

A HISTORY OF THE CORPORATE ENTITY'S ACCESSION TO POWER

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The Company: A Short History of a Revolutionary Idea.

By John Micklethwait & Adrian Wooldridge.

Modern Library, 2003. 191 pages. \$19.95.

I. INTRODUCTION

Enron. WorldCom. Tyco. It has not been unusual in the years following the collapse of the energy-trading firm, Enron, to pick up one's morning paper to discover a corporate officer being led away from an office building in handcuffs or charged with the white-collar crimes of embezzlement, fraud, or obstruction of justice.¹ While "perp walks" such as these serve to mollify a jittery investor class, as a structural force and a decision-making entity, two writers from the magazine *The Economist*, John Micklethwait and Adrian Wooldridge, believe such arrests might also signal a transformation in how our society views the corporation. In Micklethwait and Wooldridge's book, *The Company: A Short History of a Revolutionary Idea*, the two condense 5000 years of the development of what they call "joint stock companies" into a concise, readable history of one of our society's foremost powers. The authors conclude that, despite abuses of the corporate form

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1. See, e.g., Constance L. Hays & Leslie Eaton, *The Martha Stewart Verdict: The Overview, Stewart Found Guilty of Lying in Sale of Stock*, N.Y. TIMES, March 6, 2004, at A1 (reporting that Martha Stewart was found guilty of conspiracy, obstruction of justice and giving false statements to authorities in connection with her sale of ImClone stock); Kurt Eichenwald, *Enron's Skilling Is Indicted by U.S. in Fraud Inquiry*, N.Y. TIMES, Feb. 20, 2004, at A1 (recounting how former Enron Corp. CEO Jeffrey Skilling was taken to court in handcuffs and charged with three dozen counts of fraud, insider trading, and other crimes in an indictment stemming from Enron's collapse).

such as those seen in the Enron or WorldCom scandals, the joint stock company is still the most important and powerful organization in the world.

II. OVERVIEW

The Company explores the relatively rapid development of the modern corporation and, in turn, examines that entity's emergence as the dominant form of economic organization. Micklethwait and Wooldridge begin their analysis of that question in Mesopotamia in 3000 B.C. and quickly cover 4500 years of economic development, from the family merchants who traded along the Euphrates and Tigris rivers to the *societates* of Rome, to the current technology companies found in Silicon Valley.² The two observe common themes in many of these business organizations, such as the quest for limited liability and the pooling of investor resources to limit risk allocations.

Interestingly, one of the themes that Micklethwait and Wooldridge mine as an apt comparison to today's modern corporation is the level of governmental involvement or, at times, acquiescence in a particular entity's operations.³ In the Middle Ages, guilds were the dominant form of business organization. These entities resembled modern trade unions⁴ by operating umbrella groups for members of particular crafts.⁵ As guilds became increasingly powerful organizations, the crown became concerned because "they circumvented feudal fees by never dying, never coming of age, and never getting married."⁶ The sovereign, however, would not be denied its revenue. Typically, the crown granted guilds a monopoly to operate within the confines of a city's walls in exchange for substantial monetary "donations."⁷ Another source of royal revenue was to call in the guilds' charters for

2. JOHN MICKLETHWAIT AND ADRIAN WOOLDRIDGE, *THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA* 3-4 (2003) [hereinafter "MICKLETHWAIT & WOOLDRIDGE"].

3. *Id.* at 13.

4. *Id.* at 13.

5. *See, e.g.*, TED NACE, *GANGS OF AMERICA* 19 (2003). Nace discusses guilds such as the Skinners, the Fishmongers, the Goldsmiths, the Grocers, the Drapers, the Mercers, the Tailors, the Saddlers, the Haberdashers, the Cordwainers, the Merchant Tailors, the Salters, the Ironmongers, the Vintonners, and the Clothmakers. *Id.* at 19-20.

6. MICKLETHWAIT & WOOLDRIDGE, *supra* note 2, at 13.

7. *Id.*

renewal as a method to collect additional fees.⁸ Thus, although nervous about the power certain guilds wielded, the sovereign became crucial to their development by offering security and the promise of a guaranteed market.⁹

Micklethwait and Wooldridge also explore the interaction of government and business in the chartering of voyages in the sixteenth and seventeenth centuries. Companies chartered by individual countries¹⁰ popularized the modern concepts of limited liability and the pooling of capital. Due to the high level of risk involved in backing such expeditions to the far corners of the modern globe, financiers of such voyages sought to spread their capital among a number of voyages and fleets.¹¹ With pooled capital, investors were for the first time detached from the actual individuals constituting the corporation.¹² This emerging idea would come to transform the idea of a corporation as a legal entity existing apart from its owners.

With rampant financial speculation in early joint-stock companies, inevitable market corrections and “bubbles” developed similar to ones that can also be seen in today’s markets. In one investment debacle, Micklethwait and Wooldridge recount how John Law (1671-1729) intended to rescue France from its inflation problems and unstable currency.¹³ Law allowed investors to buy shares in the Mississippi Company in installments, providing loans from the Banque Royale and using the shares as security.¹⁴ Few investors questioned what Law’s company actually did because Law controlled both the central bank and the stock market.¹⁵ In 1720,

8. NACE, *supra* note 5, at 21.

9. MICKLETHWAIT & WOOLDRIDGE, *supra* note 2, at 14. The authors liken such a guaranteed market to present-day defense contractors that obtain similar security measures and guarantees of a fixed market from the United States Department of Defense. *Id.*

10. Columbus, Magellan, and Vasco da Gama were all “recipients of royal charters that gave them exclusive rights to trade with this or that bit of the world.” MICKLETHWAIT & WOOLDRIDGE, *supra* note 2, at 17.

11. *Id.* at 20. The authors compare the risks of investing in spice missions to Indonesia to those that would invest in space exploration today. *Id.* at 19.

12. The London-based Virginia Company, which helped found the Jamestown Colony in what would become the United States, counted among its “Adventurers” (investors who purchased a twelve-pound share) “wealthy aristocrats and merchants but also such notables as William Shakespeare.” NACE, *supra* note 5, at 31.

13. MICKLETHWAIT & WOOLDRIDGE, *supra* note 2, at 28-31.

14. *Id.* at 30.

15. *Id.*

Law's bubble burst when a number of investors abandoned the Mississippi Company.¹⁶ He was forced to flee the country, "leaving France in chaos."¹⁷

The chapters detailing the period between 1850 and 1900, however, are where Micklethwait and Wooldridge's narrative excels. It is at this point that the United States used state-chartered corporations with special monopoly rights to build some of the vital infrastructure of the new country and to separate itself from what would be a more traditional, stakeholder view of the corporation evident in Europe.

Micklethwait and Wooldridge contend that three events converged to prompt the "revolutionary" change in the corporation in the United States.¹⁸ The first, and most important, innovation was the railroad.¹⁹ Railroads were not just the first modern businesses; they also enabled the development of other companies, "helped build . . . the infrastructure of a modern economy," "provided the right-of-way for telegraph and telephone lines" and "revolutionized the Post Office," and made it possible to move goods throughout the country quickly and predictably.²⁰ One early beneficiary of the railroad revolution was Sears, Roebuck & Co., which used the rails to ship mail-order products to remote locales across the country.²¹

The second change that affected the company's role in the United States was legal. Beginning in 1819, the Supreme Court held in a ruling regarding the status of Dartmouth College that states could not rewrite corporate charters capriciously because the corporation possessed certain private rights.²² Subsequently, numerous constitutional rights previously accorded only to private citizens were extended to corporations as well.²³

16. *Id.* at 30-31

17. *Id.* at 31.

18. *Id.* at 45.

19. *Id.*

20. *Id.* at 62-63.

21. *Id.* at 57-58.

22. *Id.* at 45. *Trs. of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat) 518 (1819), is also important because it was the first case in which the Supreme Court indicated that the Constitution, which makes no mention of corporations, could be interpreted liberally enough to give corporations some constitutional protections. Justice Marshall also made clear, however, that corporations remain subject to state power, writing that the corporation is an "artificial being, invisible, intangible and existing only in contemplation of law."

23. The following constitutional rights were extended to corporations:

The final prompt was political in nature.²⁴ State restrictions on incorporation in the early nineteenth century bore little resemblance to today's general incorporation laws. But beginning in 1830, states began considering the impact that pro-business statutes could have on a state's ability to attract corporations to relocate within their borders. In 1830, Massachusetts decided that companies didn't have to be engaged in public works to be awarded a state charter.²⁵ In 1837, Connecticut allowed incorporation of most businesses without a special legislative enactment.²⁶ Finally, in a decision heavily lobbied for by the Pennsylvania Railroad, the State of New Jersey loosened its incorporation rules so that any corporation chartered in the state could hold stock in any other corporation in the country.²⁷ This 1899 revision of New Jersey law soon made it the preferred state in which to incorporate. By 1901, seventy-one percent of all United States corporations with assets of \$25 million or greater were founded in New Jersey, i.e., the legal recognition of the holding

County of Santa Clara v. S. Pac., 118 U.S. 394 (1886) (the right to equal protection under the Fourteenth Amendment); Chicago, Milwaukee and St. Paul Ry. v. Minnesota, 134 U.S. 418 (1890) (the right to due process under the Fourteenth Amendment); Noble v. Union River Logging R.R. Co., 147 U.S. 165 (1893) (the right to Fifth Amendment protections); Hale v. Henkel, 201 U.S. 43 (1906) (the right to freedom from unreasonable searches under the Fourth Amendment); Armour Packing Co. v. United States, 209 U.S. 56 (1908) (the right to a jury trial in a criminal case under the Sixth Amendment); Penn. Coal Co. v. Mahon, 260 U.S. 393 (1922) (the right to compensation for governmental takings under the Fifth Amendment); Fong Foo v. United States, 369 U.S. 141 (1962) (the right to freedom from double jeopardy under the Fifth Amendment); Ross v. Bernhard, 396 U.S. 531 (1970) (the right to a jury trial in a civil case under the Seventh Amendment); Va. Bd. of Pharmacy v. Va. Citizens Consumer Council, 425 U.S. 748 (1976) (the right to engage in commercial speech under the First Amendment); First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765 (1978) (the right to engage in political speech under the First Amendment); Pac. Gas & Elec. Co. v. Pub. Utils. Comm'n, 475 U.S. 1 (1986) (the right to abstain from association with the speech of others under the First Amendment).

24. MICKLETHWAIT & WOOLDRIDGE, *supra* note 2, at 45.

25. *Id.* at 46.

26. *Id.*

27. NACE, *supra* note 5, at 67. Nace details the importance of this development by showing that the amendment made it legal for companies to operate outside of the boundaries of a particular state that had licensed it to do business. By using the idea of a holding company, an entity formed specifically to own stock in other companies, corporations were able to avoid state protectionist statutes that limited the companies that could do business within their jurisdictions. NACE, *supra* note 5, at 62. A holding company is a "company formed to control other companies, usually confining its role to owning stock and supervising management." BLACK'S LAW DICTIONARY 275 (7th ed. 1999).

company.²⁸ Soon after, other states fought back beginning a “race to the bottom,” eventually won by Delaware.²⁹ By the time of the Great Depression, Delaware was home to one-third of the industrial corporations trading on the New York Stock Exchange³⁰ and it continues to be home to the world’s most powerful businesses.

Micklethwait and Wooldridge conclude that these factors—the development of railroads, the rise of “corporate” legal rights, and increasingly lenient incorporation statutes—combined with the American ambivalence to big business to create a ripe environment in which conglomerates such as Ford Motor Co., General Electric Co., American Tobacco, Coca-Cola, and others flourished. By European standards, America was much less likely to regulate big businesses because

[m]ost Americans were ambivalent about business. They dislike concentrations of corporate power—the United States, after all, is based on the division of power—but they admired the sheer might of business. They disliked the wealth of businessmen, but they admired the fact that so many of them came from nothing³¹

Americans looked at the rise in corporate power as a cost-benefit equation in which the comforts that business had made possible outweighed the sometimes corrupt practices used to deliver such luxuries.³² By improving standards of living for all citizens and helping to establish social services such as museums, parks, and art galleries in a country that was in need of such philanthropy, the authors argue that it “bound the classes together” even as “the income gap was widening.”³³

The authors also interestingly contrast the successes of the American system of corporate organization against those that involved Britain, Japan, and Germany. The conclusion drawn is that Britain suffered partially from a society-wide “snobbish distaste” for business and entrepreneurs that had the result of starving British businesses of educated recruits and up-to-date

28. NACE *supra* note 5, at 68.

29. MICKLETHWAIT & WOOLDRIDGE, *supra* note 2, at 68-69. Virginia was called a “snug harbour for roaming and piratical corporations,” the New York legislature enacted a special charter to prevent General Electric Co. from moving to New Jersey, and Delaware substantially liberalized its corporation laws. *Id.*

30. *Id.* at 69.

31. *Id.* at 74.

32. *Id.* at 77.

33. *Id.*

expertise.³⁴ Japan, meanwhile, clung to family-organized *zaibatsu* (literally, “financial cliques”) until the Second World War.³⁵ But the Japanese government’s “habit of steering the economy in pursuit of national greatness reached an ugly zenith in the Second World War.”³⁶ Soon after the war ended, the Japanese began transitioning away from the inflexible *zaibatsu* and closer to the American model. Finally, Germany was able to recruit more highly skilled workers than Britain due to the country’s emphasis on a scientific and vocational education,³⁷ but it also suffered from the government’s insistence that businesses serve the country’s interests as a whole. While appealing in an ideal society, Micklethwait and Wooldridge assert that in both Germany and Japan, the focus on the state’s goals rather than the company and its shareholders’ interests led to tragic results when nationalists forced businesses to provide resources to the war machine.³⁸

In the last half of the twentieth century, Micklethwait and Wooldridge contend both that the company experienced its highest level of power but that it is now undergoing an “unbundling” of its influence. First, the American “multidivisional” firm, in which companies were divided into multiple divisions subject only to a central authority, was implemented in many companies. This segmentation created flexibility in large companies and propelled entities that adopted such an organization to the forefront of their respective industries.³⁹ Competing businesses fell behind as the increased efficiency and growth of firms that marshaled their combined divisions together

34. *Id.* at 84.

35. *Id.* at 97. The *zaibatsu* operated as a type of holding company that managed a number of other firms through co-ownership and overlapping directorates. *Id.* Typically, the *zaibatsu* would recruit non-family managers directly from universities who would work for the extended family of companies the rest of their lives. *Id.*

36. *Id.* at 98.

37. *Id.* at 94.

38. *Id.* at 91, 98-99.

39. *Id.* at 104-107. The authors explain that Alfred Sloan (1875-1966) first implemented the multidivisional firm at General Motors. *Id.* at 105. Sloan decided that each of GM’s divisions was too distinct to be run by a central authority, so he created separate units—car, truck, parts, and accessories—to operate as autonomous divisions. *Id.* at 105-06. By combining the divisions together for purposes of buying power, GM was able to obtain economies of scale in all the products it purchased. *Id.* at 106. General Electric, United States Rubber, Standard Oil and U.S. Steel, among others, eventually adopted the multidivisional structure. *Id.* at 107.

for joint-buying clout secured cheaper prices from “everything from steel to stationery.”⁴⁰

Although the development of the multidivisional company produced increased efficiencies, the authors maintain that the last twenty-five years has seen an unbundling of the company as corporations have been forced to focus on their core competencies. The change has resulted in smaller, more flexible companies exploding out of Silicon Valley and quickly ascending the Fortune 500 list. Indeed, the dot-com emphasis on informal relationships and entrepreneurial activity rather than staid, traditional companies has made “it ever easier for small companies—or just collections of entrepreneurs—to challenge the dominance of big companies; and ever more tempting for entrepreneurs to enter into loose relationships with other entrepreneurs rather than to form long-lasting corporations.”⁴¹ Essentially, the goal today is not to form a company that could grow to become an empire on the scale of Coca-Cola or Ford. Rather, the emphasis among business and technology school graduates is on entrepreneurialism—forming a smaller start-up company with one great idea.

III. CRITIQUE

The Company is a successful book inasmuch as it achieves what it sets out to do—provide a “short” historical view of the entity known as the joint stock company. But Micklethwait and Wooldridge clearly paint a rosy history of the company:

The central good of the joint-stock company is that it is the key to productivity growth in the private sector: the best and easiest structure for individuals to pool capital, to refine skills, and to pass them on. We are all richer as a result.⁴²

Little in the way of labor rights, political machinations, legal excess, or whom the company should ultimately serve—the shareholders that constitute it or society that grants it a license to

40. *Id.* at 106-07. Ford Motors was one such company that resisted the change to market segmentation and paid for it. By 1929, Ford’s market share fell to 31 percent while GM’s had risen from 17 to 32.2 percent. *Id.* at 107 (citing ALFRED CHANDLER, SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM 53 (1990)).

41. MICKLETHWAIT & WOOLDRIDGE, *supra* note 2, at 185.

42. *Id.* at 190.

conduct business — is addressed.⁴³ Indeed, although the authors touch on the criticism that current multinational conglomerates wield increasingly more power in a variety of social and economic ways, they conclude that such arguments are overblown. After all, companies still must obtain “a franchise from society, and the terms of that franchise still matter enormously.”⁴⁴ It is this selfishness, Micklethwait and Wooldridge assert, that ironically keeps businesses from acting solely for themselves. Because companies are consistently establishing a relationship of trust with the societies in which they do business, and they continue to seek to obtain the top talent in their field from those societies, companies have “a vested interest in being seen to do good.”⁴⁵

But the authors neglect to address that even if the marketplace punishes unsuccessful and corrupt companies, these companies often take down shareholders with them. Thus, while the *legal* entities known as Enron and WorldCom appropriately paid the price for pursuing illegitimate business practices, the sums of their parts are left holding the bag.

In addition, while our society today is thought to be in a second Gilded Age, *The Company* only tangentially mentions the increasingly disparate compensation gap between executives and employees,⁴⁶ the internationalization of “blue” and “white” collar jobs,⁴⁷ or whether the spate of billion-dollar mergers will again

43. For an examination of the corporate system as it relates to focusing on profits for stockholders to the exclusion of all else, see MARJORIE KELLY, *THE DIVINE RIGHT OF CAPITAL: DETHRONING THE CORPORATE ARISTOCRACY* (2001). Kelly contends that the primary focus in modern corporations to maximize shareholder returns is flawed. She argues that a new model for the corporation that examines both external and internal constituents is needed in order for companies to reflect American democratic political ideals.

44. *Id.* at 186.

45. *Id.* at 189. Micklethwait and Wooldridge conclude that the robber barons built much of America’s educational and health infrastructure: Merck has donated millions in AIDS education, Avon is one of the world’s largest breast cancer investors, and IBM is a “strategic investor in education.” *Id.* at 188-89.

46. See, e.g., John A. Byrne, *How to fix Corporate Governance*, BUSINESS WEEK, May 6, 2002, at 68 (stating that in 1980, the average CEO of a large corporation earned forty-two times the average hourly worker’s pay; by 2001, the ratio had increased to 411 times).

47. See, e.g., Stephen Baker & Manjeet Kripalani, *Will Outsourcing Hurt America’s Supremacy?*, BUSINESS WEEK, Mar. 1, 2004, at 84 (estimating that in the past three years, outsourced programming jobs have risen from 27,000 to an estimated 80,000 and that by the end of 2004, one out of every ten jobs in U.S. tech companies will move to emerging markets); *The Great Hollowing-Out Myth*, THE ECONOMIST, Feb. 21, 2004, at 28 (citing a report by Forrester Research estimating

reshape the company as we know it.⁴⁸

Asking a relatively brief historical book to do all these things and more, however, admittedly is a bit unfair. Reading *The Company*, while enlightening, is much like enrolling in an introductory-level survey class of American history. While there are extraordinarily interesting events to discuss, the depth of coverage must necessarily be thin or incomplete in order to appropriately address the time span being examined. Thus, while those interested in a brief overview of the development of the corporate form will not be disappointed, others may be left asking for more. Crafting a history that is, in this reviewer's mind, too short, is in itself potentially a good thing. After all, there are numerous other resources one can consult to delve more deeply into any neglected areas. By authoring a concise and eminently fascinating review of the turbulent past of this business organization, Micklethwait and Wooldridge have begun the discussion regarding the terms upon which society should do business with the companies that prove so vital to each of our lives.

that 3.3 million American service-industry jobs will have gone overseas by 2015).

48. Micklethwait and Wooldridge do comment on the increased regulatory oversight of companies in the post-Enron business environment. In their opinion, because the vast majority of Americans are now currently holders of some business securities in one form or another, such regulations will unlikely severely cripple companies' performance but seek mainly to provide improved oversight. MICKLETHWAIT & WOOLDRIDGE, *supra* note 2, at 156.