so.

[6] 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 this tradition

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

J. P. Morgan successfully sold William Henry Vanderbilt's majority block in the New York Central Railway to the market in 1879.[7] In steel, Andrew Carnegie sold his majority block in the Carnegie Steel Corporation in 1901 as U.S. Steel was assembled. In smelting and refining, the Guggenheims' sold their majority block in the American Smelting and Refining Company (ASARCO) in 1908/09.

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and select their own directors. The point was also well made by Kenneth Lay, then CEO of Enron, in a speech given at an April 1999 Houston conference titled "Corporate Governance: Ethics Across the Board." : "Of course, the CEO, as well as the board, is very much involved in choosing appropriate board members. The process of building an effective board typically reflects what the CEO thinks the company needs at that point in time." Lay appears to have believed that what Enron did not need was an aggressive Board-level Audit Committee.

[7] Chernow (1990), pg. 42. Carnegie took bonds and no stock from U.S. Steel because he thought the new steel near-monopoly was overvalued. He was sorry.

William Vanderbilt and the Guggenheims *wanted* to separate ownership and control. They believed that they could maintain control through their informal influence over the Boards of Directors, and could invest the proceeds of the sales in new diversified ventures. They believed that they had found a way to achieve the benefits of diversification and the ability to enter new sectors, all without loosing *de facto* control over their original enterprises.[8]

> In selling off majority control of ASARCO, the Guggenheims were following advice from their laywers and bankers that was popular at that time and remained popular for the next half-century. This theory held that it was neither necessary nor possible for individuals or a family to retain actual majority ownership of a large enterprise. Control could be as easily maintained by splitting the stock up into small lots and selling to a broad segment of the public. ….. Morgan showed Vanderbilt how it could be done. He proceeded to show hundreds of other capitalists how they could do the same [..].[9]

Among the 200 largest U.S. coporations in 1937, few had families with majorities of the voting shares. Many had families that dominated the Boards of Directors.

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

[9] Hoyt (1967), pg. 193.

And today? ECGN (1997), La Porta, Lopez-de-Silanes, and Shleifer (1999) and Barca and Becht (2001), among other, find that the United States is exceptional in the limited influence and small size of its major block shareholders.[10] Among the largest 200 U.S. corporations in 2004, the Ford family and the Ford Motor Company are exceptions to the exception, just like they were in 1937. In the short run of years the owners who believed

[10] La Porta et. al. (1999) 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, for legal protections against formal expropriation and explicit tunneling appear to us to be insufficient to fully resolve the principal-agent problem first identified by Berle and Means. It is true that today the risk that in the United States small shareholders will be illegally expropriated by managers or large blockholders is small, despite an avalanche of successful class action suits. But (illegal) expropriation is only one danger to shareholder wealth. For example, Bebchuk (2002) makes a powerful and convincing (to us at least) argument that recent American compensation practices amount to shareholder wealth expropriation, a view that is widely shared among institutional shareholders, the general public and the press. Equally, Moeller, Schlingemann, and Stulz (2002) argue that acquisitions at the end of the 1990s have destroyed billions of dollars of shareholder wealth. However, both views are contested by Holmstrom and Kaplan (2003). Managerial groupthink generated over time as managers choose like-minded sycophants to be their successors provides another reason for shareholders to fear American-style managerial capitalism. Legal protections cannot guard against this source of reduction in shareholder value, which may be a more important spur to blockholding and shareholder voice.

that they could use the services of J.P. Morgan and Company achieve diversification and maintain control were probably right. In the long run of generations they were wrong.

This lack of blockholders appears to have had important and powerful consequences for American corporate governance. Mark Roe begins his 1994 *Strong Managers, Weak Owners* with an anecdote about General Motors. At the start of the 1990s, the two largest shareholders of GM wanted to express their views on how GM should select its new CEO. The General Motors Corporation paid no attention to them at all—a degree of managerial autonomy that is hard to imagine being the rule in almost any other industrial economy.[11]

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. If the experience of other industrial countries is any guide, America is way to one side of the point of balance. This suggests that it may well be paying heavy costs as a

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

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.[12]

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 in the 1830s, Americans have loved the market but hated monopolists. Americans love the market because it makes them free and gives them the power to say no: if you don’t like the deal you are being offered here, simply walk down the street a block and bargain with the next potential seller. But suppose that there is only one monopolist? Then you are not free, but are controlled.

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

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

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 have voting control. Roe (1994) makes a strong case that specific financial regulation prevented financial institutions–banks, insurance companies, pension funds and mutual funds—from holding blocks, as they allegedly do in German and Japan. Families were not subject to these legal restrictions. What other regulation, if any, prevented families from holding large blocks, like the Ford family has successfully done for more than a century?

Three, in the *Visible Hand,* Alfred Chandler (1977) argues that *ownership* separated from *management* because of technical progress. Roe (1994) follows this argument. Chandler (1977) brushed aside the possibility that ownership separated from control and control was also separate from management. We agree with Chandler and Roe that the desire for diversification is a powerful force that can and should induce families to disperse ownership.

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

Thus our task in this paper is to fill in these 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 (1924) to the media coverage of Wall Street celebrity culture in the 1920s made U.S. markets much deeper—and thus the sacrifice of diversification for control in the United States much more attractive—than elsewhere. It also discusses the attempts by 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 messier. The populist-progressive political tradition in America exerted pressure against finance capitalism, but the populist-progressives were not the main current of American politics. Recall that for more than half a century before 1948, the only way a Democrat got into the presidency was 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 that vote large share blocks through proxies, as well as with dispersed voting rights and contestable board control, as in the United Kingdom. And recall that it is just as compatible with uncontestable board control nominally exercised in the interest of shareholders—as in the United States, with their poison pills and entrenched directors, or as with the Netherlands' priority shareholders, who possess the sole right to nominate directors for election to corporate boards.

It is not clear that the next generation of the Gates family will have as little influence on American corporate control as the current generation of the Rockefeller 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

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.[13] Moreover, "trusts" were by and large good things: economies of scale meant that big business—large hierarchical Chandlerian[14] 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 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

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

[14] See Chandler (1977).

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.[15] 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.[16]

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[15] 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).

[16] 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 (see Lawson, 1905) 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 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

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

> …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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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 he expects to see controlling nearly all large American corporations within the near future. First, there are the other major robber baron families that made their fortunes during the Gilded Age and that now work hand-in-glove with the Rockefellers (p. 493): "smaller groups of.... Pennsylvania Railroad interests… Vanderbilts and.... Goulds... closely allied with the Rockefellers... on most harmonious terms with the Moore's of the Rock Island system, and the latter are allied in interest quite closely with… Harriman." The picture painted is not one in which rich families typically clash: in Moody's view, the era of the great struggles for control between different robber baron factions was over.[17] 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 not quite kosher, as breaking the rules of the game as played by gentlemen.

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

> It should not be supposed, however, that these two great groups of capitalists and financiers [the Rockefeller and the Morgan interests] are in any real sense rivals or competitors for power, or that such a thing as "war" exists between them.... [T]hey are not only friendly, but they are allied... harmonious in nearly all particulars... These two mammoth groups jointly... constitute the heart of the business and commercial life of the

[17] 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.

> nation, the others all being the arteries which permeate in a thousand ways our whole national life, making their influence felt in every home and hamlet, yet all connected with and dependent on this great central source, the influence and policy of which dominates them all...

Indeed, if the Rockefeller family after its extraordinary upward ride in wealth via Standard Oil possessed the wealth to buy control of whatever company or group of companies it chose, the House of Morgan—and the few other smaller investment banking partnerships—held a near lock on the ability to sell large blocks of bonds and equities into the not-yet-terribly-thick New York and London markets. Morgan had acquired its reputation by being over decades a reasonably honest broker in advising potential British investors about which American railroads were uncorrupt (and by participating in reorganizations to try to guarantee that the newly-recapitalized railroad company would remain uncorrupt. It had competitors, but they were few. When questioned by Pujo Investigating Committee Chief Counsel Samuel Untermyer in 1912, Morgan's close associate George F. Baker (President of New York's First National Bank) could not name "a single [securities] issue of as much as $10 million… that had been made within ten years without the participation or cooperation" of J.P. Morgan; Kuhn, Loeb; Kidder, Peabody; or Lee, Higginson.[18] With American securities issues then running at a pace of about $500 million a year, that is an extraordinary degree of concentration.

[18] See DeLong (1991).

The fact of the matter is that if you wanted to establish or operate a large enterprise—whether railroad, municipal utility, or industrial—in the United States at the start of the twentieth century, you had to work through or please one of a very small number of gatekeepers: the Rockefellers or one of their largely-allied families (Elkinses, Wideners, Vanderbilts) for key blocks of capital, and Morgan or one of the other few investment banks for the seal of approval that would gain one's securities a market. These groups appear not to have competed against each other: when capital-stressed 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.[19]

Standard Oil

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

[19] 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."

1865-1867. Partnership

Standard Oil has its origins in a partnership set up by John D. Rockefeller and the English engineer Sam Andrews in Cleveland in 1865 trading under the name "Rockefeller & Andrews".[20] On 4 March 1867 they were joined by Henry M. Flagler, whom Rockefeller liked and who gave him access to financing from the wealthy Cleveland businessman Stephen V. Harkness.[21] William Rockefeller, John D.'s brother, provided a Wall Street connection. The expanding "Rockefeller, Andrews and Flagler" partnership was soon in need of further capital and confronted with problem of bringing in outside investors without loosing control.

1870-1878. Ohio Corporation

It was Flagler who found the solution : In 1870 the Standard Oil Company (Ohio) was incorporated with Rockefeller family members holding 50% of the shares, as shown in Table 1: John D. Rockefeller (the President) held 26.7%, William Rockefeller (the vice President) 13.3% and William Rockefeller's brother-in-law, Oliver B. Jennings another

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[20] 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).

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

10 percent. Flagler (the secretary and treasurer) held 13.3%, his relative S.W. Harkness 13.3 percent and Sam Andrews with 13.3 percent.[22]

Over the course of the next decade the shareholdings of Standard Oil became more complex, as shown in Table 2. Principals gave some of their shares to family members. Other executives and local Cleveland financiers acquired stakes. And the enterprise grew at staggering speed.

1879-1882. Ohio Trust

Under Ohio corporation law the Standard Oil Company (Ohio) could not own stock in other corporations and operate outside the state. In reality the Standard Oil companies were run from 26 Broadway in New York. In 1879 a first legal solution to this problem was found, a trust agreement that gives us a second glimpse at the shareholder structure of Standard Oil. Three middle-management employees of Standard Oil Ohio were made to hold the shares of the Standard Oil companies outside the state of Ohio in trust (Messrs. Myron R. Keith, George F. Chester and George H. Vilas). Dividends received were passed on to the thirty-seven shareholder of Standard Oil Ohio, in proportion of

[22] 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. We have not yet tracked down the original structure.

their holding (see Table 2).[23] The group of shareholders had grown to thirty-seven but the Rockefellers' were still holding a 30% block that put them in a position of control.[24]

1882-1892. New York Trust

The 1879 trust agreement solved the problem of interstate ownership and control, but was not suitable for expanding the shareholder base while keeping control in Rockefeller hands. Standard Oil's solicitor, Samuel C. T. Dodd, devised the second trust agreement that was a legal masterpiece and extremely influential.[25] The shares of all Standard Oil companies were placed in a single trust with nine trustees, who exerted central control over all Standard Oil companies but formally did not own anything. Like before, 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 and the trustees were appointed for a staggered term.[26] In fact, Dodd had managed to

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

[24] 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).

[25] 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.

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

create a takeover-proof holding company operating an interstate business out of New York, an arrangement that conformed with the letter of the law, but not the spirit.

1892-1898. "Community of Interest"

The regulators responded. In 1889 several states passed antitrust laws, and in 1890 Congress passed the Federal Sherman Antitrust Act, marking the beginning of an ongoing struggle between Standard Oil, antitrust reformers and antitrust enforcers at the Federal and the state level.[27] The first (apparent) setback came on 2 March 1892, when the Supreme Court of Ohio ruled that the Standard Oil trust agreement violated the law and on 10 March 1992 the Standard Oil trust announced that it would dissolve, exchanging trust certificates in proportional amounts of shares in each of the constituent companies. This gives us the next opportunity for observing that the nine trustees jointly held more than 50% of the trust certificates. John D. Rockefeller alone held a 26.4% stake, allowing him and his associates to exert majority control in all Standard Oil companies.[28]

1898 - 1911. New Jersey Holding Company

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

[28] 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).

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

Standard Oil was no exception. With regulation and active attorneys depriving the Trusts of their original legal instrument they turned to the legal instruments that were still available : the “community of interest”, the holding company and outright fusion. The holding company was used as often as outright fusion, including well known names like Eastman Kodak, U.S. Steel and the E.I. du Pont de Nemours Powder Company (Bonbright and Means 1932, pp. 68-72).

But again, the enforcers caught up. In 1904 the Supreme Court culled the J.P. Morgan led merger of the great transatlantic railroads through the Northern Securities Holding company (Ripley 1915), casting serious doubts on the effectiveness of the holding company as a vehicle for circumventing antitrust regulation in the context of horizontal combinations. Worse, in 1911 the Supreme Court ruled that the American Tobacco Company, that had been created through outright fusion was also in violation of the antitrust laws.[29] The landmark ruling breaking up Standard Oil into its constituent

[29] See Stevens (1913) for a facsimile of the Court’s decision.

companies was pronounced in the same year, marking the de facto end of Rockefeller rule over the oil industry.

Thus, if we can take John Moody as a reliable observer,[30] American corporate control at the start of the twentieth century appears to have looked remarkably "normal," where

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[30] 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-

"normal" is understood as "like other countries." Immensely wealthy families with powerful voting blocks. Stock locked up in "Trusts" (voting trusts, holding companies, amalgamated corporations) whose trustees and boards closely scrutinize managers. Large financial institutions that see it as their business to choose and 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."[31]

But then it began to fall apart.

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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 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.

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

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.[32] Theodore 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.”[33] And,

[32] See Hofstadter (1964).

[33] 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).

Brandeis added, this fear was a very unhealthy thing: "I believe the effect of your position is toward paralysis rather than expansion."[34]

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 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

[34] See Lamont (1913).

policyholders (in his role as vice-president of New York Life) with an interest in buying at a low price, and could act accordingly.[35]

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[36]—one of the "insiders" of the Money Trust—reminisced about the times:

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

Conflict-of-interest and malfeasance cannot be the whole story. If so, why would both the McCormick and the Deering 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

[35] Pujo Committee (1913b).

[36] See Vanderlip and Sparkes (1935).

to be combined into International Harvester?[37] 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.

Even before 1900, there was at least one family that had decided that the political pressure and the lack of diversification were together too large risks to run. As Carosso (1879) recounts the story, in 1879 William Vanderbilt decided that he wanted to sell off the control block in the New York Railroad that he had inherited from his father, the Commodore. Hoyt (1966) quotes William Vanderbilt as saying: "We get kicked and cuffed by Congressional committees, legislatures and the public and I feel inclined to have others take some of it, instead of taking it all myself."

How do you sell off a control block in one of the leading enterprises of the age, when nothing like it had been attempted before? Junius Spencer Morgan and his son, John Pierpont Morgan, had a plan. The principal market for the shares was to be England, where J.S. Morgan lived and did most of his business. English investors would be offered a share in a well-run railroad that had good track and a clear line from the port of New York all the way to Chicago. How could English investors be sure that the railroad line would continue to be well-run? When J.S. Morgan sold them their shares, they would

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[37] 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.

sign the proxies over to his son J.P. Morgan, who lived in the United States, would represent them on the New York Railroad's board, and would vote their proxies. A combination of (a) political pressure and (b) the promise of a wide and diversified market that would purchase the control block at a good price together induced this first step toward Berle-Means style finance fifty years before they wrote this book.

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

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. 1914 also saw the passage of the Clayton Act, with its Section 7 prohibiting corporations to hold controlling stakes in competing corporations. 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. 1935 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. 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.

Standard Oil

But more is going on. Consider the flagship company of the post-1911 Rockefeller fortune: Standard Oil of New Jersey (now Exxon). In 1912 John D. Rockefeller senior alone owned a quarter of Standard Oil (New Jersey), as Table 3 shows. The top 1.5 percent of shareholders owned 72 percent of the company's shares. The Rockefellers and their allies both *owned* and *controlled* Standard Oil (New Jersey). Yet over the subsequent generation and a half, ownership of Standard Oil (New Jersey) became remarkably dispersed.

We have data year by year from 1912 to 1950 on the number of shares and shareholders, 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).[38] 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[39]: that the share S of stock shares held by the top share B of shareholders at any moment in time follows the equation $S = A(B^p)$. We use our data to obtain a log least-squares estimated value of 1.43 for A.[40]

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[38] From Gibb and Knowlton (1976).

[39] 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.

[40] 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.

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. Figures 1 and 2 present our results.

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 powerf—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.

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 estimates are, of course, vulnerable to the heroic assumption of a power-law distribution for shareholdings. At the most basic level, the underlying facts are these: In 1912 105 shareholders—1.8% 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 dispersion of Standard Oil (New Jersey) shareholdings, and the resulting increase in the likely power of established managers and decrease in the power of owners over decisions about corporate direction and managerial succession. Incumbent shareholders sold off their shares, seeing the value of diversification in reducing the expected cost of the idiosyncratic risk borne by holding large blocks as worth more than the loss of the ability to easily assemble a controlling voice at annual meetings should one want to challenge or replace management. And over the course of a generation and a half this process of diversification proved to be remarkably powerful in its effects.

Politics

The effects of the drift away from control and toward diversification that we have seen at work were, of course, reinforced by the workings of the political factors stressed by Roe (1994). In striking contrast to banking elsewhere, American banking *was* fragmented – by the inability to branch across state lines, and often by the inability to branch at all.[41] The earlier national banks and the later members of the Federal Reserve system could not own shares of stock.[42] The Armstrong investigation of 1905-1906 knocked out insurance

[41] See White (1982).

[42] 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

companies as possible attractive locuses for the exercise of supervision, monitoring, and control.[43] 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.[44] 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 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."

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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.

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

[44] 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).

General Motors

But there is more to it than that. Where there were substantial blockholdings, circumstances 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.[45]

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 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

[45] See Sloan (19??).

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."[46] 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.

IV. The View from the End of the 1930s

It was actually[47] Gardiner Means (1931) who wrote that:

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

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[46] See Harbeson (1958).

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

Empirically, this insight was based on an analysis of the growth in the number of stockholders between 1900 and 1928 (Means 1930, updating Warshow 1924) and the distribution of ownership blocks among the largest 200 U.S. corporations at the end of 1929 (Means 1931).[48]

Means (and a year later Berle and Means) were certainly right in seeing a substantial diffusion of shareownership. Figure 3 shows the number of shareholders in America's three largest corporations. By the end of the 1920s AT&T had nearly half a million shareholders. The Pennsylvania Railroad had 150,000. Table 4 reports Means's numbers on the growth of shareholding for a broader range of companies. The pattern is the same: wide diversification is well under way.

Means attempted a five-fold classification of "the separation of power over corporate resources and ownership interests therein." The spectrum ran from (i) almost complete ownership, (ii) majority control, (iii) control through a legal device (a pyramid, non-voting preferred or common stock, voting trusts), (iv) minority control through a stock interest, down to (v) management control[49].

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[48] A shortened version of Means (1930) became Chapter I of Book I in Berle and Means (1932); Means (1931a) became Chapter V. Chapter III of Book I is a shortened version of Means (1931b). More generally, it appears that Means was responsible for Book I and Berle for Book II.

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

The key to control with little (or no) ownership were the rules governing board elections. In Germany votes attached to bearer shares typically fell into the hands of depository banks; in the United States proxy voting by mail and record ownership made put these votes *de facto* into the hands of the incumbent board of directors :

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

It is no coincidence that the proxy process was a major concern of the drafters of 1933 Securities and Exchange Act[50] and continues to be so to this day.[51]

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

Figures 4 and 5 show Means's classification of corporate control for large corporations at the end of the 1920s for both "immediate" and "ultimate" control.

From our perspective, Means's assessment of corporate control at the end of 1929 is not satisfactory. First of all, conceptually, his classification does not distinguish between control by a chief executive officer-as-president who dominates a board of "yes men," and family control with little ownership that is exerted via a family dominated, self-appointing board.[52] Two, the data in Means (1931a) and Berle and Means (1932) does not allow us to make the distinction between family control through ownership, family control through boards and management control.

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[51] The 1933 Act contained specific provisions on the proxy voting process but, to date, these provisions have not changed the nature of U.S. board elections in a fundamental way: "Shareholders typically are provided proxies allowing a vote only on company-nominated candidates, and disclosure in company proxy material is limited to those candidates. Also, most companies use plurality rather than majority voting for director elections, so candidates are elected regardless of whether a minimum percentage of shareholders approve. Therefore, company nominees are nearly always elected to the board, regardless of the number of shareholders who object to their candidacy." SEC Chairman William Donaldson, Introductory Remarks at the 8 October 2003, Open Meeting on the SEC's Proxy Access Proposal. On the SEC's 2003 Reform Proposals see also Bebchuk (2003, 2004).

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

To investigate family control, we turn to the earliest comprehensive and reliable cross-section of blockholder control in the largest 200 U.S. corporations—the Temporary National Economic Committee's (TNEC) "Investigation of Concentration of Economic Power".[53] The TNEC report was laboriously compiled from SEC filings and questionnaire surveys by SEC staff and was considered to permit "for the first time, to determine with some precision the magnitude of the largest holdings in each of a wide group of giant corporations" (Gordon 1945, pg. 31).[54] The TNEC (1940) report reflects the general ownership situation around the end of 1937 and, for each of the largest 200 corporations, listed and non-listed, contains information on record ownership, beneficial ownership, share classes and the names and holdings of directors. More importantly, the TNEC volume contains a control classification that is more suitable to our investigation than Means (1931a). The TNEC classification is also based on the size of the largest

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

[54] Holderness, Kroszner and Sheehan (1999) use an even earlier cross-section compiled from Section 16 reports of insider holdings for 31 December 1935 covering more than 1500 publicly listed corporations, but not non-listed companies. The SEC report contains data on direct ownership and beneficial ownership of individual officers and directors, but does not contain information on the holdings of outside blockholders and, hence, corporate control. In the 1930s the data was used extensively by Gordon (1936, 1938). Comparing the SEC's 1935 and the TNEC (1940) data, Gordon (1945, pg. 25) considers the TNEC (1940) data more reliable, but Holderness, Kroszner and Sheehan (1999, pg. 447) show that a comparison of insider ownership for the 169 firms in both samples gives very similar results.

block of voting shares, but it also considers the distribution of other blocks and the presence of shareholders on the boards.[55]

Table 5 reports the distribution of control in terms of numbers of companies, and as percentages of total assets. Figure 6 reports the size of the largest share block for the TNEC companies, and Figure 7 characterizes the type of the potential control share block. Note the important differences, shown in Figure 8, between utility companies and others: utility companies had the most diversified ownership by far, and attempts to gather utilities into a more centralized control structure were defeated by the combination of finance and politics—the Morgan-led raid and carveup of Samuel Insull's utility empire, and then the Public Utility Holding Company Act of 1938.

The TNEC (1940) list of the largest 200 corporations includes companies that are subsidiaries of other companies on the list (complex and pyramidal holdings). Gordon (1945) argued that this induced an upward bias into ownership concentration statistics and excluded the 24 subsidiaries from the sample (21 companies with majority ownership by a corporate and 3 leased lines).

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

Where Did the Founders Go?

The TNEC sample gives us the data that we need to answer our key question: where did all the founders go? In the TNEC 1938 cross-section, 96 of the largest 200 U.S. corporations were in the manufacturing sector, and 34 (35.4%) of those had no dominant blockholder. The largest investors were Dutch institutional investors[56] and the Sun Life Assurance Company of Canada, holding small blocks under five percent. We have traced the origins of the 34 industrial companies without a dominant ownership interest back in time. The results suggest that the origin of the "modern corporation" in 1939 is found in the first horizontal merger wave, trust promotion and antitrust measures.

Tables 6, 7, and 8 show the links beween the TNEC cross-section of manufacturing corporations without a dominant blockholder, and John Moody's original list of trusts in 1904. In 20 cases there is a direct link through the company name. In three cases the companies changed their names: Atlantic Refining and Continental Oil had been part of the Standard Oil Trust, that was broken up in 1911; the Anaconda Mining Company was a previously-acquired subsidiary of the Amalgamated Copper Company; in 1901 Bethlehem Steel was part of the United States Shipbuilding Trust—although its rapid expansion came afterwards. For ten companies there is no direct trust origin could be established. Nevertheless, it is striking that two-thirds of the manufacturing corporations

[56] See De Jong and Roell (2004) for a history of ownership and control in the Netherlands. The major Dutch investors were Hubrecht Van Harencarspel Maatschappij, Broes & Gosman Maatschappij, Nederlandsch Administratieen Trustkantoor, Wertheim & Gompertz Westendorp Maatschppij,

without large blocks in the late 1930s had been part of Moody's finance-capitalist corps a genration earlier.

Why did trust formation lead to widely held ownership? Looking at the history of the 24 widely-held manufacturing companies with trust origins, we identify three principal reasons.

1. One, the original dominant shareholders were bought out by trust promoters. The most prominent example is U.S. Steel, with J.P. Morgan buying out Andrew Carnegie.

2. Two, trust promoters who kept dominant ownership positions in the trusts were forced to relinquish control by antitrust action. The outstanding example is the Standard Oil of New Jersey holding company, which was dissolved in 1911. Although the Rockefellers were given equal ownership blocks in the individual post-breakup companies, it was clear that further antitrust action would have resulted had they sought to influence or coordinate the activities of these companies in a major way. Antitrust action against influential owners was also important in some other cases, in particular when families held blocks in related businesses. The classic example is a 23% block the Du Pont family acquired in General Motors via the E. I.. du Pont de Nemours chemical company in 1917-

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Administratiekantoor Van Binnen en Buitsenlandsche Fondsen, Broekmans Administratiekantoor, Niew-Amsterdamch Administratiekantoor (TNEC pp. 1502-1504).

1919. Du Ponts was forced to sell the block as a result of civil action brought by the government under the Clayton Act of 1914.[57]

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

In all of the 34 companies without dominant ownership, the separation of ownership and control emphasized by Means (1931) and Berle and Means (1932) was complete by the late 1930s.

Why did the original owners and the trust promoters sell their control blocks in the first place? One reason—stressed by Dewing (1919)—was that the American stock market gave them an opportunity to sell the stock for more than it was worth. “Physicians,

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[57] The 23% block was bought 1917-1919, the Federal Government took civil action under § 15 of the

teachers, dentists, and clergymen" constituted "the happy hunting ground" of the "sucker list," where people were persuaded to buy "highly speculative and worthless securities" by "devious and dubious" methods. A second reason was the very success of Morgan and his peers—George F. Baker, James Stillman, Frank Vanderlip, and company—not at swindling the investing public but at persuading the investing public, through a good track record, that they would not be swindled. As DeLong (1991) calculated, large industrial combinations promoted and organized by J.P. Morgan were by and large quite good investments. Giving founders peace of mind through special or preferred stock, merging competitors, maintaining a presence on the board of directors, and putting the weight of the Morgan name behind behind the newly-diversified enterprise all raised the price that founding families could get for their control blocks. Moreover, this strategy appeared to involve no inevitable loss of control—or so it looked for a while, until the Morgan partners and the founders died or rotated off the board and were replaced by managerial picks.

Thus Vanderbilt and Carnegie were bought out by attractive offers for their shares they could not refuse; Havemeyer, Rockefeller, and Du Pont were forced out by government antitrust policy; the Guggenheims diversified while attempting to keep control of the board. And sooner or later many of them turned to philanthropy. The fact that America was not supposed to be a land of aristocracy combined with Teddy Roosevelt's crack about "malefactors of great wealth" stung. So Rockefeller endowed the University of Chicago and Rockefeller University. Carnegie built 3,000 libraries, bought 4,100 church

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Clayton Act to enjoin violations of § 7 of that Act in 1949, the case was initially dismissed by the District Court but upheld by the Supreme Court in 1957; the block was sold in 1961.

organs, Carnegie Hall, the Carnegie Institute, and the Peace Palace at the Hague. And he said, “He who dies rich dies disgraced.” As the founding families’ turned their interests elsewhere, control slipped bit by bit into the hands of the managers.

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

V. Conclusion

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

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

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

During the 1990s, when the Internet boom seemed unstoppable and the U.S. stock market at its most bullish, 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 the convergence 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.

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

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. There are few parallels to these arrangements in the United States.

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

However, remarkably little is known about how corporate governance structures arose, how well they work, or whether any one of them would work outside its national context. Views on the successes or failures have oscillated wildly over the past two decades, with each model getting its season in the sun. The lack of data on the question has prompted even corporate governance reformers at the Organisation for Economic Co-operation and Development and the World Bank Group [FC:(http://www.gcgf.org)] to explore creation of a global corporate governance research network.

It is probably right to believe that diversity in corporate control will persist. But in 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 a trend toward a greater role for the stock market.

But even if firms with many shareholders become more prevalent, they need not all be governed alike. Such widely distributed ownership is compatible with dispersed voting rights and contestable board control, as in the United Kingdom. But it is just as compatible with uncontestable board control nominally exercised in the interest of shareholders—as in the United States, with their poison pills and entrenched directors, or as with the Netherlands' priority shareholders, who possess the sole right to nominate directors for election to corporate boards.

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

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