Lecture IV

Corporate Constituencies

Corporations, especially large ones, must contend with and seek to satisfy at least four different constituencies: (1) their stockholders and creditors; (2) their employees; (3) their customers; and (4) government regulators. In the early years of the corporate form of business organization the newly incorporated entity would have only a few dozen shareholders, usually wealthy individuals who would also take a direct hand in running the new company. The Virginia Company of London, sought wider participation as a way of raising additional revenue but still had only 1,700 registered shareholders at its peak in the early 1600s. With the advent of mass stock ownership, usually through mutual funds or participation in pension systems, the character of ownership has changed radically since the 1950s. Given the often indirect nature of stock ownership today – most of us do not track individual stocks held on our behalf by our mutual funds or pension plans – the average stockholder is quite unaware of how the company he owns a tiny piece of is being managed. The average shareholder also pays much more attention to the price of a stock (or an index of stock prices) than he does to dividends paid by corporations. At one time, investors expected and received substantial dividends from their stock holdings, but for the last few decades most of us have settled for smaller dividends in favor of "capital gains," i.e., rising stock prices. Stodgy, established corporations that pay a hefty dividend even though their stock does not show much price appreciation are rarely the darlings of the market. Most Americans also are less likely than in the past to be "buy and hold" stockholders. Unless the company they work for has an employee stock purchase program that allows them to buy company stock at a lower price than on the open market, most people use a mutual fund with a wide array of corporate stocks and bonds in its portfolio. The bottom line is that, except for a few large shareholders – mutual funds, hedge funds, big investors like Warren Buffet, for instance – corporate management is unlikely to be held to account by the mass of shareholders.

The company's employees are a different matter. In addition to their "managers," companies usually have to hire employees who help carry out the company's activities. Large industrial enterprises that were organized in the 19th and 20th centuries in Europe and the United States also were faced with the growth of employee unions. Trade, or labor, unions were considered illegal in most instances during the 19th century, sometimes viewed as conspiracies to extort concessions from companies, at other times viewed as attempts to dragoon workers into joining an organization they did not want to belong to. Two of the companies featured in these lectures – Amoskeag and Pullman – suffered long and costly strikes organized by unions of their workers. The Pullman Strike of May to July of 1894 was one of the most violent in the nation's history, leading to the blocking of railroad traffic and eventually to the intercession of federal troops to "move the mail." The strike was unsuccessful, but it did succeed in challenging the idea that corporate management could cut wages or otherwise harm workers' interests without suffering some serious consequences. The strike at Amoskeag in 1922 was far less famous. It signaled in a way the power of organized labor, but also the declining fortunes of the New England textile industry, which would eventually migrate to the South to escape union organizers. With the decline in manufacturing in the U.S. and the concomitant decline in union membership, employees today are largely powerless when dealing with management. This situation is somewhat offset by the greater ease with which employees today can change jobs, seeking to better their career prospects and financial standing through their own initiative rather than await a promotion from a company they plan to work at for many years. As with its relations with its stockholders, the corporation's relationship with its employees is not nearly as close as it was in the 1950s. The "organization man (or woman)" hardly exists anymore.

The third constituency -- customers or consumers -- became more important starting in the 1920s with the advent of the consumer revolution, a sort of "second industrial revolution." Automobiles, first of all, but then consumer electronics and home appliances marked the transition from the primacy of production of

capital goods – railroad equipment, steel, coal, etc. – to the new era of the internal combustion engine and electric power. For corporations, one important aspect of this new form of enterprise, or, more correctly, this greatly expanded version of an old enterprise, was the need for advertising and the creation of a public image. The corporation that hoped to serve a large customer base had to create products and sell them to a public that might actually not be interested in buying them, or, more likely, unable to afford them in the quantities the new assembly line of mass production could produce them. Unlike capital goods manufacturers, consumer goods corporations had to appeal to millions of potential buyers. When it came to radios or movies, household appliances, packaged foods, and a host of other products, the demand might be there, but it might also have to be stimulated and directed to your "brand."

Finally, corporations had to be wary of potential government regulations, or even anti-trust action that could wreck the company's plans for growth. AT&T, as noted, provided a case study in how to turn government regulation of a monopoly into an actual plus. For a while, RCA and its broadcast arm, NBC, achieved somewhat the same level of government regulated monopoly status. In general, the federal government in the 1920s and 1930s, and again in the post-World War II years, seemed comfortable with bigness and the economies of scale it provided. Anti-trust enforcement hardly existed until the last years of Roosevelt's New Deal, and then was shunted aside in the rush to build the country's defense capacity. Gradually the dozens of automobile companies of the 1920s were essentially reduced to "the Big Three" by the 1950s and early 1960s, when Packard, Nash, Hudson, Studebaker, and Kaiser all ceased to exist. This "oligopolistic" industry became more or less the model of America's postwar economy and the government regulators felt comfortable with it. GMC chief executive Charles Wilson famously maintained in his confirmation hearings to be Eisenhower's Secretary of Defense that he could not conceive of a situation in which the interests of GMC would conflict with those of the country as a whole. That being one of the reasons he decided it would be okay for him to hold on to his large portfolio of General Motors stock while heading the Pentagon. There couldn't be a conflict of interest, in his view. Similar close relations existed between companies like IBM and RCA and the government agencies they either contracted with or were regulated by (the FCC in the case of RCA/NBC). Today we see a similar close tie between Boeing, Lockheed, Raytheon, United Technologies, and other large defense contractors and the Defense Department. President Eisenhower, in his farewell address to the nation, warned against what he saw as a potential "military-industrial complex," that could undermine the control of the elected government officials and create a corrupt system of defense procurement. It seems certain that were any of the major defense contractors threatened by bankruptcy the federal government would step in the save them in the name of protecting the national security. In many ways, the dividing line between large corporations and the federal government has narrowed even more than what it was during the Eisenhower years.

Incorporation and the Stock Market

Stocks and bonds, otherwise known as "securities," are the financial life blood of all corporations. Early financiers like J.P. Morgan and Jay Gould made millions "organizing" companies through the sale of their stock to the public. Corporations also used large issues of bonds in order to raise capital for growth and acquisitions. Until the early part of the 20th century, the largest segment of the stock market was occupied by railroad stocks and bonds. But with the formation of General Electric in the 1890s and U.S. Steel in 1901, large non-transportation industries started to come under public ownership. Most large corporations were closely held by a small number of stockholders and when they sought to raise money for their operations, they sold bonds through the major investment banks. As late as 1920, only a tiny percentage of Americans owned stocks or bonds. The Dow Jones Index of stock prices came into existence in 1896, but the number of corporations listed on the New York Stock Exchange was only a few dozen, mainly railroad companies. Bonds of foreign countries were also a very popular investment. None of the companies on that first Dow Jones Industrials Index are on today's Index. The turnover in the post-World War II has also been quite great, especially starting in the 1970s. Of the 30 companies on

the Dow Index in 1956, for instance, only 10 or 12 still exist as independent companies. What became of these one-time industrial and commercial giants makes for edifying reading.

While the New York Stock Exchange has been the preeminent place for buying and selling securities for over one hundred years, in the 1800s there were also separate exchanges for trading the stock of mining companies and even petroleum producers. These issues were considered too speculative for the nascent NYSE, but in the 1850s and the immediate post-Civil War era the vision of great wealth gained overnight from a successful speculation in gold or some other precious metal obsessed many traders. Originally the NYSE members bought and sold stocks at daily "auctions," in which issues were put on the block and stock market members shouted out their bids. This system proved to be untenable as the number of issues climbed in the post-Civil War era and so-called "continuous trading" took hold in a separate Open Market that ran all day, every work day. The problem from the point of view of NYSE members was that so many of the stocks in the Open Market were of questionable value. Thus, the two markets – the Open Market and the NYSE – agreed in 1869 on a system of registration for stocks that required the corporations wishing to place their stocks and bonds in the market for resale to agree to an investigation of their books to establish their ability to conduct the business they claimed to be in. This did not entirely end shady practices, of course, but it was a start in the direction of a more orderly system of stock trading.

Amateur, small time traders were at a distinct disadvantage in the early stock market. Inside information allowed holders of large stock positions to buy and sell with some assurance of making a profit, while the smaller stock holders risked big losses. This problem became more acute once telegraphic stock tickers were invented in the post-Civil War years, providing stock brokers with instantaneous information on price movement, enabling them to make buy/sell decisions before less canny investors had a chance to react. The stock market in these years was no place for the amateur.

The great majority of issues on the "Big Board," as the New York Stock Exchange came to be known, were railroad companies, both their bonds and stock. European investors, especially British capitalists were big buyers of American rail stocks and by 1869 about 20 per cent of U.S. railroad stocks and bonds were owned by foreigners. The biggest part of early railroad construction costs prior to 1870 were covered by the federal and state governments, with about 40 per cent of the expenditures in the form of land grants, low interest (and forgivable) loans, and outright grants. Many of the loans for railroad construction guaranteed by state governments turned out to be highly risky, with a number of states defaulting on interest payments. Eventually private capital had built up to the point where most of the construction costs in the 1880s were covered by non-state sources. Private investment in risky mining, railroad, and manufacturing start-ups led to numerous bankruptcies. Writing about American finance in the 1820s, a historian of the New York Stock Exchange noted that "Foreigners were amazed at how easy it was to go bankrupt in America, and how blithely the Americans seemed to take what, for them, was the disgrace of failure." (Sobel, p. 35) Non-payment of debts became much more common in the United States than it was in Europe, where such defaulting could lead to a stay in prison. Risky investments, in other words, were encouraged by the ease with which jilted creditors could be dispensed with through court supervised bankruptcy proceedings. The bankrupt person could then much more easily reenter business without a stain on his reputation than would have been the case in Europe.

Financial Reporting and Mergers

Starting in the 1890s, any corporation wishing to list its stock on the New York Stock Exchange had to provide the Exchange with a copy of its annual report. This requirement was followed with demands for further financial data in the ensuing years culminating in the creation of the Securities and Exchange Act of 1933 which created the Securities and Exchange Commission to oversee the probity of stock issues and the manner in which trading was conducted.

Starting in the 1880s, financial reporting became an important part of the Wall Street scene. Henry Varnum Poor is credited with creating the first modern market analysis publication, the *American Railroad Journal*, which by the 1880s had 5,000 subscribers. The *Journal* specialized in railroad stocks, the dominant issues of the day. Investors trying to get an honest evaluation of a company's worth and its stock prices turned to this little paper. John Moody, an analyst for one of the Wall Street stock brokerages set off on his own by publishing a *Manual of Industrial Statistics* starting in 1900. In this *Manual* investors could get some idea of the financial situation of non-railroad corporations listing their stock on the New York Stock Exchange. The most important and long-lasting of the financial reporting services was created by Charles H. Dow and Edward D. Jones in 1882, the Dow-Jones service. Jones left the partnership in 1899 and shortly thereafter Dow established the *Wall Street Journal* "which soon became the most influential nonbanking voice in the district." (Sobel, p. 176) Dow retained the name of Jones on the newspaper's daily Dow-Jones Industrial Average, the first of the stock indexes.

The 1890s and early 1900s were a period of intense consolidation of companies with some 3,000 firms disappearing into mergers between 1895 and 1904. The merger mania reached its peak in 1899 when 1,208 companies with a total capitalization of $2.27 billion combined. The big investment banks led by J.P. Morgan oversaw this movement and profited greatly from it. They also ended up controlling many of the newly merged firms, including industrial giants like General Electric and U.S. Steel, through membership on corporate boards. This consolidation process spawned the giant trusts in certain industries like tobacco and sugar, and, as already noted, led to the creation of six giant railroad groups that controlled the majority of the nation's railroads.

The Corporate "Personality"

Many of the early corporations embodied the personality of their founder and partook of an almost feudal sense of paternalism. Company names like Carnegie, Ford, Woolworth, and, more recently, Walton, gave many corporations a human face, even though, in the final analysis, they were no more human than Standard Oil, AT&T, or today's Exxon. Behind every great corporation we can identify a founder or founders whose entrepreneurial spirit (and, one might say, good luck) created vast wealth for themselves and their business associates and shareholders. Early, privately-held corporations, like Carnegie Steel and Ford Motors, eventually sold stock to the public and became full-fledged corporations. We still have a few large, privately-owned companies in the U.S.: Mars, United Parcel Service, and Cargill are some of the largest. But, in general, the lure of great wealth for the original owners through the sale of stock in the company (which the former sole owner will own a large part of) is usually too strong, while the need for capital to grow the business can also be a compelling reason for "going public."

The illusion that the business corporation is a personality writ large usually leads to the idea that the business must cultivate an "image" with the public that will make it admired or at least well-known, and, in more recent times, to the urge to provide its employees will something more than just a salary. There are many ways in which companies can gain employee loyalty. In the old days the company might have sponsored sports teams, local civic organizations, or, as we shall see, some form of health care or perhaps even a day care center. As the scale of corporations has grown, they feel less attachment to any particular geographic area, they become multinational concerns. With "de-industrialization" in the U.S., towns that used to rely on a local factory or other big business for employment and sponsorship of local civic activities will feel bereft when the factory closes or the business relocates. It is perhaps indicative of the "delocalization" of businesses that companies that once had names indicating their home geographic location – Owens-Illinois, Weirton Steel, or even the Standard Oil Company of New Jersey – opt for names like CSX, USX, or Exxon. Similar transformations from the name of a founder to something more abstract are also common: Commonwealth Edison becomes Excelon, or the now departed Woolworth's assumed the alias of "Woolco." The removal of founder's names or geographic designators from corporate nomenclature is often a sign that the formally paternalistic approach to business in a largely

local and protected market is ending. The merger of Houston Natural Gas and Inter/North Corporation in 1985 to form Enron is another example of the creation of a corporation that discarded its local geographic designation (while retaining its headquarters in Houston) as it sought to become a global energy trading operation. Enron employees, whose retirement pensions were largely in Enron stock, eventually paid a high price for their loyalty to the company, whose top management turned out to be fraudsters of the first order.

An interesting example of "corporate personality" is the construction of an imposing headquarters building. Today, major corporations tend to be much more dispersed in their operations than they were fifty or one hundred years ago. Thus, the construction of enormous skyscrapers with the corporate logo on them is less common than it used to be. Perhaps the most striking examples of this form of corporate hubris can be found in the Woolworth building in New York and the (former) Sears Tower in Chicago. Both buildings were the tallest in the world at the time of their opening, the former in 1913 and the latter in 1974. Other examples were the Metropolitan Insurance skyscraper in New York and the Pan Am building which for many years loomed over Grand Central Station in New York. It is indicative of the life cycle of major corporations that, with the exception of Metropolitan Insurance, all of the companies concerned are currently bankrupt or have disappeared entirely.

Advertising, which took off in the 1920s, provides corporations and other businesses with the means to define their image before the public. That is, in addition to stimulating sales, advertising creates a public face, such as RCA Victor's famous dog listening to an early bull horn type phonograph, or IBM's "Think" motto, connoting a business that doesn't just make money, but forms a culture. Although most Americans starting early in the 20th century did not realize their world was being "commercialized," the process has proceeded apace, with today's practice of selling the naming rights to sports venues to various big businesses. The corporation has, in many ways, formed much of modern America's popular culture in the process of marketing products and services. Big businesses have become peoples' friends, or at least their companions. I Phone users, for instance, demonstrate fierce loyalty, as do all those who swear by the superiority of Apple products. Behind this façade, of course, the actual corporation goes about its business of shaping public taste to its advantage.

In recent years the corporation has sought greater influence through political contributions to the major parties, a practice protected by the Supreme Court in its 2010 decision in the *Citizens United v. Federal Elections Commission* case. The Court found that corporations, unions, and non-profit associations enjoy all the free speech rights of private citizens under the First Amendment. This decision allows corporations to engage in political fundraising and sponsorship of candidates or causes previously prohibited.

The other side of the coin, so to speak, is that corporations are increasingly called upon to enforce fair hiring and employee relations practices aimed at ending discrimination in the work place. Just recently, for instance, corporations headquartered in Georgia – Coca Cola, Home Depot, Delta Airlines, and United Parcel Services – spoke out against the move in the Republican-controlled legislature to restrict voting practices in the state. Corporate involvement in the rough and tumble of politics and in the movement to expand opportunities for minorities of all sorts poses numerous dilemmas for companies seeking to satisfy the conflicting demands of customers, employees, and stockholders (and sometimes the federal government). Being a good "corporate citizen" has become a *sine qua non* of modern corporate public relations, but just how to do this without creating enemies is a delicate question.

Corporate Welfare

The corporation is an institution that was designed to spread the risk of failure so that no individual investor would suffer a devastating loss. It promised profits in return for an acceptable level of risk and in many cases spread the risk (and the profit) much further by selling huge quantities of stock that often proved to be virtually worthless, but the sales of which greatly enriched the original investors who had become the actual owners and managers of the enterprise. The spreading of risk is, of course, the key principle behind the idea of insurance, but it also a way of off-loading responsibility for future risk onto often unsuspecting individuals and institutions. As Jacob Hacker notes in his book *The Great Risk Shift*, "Corporations enjoy limited liability . . . precisely to encourage risk-taking. But while today we still have limited liability for American corporations, increasingly we have full liability for American families." (p. 160).

By establishing the corporation as a separate legal entity for whose debts individual investors are not responsible, the corporate form of business organization insulates the stock owners from the worst side effects of a business failure. Although their stock in the company may become worthless, they will not be held personally responsible for the debts incurred to creditors, suppliers, and, as Hacker points out in his book, they have no obligation to help the company's employees who stand to lose their jobs, their pensions, and their health insurance when the venture goes under.

The Federal Government has intervened to provide or safeguard pensions for American workers since the 1930s. The first such program was the Railroad Retirement Act of 1934 (amended in 1935). This Act predated the Social Security Act of 1935 and retired railroad workers with ten years or more of service still receive Railroad Retirement pensions rather than Social Security. The widespread bankruptcy of the railroads in the 1930s necessitated government intervention and with the return to financial stability the railroads continue to pay into the Railroad Retirement fund, which today provides pensions to some 68,000 retired railroad workers. Congress tried to lessen the impact of business failures on other employees with the passage of the Employee Retirement Income Security Act of 1974, known as ERISA, which, among other provisions, created the Pension Benefit Guarantee Corporation (PBGC). This government-chartered non-profit corporation insures both defunct single-employer and multi-employer defined benefit pension plans. In 2018 the PBGC was responsible for administering 4,919 single-employer plans and paid benefits of $5.8 billion to 861,000 retirees covered by these plans. In addition, the PBGC paid $151 million to 62,300 retirees in multi-employer plans. The private pension plans had been established by companies that went bankrupt – companies as large as United Airlines, for instance – as well as unions and other non-profit organizations that found themselves unable to sustain their obligations due to years of underfunding. The hazard of insuring pensions became clear when United simply stopped funding its pension fund for three straight years and then granted 23,000 ground personnel a 40 per cent *increase* in their pension benefits. "Then, it filed for bankruptcy and dropped its pension fund – whose liabilities surpassed its assets by $10 billion – into the lap of the PBGC," writes financial journalist Roger Lowenstein. Of course the problem of underfunded pension plans in both the public and private sectors remains largely unsolved and threatens the long-term fiscal health of the United States. The recently enacted "American Rescue Plan" includes a staggering $86 billion to fund the PBGC to enable it to continue paying pensions to retired employees of over 1,000 multi-employer pension plans that would otherwise run out of money leaving thousands of retirees without their pensions.

Perhaps the biggest forms of "corporate welfare" are the myriad company-funded health insurance plans. Starting during World War II, corporations offered health insurance to their employees as a way of obtaining and retaining scarce workers. After the War, the United Auto Workers agreed to accept company-funded health insurance for its members instead of the big wage increases it sought. Eventually, these employer-provided health insurance plans grew to cover 49 per cent of Americans as of 2021, according to a Kaiser Family Foundation survey. The plans vary widely in terms of benefits, with

employees making payments monthly equivalent to about thirty per cent of the premium and the employer picking up the rest. With the rapid increase in health insurance premiums, many employers are asking employees to make larger contributions. Employers can take their contributions to employee health insurance off their company income tax as a business expense, and the contribution is not treated as income for the employee, so, in effect, the federal (and state) government ends up footing the bill for a large part of the health insurance premium due to the lost revenue. Even so, health insurance costs have become a major drag on corporate profits, unless, of course, the corporation happens to be in the health insurance business.

Most companies – large and small -- also contribute to employees' 401(k) retirement accounts on a matching basis. These retirement plans, denominated "defined contribution" plans, as opposed to the traditional "defined benefit" plans common in America through the 1970s, constitute another example of a "corporate welfare" system that has grown up to rival Social Security – which is, in effect, a defined benefit plan -- as a way of providing for illness, accident, and old age. Given the fleeting nature of both employment (or even the continued existence of one's employer), it is not clear that such forms of private enterprise welfare provide a reliable alternative to government-administered health and retirement plans. According to the Census Bureau, the average employee changes jobs every five years, with those in the private sector changing jobs much more frequently that those employed in the public sector.

The corporate-sponsored health insurance and retirement plans have created a giant administrative apparatus to invest 401(k) funds and to adjudicate health insurance claims. The question is: would private employers be better off turning the whole business of health care and retirement pensions over to the government and concentrating on their core businesses? Would the beneficiaries of these plans be better off with a "single-payer" pension and health insurance system? While such a change would surely amount to the creation of the much-maligned "welfare state," we need to recognize that we already have a form of "welfare capitalism" and it does not work well for a growing number of people.