A Survey of Some Aspects of Corporate Enterprise

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A SURVEY OF
SOME ASPECTS OF CORPORATE ENTERPRISE

being

A thesis presented to the Graduate Faculty
of the Fort Hays Kansas State College in
partial fulfillment of the requirements for
the Degree of Master of Science

by

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Business enterprises have been an integral part of human society ever since the dawn of civilization. Various forms of business organizations have been developed in response to the growth of the economy. The corporation is the dominant type of business enterprise at the present time. The corporate economic system has evoked extensive admiration as well as wide criticism.

It is the purpose of this study to make a review of how a corporation should function, and what a corporation should be. Part of the study is an attempt to locate the merits and demerits of the corporate form of enterprise. A survey was made of the literature available on this subject in the Forsyth Library and in the library of the Division of the Economics and Business of Fort Hays Kansas State College. Attention was devoted to the historical background as well as the current position of business corporations.

The business corporations are especially adapted for our modern economic system, which is featured by mass production and mass distribution. However, the business corporation is capable of both great use and great abuse. Alongside the corporations which are formed for genuine business purposes are those abused as shelters for committing business torts and crimes, or as vehicles for concentrating personal economic power.

More complete governmental supervision over business corporations and the further development of social consciousness on the part of
corporate management are two possible approaches to correcting such
demerits as are incidental to the corporate form of business enterprise.
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CHAPTER I

INTRODUCTION

The business organization is a complex of labor and capital brought together and directed by an entrepreneur for the purpose of profit. Labor, under this definition, includes all human effort, whether mental or physical, directed toward the prosecution of the enterprise. Capital includes all money, securities, equipments, and natural resources, that are used in the business.

The forms of business organization are numerous; each has different characteristics, and plays a role of varying importance in business activities. Among them, the business corporation is the dominant one.

Many attempts have been made to define concisely the corporation, but all have encountered difficulties and limitations because of the fact that the nature of corporations differ somewhat in the purposes for which they are formed. One of the most famous definitions was that given by Chief Justice Marshall:

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being a mere creature of the law it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence.\(^1\)

This definition emphasizes the strictly legal aspects of corporate existence and it seems to be satisfactory for a corporation

\(^1\) *Dartmouth College v. Woodward*, 4 Wheat (U.S.) 518, 636 (1819).
set up by the government for accomplishing a specific public purpose. It is not as satisfactory when applied to the business corporation, which comes into existence through quite different ways. A business corporation is a voluntary association possessing autonomy and continuity of existence with compulsory unit of action, through a governmental grant of privilege known as the charter. Immunity from personal liability by stockholders and the facility of effecting massive capital accumulations by gathering small fractions of the total from many individuals appear to be its underlying features. Moreover, the latter is contingent on the former, because it is the limited liability feature that offers the investors a safeguard which is indispensible to attract contributions from capitalists who are not acquainted with one another.

In the past century in the United States, the number and size of business corporations have risen by leaps and bounds. While some economists hold that the development of large scale production should be accredited to the growth of the corporation, others contend that it is the employment of the corporate form of enterprise which has made the massive production possible. They point out the relationship between the growth of the corporate form and the rapidity of the rate of real capital accumulation which, in many ways is the most important single characteristic of economic development in the period since the industrial revolution and a fruitful source of contentious problems plaguing the present era. The great mechanical inventions after the industrial revolution has stimulated a rapid growth in the size of the business unit. This demands vast sums of capital which could not
be secured without the sale of publicly owned securities as instrumentalties of capital accumulation.

The limited liability feature of business corporations and their facility for accumulating capital have elicited criticism as extensively as they have evoked admiration. Too often the limited liability feature is abused. A large number of closed corporations and single family corporations are created for the sole purpose of taking advantage of the limited liability privilege. Many dishonest persons have turned this privilege into a paradise for bankrupts, a refuge from creditors' claims, and, even worse, a shelter for committing business torts and crimes. On the other hand, the diffusion of ownership of equity shares has enabled the small number of persons comprising corporation management to advance their personal interests unfairly and to exercise excessive economic powers. Acquisition, merger, formation of holding companies, interlocking directorates, and intercorporate stock ownership are part of the tactics employed to achieve economic power. All of these may be inculpated, in part at least, to the abuse of the corporate device.

It is the purpose of this study to make a review of how a corporation should function, and what a corporation should be. Part of the study is an attempt to explain briefly the circumstances which give rise to the application of the concept of a business being a legal entity, and to account for the development of the business corporation to the position that it commands today.
A survey was made of the literature available on this subject in the Forsyth Library and in the library of the Division of Economics and Business of Fort Hays Kansas State College. The information contained in current business journals supplied a wealth of information that supplemented the information available in the numerous general reference books. Articles contained in these journals have been extensively used except in cases where they tended to be repetitive. Since the corporate form is especially adapted for the operation of huge business organizations, it is noteworthy that many of the principles reviewed here are applicable to large corporations only.

In preparing this thesis the writer kept in mind those who are planning to enter, or to do a serious study of the corporate enterprise. The evaluation was, therefore, made of the most authoritative literature available to enable the interested readers to locate readily valuable information on their particular subjects. Also the writer feels that this study would benefit his further research work in business and his future career in his home country where the corporate enterprise is still in an embryonic stage.

The thesis is divided into seven chapters. Chapter I is an introduction. Chapter II gives a short sketch of the background of the business corporation with attention centered on the relationship between the growth of corporations and the development of our economic society.

Chapter III deals with corporation organization, management and control, including the problems of types of organization, stockholders'
meeting, board of directors, and corporate officers. Chapter IV deals with financing corporation through the use of common stock, preferred stock, bond, and through non-security channels. A brief description of the business policies and practices followed and discussion of their advantages and disadvantages are part of the contents of Chapters III and IV.

Chapter V deals with the quasi-public corporation. The naturally monopolistic characteristic of transportation and other public utilities and their intimate relations with the consuming public have invited extensive public intervention. The main governmental regulations applicable to public utilities have been portrayed in this section of the study.

Chapter VI is devoted to a general discussion of the sociological functions of the business corporation—its responsibilities to the investing public, the employees, the consumers, the suppliers, the community, and the government. This is a problem of rather recent origin, arising chiefly out of the appearance of giant corporations.

Chapter VII presents a resume of the study and sets forth the conclusions drawn from it.
CHAPTER II

HISTORICAL DEVELOPMENT
OF THE BUSINESS CORPORATION

The origin of the corporation is very old. Many writers attribute the honor of inventing these artificial beings to the Romans, and refer their original to the time of Numa. The judgment was that this fictional "legal being" arose on the frequent occasions of crisis when the father of the family died, and his family with his sons, daughters, adopted children, and slaves had to be reorganized in order to perpetuate the property and the civil functions of the members of the family. Originally the corporation was used more for governmental than for business purposes. When towns began to appear they were often incorporated under a charter conferred by the ruler, and were referred to as public corporations. This became very common in the Middle Ages, and even today it is the rule for the states of this country to incorporate a village as a city when its population reaches a certain number. The city is a municipal and public corporation acting under authority granted it by the state. A public corporation is one established for governmental purposes and for the administration of public affairs. A municipal corporation is a public corporation


charged with the city affairs. Some public bodies which have some corporate powers, such as school districts and election districts, are known as quasi corporations.

In the Middle Ages, there were also many guilds incorporated under the charters given by the Crowns of their respective countries. The guilds were not merely business organizations, since they performed certain governmental functions as well.3

Another category of non-profit corporations are ecclesiastical corporations and eleemosynary corporations. An ecclesiastical corporation is one organized for religious purposes, such as churches. An eleemosynary corporation is one organized for charitable or benevolent purposes, such as hospitals and universities.

Since the writer's interest lies in the rise of the corporation as a business organization rather than as a non-profit organization, no further attention is to be devoted to the latter type. The various types of non-profit corporations are not germane to the underlying purposes of this study.

Much of the history of the business corporation coincides with that of the chartered joint stock company. The joint stock company is an association of capital. It facilitates the raising of large capital funds to be administered by appointed or elected officers for the development of some branch of production, trade, or finance. The

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may be a foreigner, a minor, or a woman, and the sources from which capital may be drawn are thus immensely expanded. Also capitalists of every class are willing to contribute to the undertaking because of the peculiar safeguards which this form of association offers to them. In the first place, although the investment is permanent from the standpoint of the company, thus enabling the management to carry out far-sighted plans, and yet it endures only as long as the stockholder pleases from the standpoint of an individual subscriber. The device of transferable shares enable a stockholder to sell his interest whenever he likes, and so change his investment. In the second place, the stockholders have a voice in the management of the company proportionate to their interest in it. They choose the persons to whom they will entrust the active direction of affairs. The managing directors must produce periodical reports for the stockholders, and are subject to removal from office by the stockholders whenever their conduct proves unsatisfactory.

While the origin of the joint stock company is commonly placed in the trading companies in England in the early seventeenth century, there is the assertion, however, that the first joint stock company was formed much earlier. Melvin M. Knight pointed out that:

The actual transition to a stock company occurred in Genoa, in the fourteenth century. The Genoese Government had incurred a debt in connection with the conquest of Chios and Phocaea, sources of alum (used in dying) and gum mastic (for dyes and varnishes). There being no immediately available revenue to assign to the furnishers of the funds for conquest, the alum and other works themselves were turned over to be exploited for twenty years. The debt was divided into shares. The State being still unable to fund the debt at the expiration of the
period, the alum company was left in possession of the property, represented by transferable shares. A century later the company was bought by the Bank of Saint George, of Genoa. 5

In England the corporate idea emerged very early in the form of boroughs and trading associations. As such, corporations had definite governmental functions; in accordance with prevailing governmental practices, they derived their revenues from special privileges, such as the monopoly of some branch of trade. After the beginning of the seventeenth century, the use of the corporate device as a means of promoting overseas expansion rose very fast, and charters granted by special acts of incorporation multiplied. The great trading companies of this period were designed for that purpose.

Accompanying the development of the joint stock idea was the rise of speculation. The speculation in stock resulting from overseas expansion culminated in the fiasco of the South Sea Company in England in which investors and speculators were ruined in large numbers. 6 This led to the enactment of the Bubble Act of 1720. This legislation was designed to curb severely incorporation for business purposes and the use of transferable stock. For the following hundred years, the use of the legally recognized corporate device as a means of conducting business developed very slowly, while its employment as an agency of government was gradually disappearing. 7

5 Melvin M. Knight, Economic History of Europe to the Middle Ages (Boston: Houghton Mifflin Company, 1926), p. 123.


7 Tippets, op. cit., p. 104.
The joint stock form of business organization has not been used in the United States as widely as in the Europe. The express companies are the chief examples of this type of organization in this country. The reasons probably are that because of their interstate and inter-territory business they avoided thereby possible legal difficulties, and that, at the same time, in most states they enjoyed partnership privileges and were free from the heavy tax burdens and severe regulations to which the corporations were subject. Even today the shares of the Adams Express Company are bought and sold on stock exchanges in the same way as that of a corporation. Generally speaking, however, the business corporation has almost completely replaced the joint stock form of business organization in America at the present time.

One of the distinct features of the joint stock company is the permanence of its capital. This idea developed in the early trading companies. Two illustrations may be cited to evidence this fact.

On December 31, 1600, under a charter granted by Queen Elizabeth, "The Company of Merchants of London trading into the East Indies"—more commonly known as "The English East India Company"—was formed on the ground that the Indian Ocean was too remote to be visited by a flock of regulated individual merchants and must be approached by a

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9 Tippets, op. cit., p. 106.

10 Bonneville, loc. cit.
joint and united association." The names of 220 people appeared in this document. But the capital of this company did not become a permanent fund immediately. Originally each voyage was financed by separate contributions from those members who felt disposed to participate. When the ships came home and the accounts were made up, the contributors could get back their capital, plus whatever profit had been made thereon.

This method produced confusion in bookkeeping. The accounts of one journey had not been wound up when the next one left, the ships might not even be back, and investors were therefore invited to allow what was going to come to them from the last trip to be invested in the next one or even the next one. For a long time, also, the Company had to contend with the hostility of the powerful Dutch. Its life was precarious, and some single trips were again financed. Yet the need for defense of the trade called for the sinking of money in forts and other protective equipment, and, therefore, the sponsors could not get back their contributions in the time that they expected.

In 1657 the Company promised that at the end of the following seven years the assets of the company would be valued, and that any member could withdraw his shares at that time if he so desired. During the seven years some good dividends were paid. And when the term of the seven years expired, the assets of the Company had become so valuable that few stockholders wished to withdraw. Thus the Company got

its permanent capital; stockholders henceforth received dividends only. Also, because of the optimistic prospects of the Company, those who wished to sell their shares had no difficulty in finding buyers.12

Like the English East India Company, the principle of permanent capital did not take its full shapes in the Dutch East India Company overnight. To avoid competition among themselves, the Dutch government amalgamated all Dutch enterprises which were engaged in overseas business in the East to form an United East India Company, with a charter granted by the State-General for twenty-one years, but periodically renewed. The Company was given a monopoly of Dutch oriental trade, with sovereign power to make peace and war, form colonies, build forts, maintain an army and navy, and do whatever seemed necessary for the expansion of its power and profits. That extension was effected by a combination of trading, fighting, and establishing control over native peoples. It established trading stations at various points on the Asiatic coast and in South Africa, and founded the mainstay of its power in the islands of the Malay archipelago, especially in the small group of spice islands and in Java. Here it broke the power of the Portuguese. The headquarters of the Company were at Jakatra, not far from Bantam where the Company built a city called Batavia.13 The capital was provided by groups in six towns or provinces. Each of these six "chambers" had


13 Gibbins, op. cit. pp. 111-112.
its own directors. They equipped their own ships, supplied their own cargoes, and received their own goods from the Orient. The central body exercised only general control. According to the charter, each investor was entitled to withdraw his investment from the Company at the expiration of each decade. At the end of the first decade, however, the directors repudiated this provision. Like the case of the English East India Company, the directors of Dutch East India Company pointed out that part of the funds had been sunk in forts, ships, and arms, and could not be reconverted into cash. They suggested that dissatisfied stockholders get back their investment by selling their shares, since there were plenty of people eager to buy them. Henceforth, the capital of the Company became permanent.14

The early trading companies were governmental as well as commercial companies. In addition to rich merchants, their membership included noblemen of high rank, gentlemen, and governmental officials. Thus the London Company was composed of 659 persons, including 21 peers, 96 knights, 58 gentlemen, 110 merchants, and 282 citizens.15 In actuality, these companies were the colonizing agencies of their respective governments for two and one-half centuries following 1600. They enjoyed a greater or lesser degree of complete sovereignty in the region specified in the charter. Illustrative of the exercise of powers conferred upon them, these trading companies made the laws, built forts,

14 Heaton, loc. cit.

coined money, selected officials, regulated business, and maintained an army and navy. On the other hand, they were by no means self-controlled and independent companies; they were dependent on their respective governments for many rights and privileges, and for constant support, protection, and subsidy. In return these companies were expected not only to develop a profitable trade, but also to furnish certain advantages to the nation, such as the creation of colonies, the increasing of shipping, the provision of materials for military purposes, the humiliation of political rivals, and the preservation of a favorable balance of international trade. The chartered trading companies stood, therefore, midway between unregulated individual trading firms in which the government took no interest, and the complete organization and control of trade by the government.

Some seventy companies of this kind were chartered by England, France, Holland, Sweden, and Denmark before 1700. By 1588 England alone had chartered six: Russia, Cathay, Eastland, Levant, Morocco, and African (first). Not all these companies existed at the same time, nor was the membership of an individual necessarily limited to but one company. For example, 116 members of the Virginia Company were members of the English East India, 13 of the Russia, 46 of Bermuda, and 38 of the New England companies.


17 Carman, loc. cit.
These companies sought their fortunes in the Eastern Hemisphere as well as in the Western Hemisphere, and succeeded to a great extent in both areas. In the East, the English East India Company, the Dutch East India Company, the French East India Company, and others established a chain of footholds and colonies in Africa and in South Asia. Many of such colonies have since declared and won their independence. In peopling colonial America, the Virginia Company of England, the Dutch West India Company, and the French Company of One Hundred Associates of New France played a leading role. In performing their functions as the colonizing agents, these companies furnished the money and leadership necessary for transferring emigrants from the Old to the New world. Those colonies which they established subsequently became parts of the United States, or Canada. For example, Virginia was founded by the London Company in 1607; New Netherland by the Dutch West India Company in 1621; Massachusetts by the Massachusetts Bay Company in 1630. The work of the Company of One Hundred Associates of New France was primarily centered in Quebec, Nova Scotia, and Newfoundland.

19 Ibid., p. 100.
20 Ibid., pp. 102, 106.
21 Cheyney, op. cit., p. 147.
22 Carman, op. cit., p. 44.
As noted previously, the joint stock idea was first conceived in the early chartered trading companies. This embryonic type of corporation was found to be inadequate later. The radical change of the economic system after the industrial revolution warranted a further development and more extensive application of the corporate form of business organization. If, however, the success of a corporate system is to be assured, several things are needed: the legislation must facilitate the formation of corporations and clearly define their rights and obligations; the supply of capital must be plentiful; the investing habits among the owners or controllers of that capital must have been developed; and there must be a market in which new and old securities can be sold.

Originally, no country allowed a joint stock company to be created easily or cheaply, a special act of parliament was generally required. When a specific need arose, parliament was willing to take action; the canal promoters procured the special acts of the parliament, so did the turnpike trust, dock makers, insurance firms, and later the railroad builders; but there was no open road for general businessmen and manufacturers. Yet the rapid growth in manufacturing and the increased size of business taking place since the turn of the nineteenth century led to a recognition of the necessity of adjusting the laws to the new situation. As a consequence, legislation for the easy formation of corporations appeared, and thus was laid the foundation for present day business corporation laws. The need for the corporate device was met gradually. In 1844, the Parliament of England passed a
general incorporation law, definitely distinguishing the business corporation from the unincorporated enterprise. In 1856 the principle of limited liability was made a matter of general right of corporations. Corporation law took its full shape in 1862 when the laws allowed a corporation to be established by handing the state a "memorandum of association," signed by seven persons and giving the name, purposes, directors, and nominal capital of the firm. The corporation must also file its "article of association" with the authorities when it had raised enough money to start business. Thus the liability of stockholders of the corporation was limited to the par amount of the shares which they held. To provide the creditors and the investing public a safeguard, the authorities required the corporate management to supply it annually with a statement bearing the capital, stockholders, and directors of the corporation. The corporate management was also charged with the responsibility to publish each year a properly audited balance sheet. Moreover, the word "Limited" must be added at the end of the corporate name to tell the public the liability limit of the corporation. The mode of the general corporation laws of England spread rapidly over the rest of Europe. France moved in the same direction in 1867, and Germany in 1870. Because the secrecy of business was essential to successful competition, it was the general practice of the corporations of these countries not to include every detail in the reports for publicity.

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24 Heaton, op. cit., p. 573.
After 1892, both Britain and Germany allowed a corporation, subject to the restriction that its securities could not be sold on the stock exchanges, to be composed of less than fifty persons; but since it was thus debarred from appealing to the public for funds, it need not file and publish an annual balance sheet. It was from this time that many single-family corporations and closed corporations made their appearance, as a large number of family firms and partnerships promptly took advantage of the limited liability provisions by reorganizing their enterprises as corporations.

The spread of corporate formation depends not only on the state of laws, but also on the supply of capital available, the willingness of the owners of that capital to invest it, as well as the development of security markets to bring investors and investments together. In Britain, around the beginning of the nineteenth century, there were about four thousand widely-dispersed holders of East India Company stocks. The Bank of England's stocks were owned by an army of about two thousand investors; a sixth of them were Dutchmen, over one hundred lived in other European countries; half were Londoners, the rest included colleges, banks and individuals in most parts of the British Isles, and the percentage of widows and spinisters was particularly high. Meanwhile the stocks of the canal corporations had their boom markets in the areas that were to be served. In the early history of modern

25 Ibid., p. 574.

26 Ibid.
business corporations, the railroad corporations had contributed greatly in cultivating the investing habits of the public. The offered wares to suit all kinds of buyers—bonds for the timid, preferred and guaranteed dividend stocks for the cautious, and common stocks for the venturesome; and there was always the prospect that a corporation born in boom times might prove so profitable that its stocks would rise to fantastic high prices. Newspaper advertisement, public meetings, and other means were used to make the public stock conscious. There were quite a few stock exchanges dealing in railroad securities. Banks also helped to put the railroad securities on the market. Thus the railroad booms broke the crust of investment habits and opened up mass investment. All of these facts emphasize that, in the nineteenth century, the momentum of the rise of corporations in England was not merely the result of favorable legislation but was strongly influenced by the growth of the supply of capital and by the development of investing habits as well.

In other countries as well as in Britain, the limited liability feature invited abuse. Alongside corporations which gathered capital together for production and transportation were those formed to benefit promoters of new corporations and liquidators of bankrupt corporations at the expense of both creditors and investors. Every new wave of investment opportunity arising out of the new industries or new markets rose to a crest of overoptimism, speculation, and promotion for promotion's sake.

It is very interesting to note that the public interest shifts according to the stage of development of an industry. After the rush to
purchase the securities of railroads in Britain, the public turned their attention to the railroads in the United States, Canada, and South America; and then, in chronological order, to the finance corporations, hotels, coal and iron, skating rinks, gold mines, banks, electricity, bicycles, automobiles, rubber, rayon, electronics, and holding companies. Possibly the public interest will shift to the atomic energy plants and space traveling some day.

As noted previously, the general incorporation laws came later on the European continent than in Britain. Also the popularity of the limited liability corporation on the European continent lagged behind. Capital there was less abundant and more shy, and its provision had, therefore, to be undertaken by banks which devoted most or all of their attention to the flotation and financing of corporations.

Corporations in America go back as far as the Colonial period. The first commercial corporation was the New York Fishing Company, which was chartered on January 8, 1675 by the Governor and Council of New York acting for the Duke of York. Shares of the capital stock were one pound each.27 But the first corporation formed after the Colonies gained their independence was the Bank of North America. The Bank of North America was chartered in 1781 by Congress and later rechartered by the state of Pennsylvania. It was the first modern bank in the United States, had a capital fixed at $160,000 in May, 1781, and this

was increased to $4,000,000 on the last day of the same year to supply the government with money. 28 Most of the earliest corporations in this country were bank, turnpike, or canal corporations, followed by insurance corporations and a few general business corporations and railroads. Up to 1800, 335 corporate charters had been issued, of which 295 were obtained in the last ten years of the eighteenth century. Of the total, 219 were for highway corporations, 36 provided public services, 67 were for banking and insurance, and only 13 were for manufacturing, mining, agricultural, land and other general business corporations. 29

As the number of applications for corporation charters grew, the states began to pass general incorporation laws so that it was no longer necessary to enact a special statute for each and every charter. This movement was initiated by the state of New York which passed its general incorporation laws in 1811. Other states followed in the course of the first half of the nineteenth century. By the end of the Civil War, the corporation with its limitation on liability had become firmly established as the prime vehicle of modern, large-scale business enterprises. 30

Along with this, there developed the right of one corporation to own the stock of another. New Jersey, in 1889, passed the first

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general incorporation laws which allowed corporations to be formed for
the sole purpose of owning the stocks of other operating corporations.\footnote{Clair Wilcox, Public Policies Toward Business (revision edition; Homewood, Illinois: Richard D. Irwin, Inc., 1960), p. 95.}

This laid the legal foundation for the holding company.

One of the most spectacular aspects of the growth of corporations
in modern business in the United States has been the emergence of a
number of gigantic enterprises. At the turn of the current century
the United States Steel Corporation appeared as the first billion-dollar
concern. More important, the position of the United States Steel Cor-
poration, which was challenged by the Federal government under the anti-
trust laws, was sustained by the District Court of New Jersey.\footnote{Carruth, op. cit., pp. 435, 437.}

The Twentieth Century Fund, Inc. found that 594 corporations, each with
assets of $50 million or over, out of the 504,080 corporations in the
United States in 1933, owned more than half of the total assets of all
business corporations. Put in another way, this meant that, in 1933,
95 per cent of the corporations in the United States owned less than
14 per cent of all the corporate assets. In the same year, the same
594 top corporations produced 18.4 per cent of the total national income,
or 20 per cent of the incomes created by profit-seeking agencies.\footnote{Bernheim (ed.), op. cit., pp. 96-99.}

In 1957, about one half of the total assets of manufacturing enterprises
in the United States were held by the 150 largest corporations. When
the finance and transportation industries were included, the concentration of economic power became even more sharp, because many financial corporations held the securities of other corporations. The statistics showed that, in 1957, two-thirds of the non-agricultural productive assets of the United States were owned by the 500 top corporations. But in terms of economic power, without regard to asset positions, not only do the 500 corporations control two-thirds of the non-farm economy, but within these 500 corporations a still much smaller group has, by employment of the pyramidal device of the holding company, the ultimate decision-making power. Indeed, this was a very high concentration of economic power.

Although there has been an enormous growth in size of a few corporations, a great increase in the total number of corporations in existence in this country has taken place at the same time. As already indicated, only 335 corporate charters were issued in the United States up to the year 1800; and down to the Civil War, the corporation was a relatively unimportant form of business organization. Yet the number of the corporations chartered in the United States had reached a total of 533,631 in 1935. There were 536,833 corporations submitting


balance sheets to the Internal Revenue Service in 1948.\textsuperscript{36} In the fiscal year 1956, the number of corporations submitting income tax returns to the Internal Revenue Service was 885,747.\textsuperscript{37} In 1958 alone, 150,268 new corporations had been formed.\textsuperscript{38}

Corporations have grown rapidly both in size and in number during the last hundred years, and have established firmly their dominant position in business today. An even more exciting development of this type of business enterprise seems assured in the years ahead.

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CHAPTER III

CORPORATION ORGANIZATION,
MANAGEMENT, AND CONTROL

Organization is the structural relationship between the various factors in the enterprise. Organization also refers to the personnel or persons filling the various positions in the structural relationships. The problem of the organization of business is as old as organized businesses. However, the critical points in organizational procedures was not reached until the arrival of the period in which rapid replacement of small scale enterprises by the large ones began taking place. Today, such big corporations as General Motors, General Electric, and many of the aircraft industries are divided into some eighty divisions scattered throughout the country. Some of these divisions employ as many as ten thousand men. Each division is a huge business enterprise within itself, and yet all divisions must be brought into coordination and harmony. They must work toward a common purpose and in conformity with the established central policies. In order to comprehend more fully the problem of business organization and management, a distinction must be made between the function of administration and the executive function.

The phase of a business enterprise which concerns itself with the overall determination of major policies and objectives is administration.

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Administration predetermines the specific goals and lays down the broad areas within which the goals are to be achieved. The administration devotes its attention to the relation of the enterprise to the outside world, and modifies the major objectives and basic policies of the corporation if the situations so demand. The administrative function is invariably discharged by the top management, notably the chairman of the board of directors.

The function of the executive is to carry out the administrative policies laid down by the administration. The executive is concerned primarily with internal affairs such as the formulation and execution of operating plans. Based on the administrative policies, the executive develops the most efficient and satisfactory method of manufacturing and marketing the products so as to achieve minimum cost and maximum profit. The executive function, in carrying out the policies of administration, expands as the lower levels are reached, while the administrative function decreases in importance. The relationship between the administrative function and executive function may be illustrated as follows:

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+-----------------+                        +-----------------+
| Administrative  |                        | Top Management   |
| Function        |                        | Level           |
|                 |                        |                 |
+-----------------+                        +-----------------+
| Executive       |                        | Lowest Management|
| Function        |                        | Level           |
|                 |                        |                 |
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Diagram 1

The relative importance of administration and executive at various management levels.

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The types of business organizations generally fall into four classes; the line organization, the functional organization, the line and staff organization, and the committee form of organization. Each of these types has its distinct merits and demerits. The best type of organization for a particular business is one which serves its operation purpose most satisfactorily.

The line organization is also known as military organization and, more recently, as scalar organization. This is the oldest type of business organization. In modern business, the use of line organization is primarily confined in the small and simple enterprises. The underlying feature of line organization is directness of action. The authority and responsibility flow in a direct line from the chief executive officers to the lowest employees. At each successive level, authority and responsibility are alike in kind but more limited in scope than that of the level just above it. Each man has relatively or even exactly the same task to perform. Because it is difficult to find a situation where the nature of the work in various levels are nearly identical, the pure line organization is seldom found in a business of comparatively large size. However, a modified line organization known as departmental line organization has achieved extensive application in modern industry.4

4 Spriegel, op. cit., p. 55.
The departmental line organization divides the enterprise into divisions on the basis of function or process. Each department head runs his division almost as though it were an independent unit; he receives no staff aid from any other division, and reports directly to the supervisor immediately above him.

The distinct advantages of line organization are directness, simplicity, and fixed responsibility. Each member of the organization is clearly aware of the responsibilities with which he is charged and to whom he is responsible. Control is direct, relationship is simple, and responsibility is undivided. The singleness of responsibility makes it easy to appraise the merits and demerits of a person, thereby facilitating discipline. The directness of control makes the line organization capable of adjusting quickly to changing situations. Each executive has sole authority and is in a position to take the needed action in his division without waiting for advice from someone over whom he has no control. Moreover, the line organization facilitates the development of all-round executives at the higher levels of authority. The line organizations requires the executives to perform functions of a comprehensive nature. This arrangement provides the enterprise with trained men to fill the higher position when they are vacated by retirement, death, or resignation.

On the other hand, there are some disadvantages inherent to the line organization. In the first place, this type of organization relies excessively on the executives. This results in overloading the executives with work and overemphasizing their importance to the business.
The details of operations usually consume most of executives' energies, and thus deprive the organization of constructive development that is the product of reflective thinking. In the second place, this type of organization neglects the value of coordination, cooperation, and specialization. As noted previously, the line organization does not develop large scale cooperation; each division head runs his division as it were an independent unit. He neither gives assistance to, nor receives advice from executives of any other division. Within a division, the executives of every level discharge their responsibilities without the aid of special staff members. Thus the enterprise is deprived of the benefits of coordination, cooperation, as well as specialization, and tends to decline in efficiency.

The functional organization was developed by Mr. Frederick Winslow Taylor. Mr. Taylor, the father of scientific management, in his attempt to improve the production methods when he worked at The Midvale Steel Company in 1880's, recognized that greater efficiency could be gained by segregating mental and manual operations, and by making each employee a specialist in performing his assigned task. His plan was to replace an all-round line executive and foreman by several specialized foremen and clerks having equal authority. Each specialized foreman and clerk dealt with the workmen in respect to but one aspect of the work. The foremen and clerks were, in turn, responsible to the manufacturing superintendent. Thus the manufacturing superintendent

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discharged his responsibility in the following manner: (1) by dividing his function into several sub-functions; (2) by assigning each sub-function to a specialized foreman or clerk; and (3) by having each foreman or clerk performing the assigned function and report to the manufacturing superintendent. Taylor's specialization concept applied to the workers as well as the supervisors. Like the specialized foreman or clerk, a worker was expected to do a small part of the job only.

The major advantage of Taylor's functional organization lies in specialization. Both the workers and supervisors can develop a high degree of proficiency, and thus increase their efficiency. Specialized skills and abilities are made available to the individual worker and supervisor so the need for all-round employees is minimized. This makes it possible to train a worker or supervisor for his specialized task within a relatively short period of time, and to use less expensive workers and supervisors than is generally required by the line organization. Accompanying the division of functions are the promotion of cooperation and the elimination of one-man control.

The weak points of functional organization are a reversal of the strong points of the line organization. To be specific, as a result of the division of responsibility in functional organization, the discipline tends to break down among the workers, and even among the supervisors at the lower levels; the ability to take prompt action to meet a changing situation tends to be hampered; and the development of all-round personnel tends to be more difficult.

The line and staff organization combines the characteristics of the line organization with those of the functional type of organization.
to preserve their advantages, and to get rid of their disadvantages.6

The basic concept of this type of organization is the taking advantage of specialization without hampering the effectiveness of control. In the line and staff organization, the staff men are attached to the line of every level to assist the line officers in discharging their responsibility. Because each staff officer concentrates on a small part of the line officer's assignment, the benefits of specialization and a high degree of proficiency may be achieved. Because the staff officers perform only advisory, coordinating, and service functions for the line officers, the merit of direct control which exists in a pure line organization can be maintained, too. Occasionally, a measure of control may be delegated to the staff officers, but in such cases, it is exercised in the name of and on behalf of the line officers; the control channel is not thereby disturbed.

By the addition of the staff to the line, the flexibility of an organization is improved. Likewise cooperation is promoted and specialization is fostered. New activities may be undertaken without disturbing the line procedure. On the one hand, the line officers are strengthened by having a staff under their command to advise them; on the other hand, the line officers are relieved from the planning, investigative, and other detailed functions, and thus are able to concentrate on the executive function. Moreover, frequently the staff officers are delegated by the line officers to correlate inter-departmental relationships,

6 Spiegel, op. cit., p. 557.
thereby improving inter-departmental coordination and cooperation.

The disadvantages of line and staff organization arise largely from the fact that an appreciation of structural relationships in an organization is difficult for most people. The functions of line and staff officers are frequently confused. On the part of line officers, they may rely too much on their staff and thus weaken the line officers in the performance of their regular duties. In another instance, the line officers may so dominate their staff as to reduce them to positions of unimportance. On the part of staff officers, the psychology that they are not directly responsible for the success or failure of the operation may lead them to give advice carelessly. Conversely, some staff officers may usurp line responsibility and thus disturb the unity of command. Again, sometimes the borderline functions provide both the line and staff officers with an alibi for their own failures.

In spite of these disadvantages, the line and staff organization is the type of organization most commonly used in modern business. Two reasons have led to this tendency. First, obviously the merits of the line and staff organization outweigh its demerits to a great extent. Second, as cited previously, the disadvantages of line and staff organization arise primarily out of the lack of adequate knowledge by executive and staff officers of their basic relationships. This may be overcome by careful training and appropriate indoctrination of the executive and staff personnel in the principles of organization.

The committee type of organization is a form of organization in which the decision is made by a committee consisting of the representa-
tives from various departments and, in some cases, from various levels. The committee type of organization in its pure form is almost unheard of today. The inherent weaknesses of the committee form, such as the slowness in taking action and the tendency to shift responsibility among its members, make it impracticable to allow an enterprise to be administered solely by a committee. The committee, as an instrument of executive management, is notoriously weak in that it lacks initiative. With a small fraction of authority, the individual member of the committee is unwilling as well as unable to take any initiative. Another weakness of the committee form of organization is that the heads of various departments are frequently tied up with time consuming meetings, thus being prevented from concentrating on the departmental affairs to which they might contribute more effectively.

The committee form of organization has considerable value when it is properly conceived, constituted, and led. The outstanding advantages of the committee form are coordination and harmony. Problems and opinions of every department and of every level of the organization may be presented to the committee by their respective representatives. Through full discussion, proper coordination, and a careful consideration of all angles of the situation, the committee is able to formulate a policy based on broad view. To this point, however, it may be argued that usually the decision reached in a committee is based on a compromise among the various interests, not on the facts of the situation. Internal agreement is therefore secured at the expense of the interest of the business as a whole. As a result, the harmony among various departments
may be a catastrophe rather than a fortune of the enterprise. Another advantage of the committee form of organization is primarily a psychological one. Because the members of the committee, usually the heads of various departments, have a voice in determining the policy, there is a personal obligation for them to make the program a success.

The ultimate control of a corporation rests with the stockholders while the actual formulation of basic policies and the daily conduct of business affairs are the duties imposed upon its directors and officers.7

The stockholders exercise their power of control indirectly. They control the business activities of the corporation by selecting the directors and thus indirectly determine the policies to be followed. The direct management functions of the corporation are conducted by a small group of executive officers and the board of directors.

Actions by stockholders must be taken at a regular or special meeting of stockholders; otherwise, such actions have no legal effect unless the consent of all stockholders is obtained.

Regular meetings are primarily called for the election of directors and for the transaction of other regular business. However, any business, other than such matters as the laws provide otherwise, may be transacted at regular meetings. In fact, management of large corporations usually do plan to cover at the regular meeting all ques-

tions on which stockholder approval is required so as to avoid the expense of calling special meetings. The regular meetings must be held at regular intervals, usually once a year, as prescribed in the corporate charter or corporate by-laws. Unless the by-laws provide otherwise, no notice to stockholders of such meetings is required, but it is normally given as a matter of good business practice.

Special meetings are generally called by the board of directors. It is sometimes provided in the by-laws that a special meeting may be called by a certain percentage of the stockholders. The purpose of this alternative is to prevent a board of directors from ruling the corporation with an iron hand. Notice of the day, hour, and the place of a special meeting must be given to all stockholders. The notice must also include a statement of the nature of the business to be transacted, and no other business may be transacted unless all the stockholders entitled to vote are present or represented by proxy, and unless all of them consent to the transaction of such business. Business transactions that can be conducted only at special meetings generally fall into two categories. One category pertains to such matters as requiring an amendment of the certificate of corporation, such as a change of corporate name, a change in the purposes of the corporation, a change in the number and tenure of the directors, a change in the amount of capital or shares of capital stock, and a change in the method of voting. The other category pertains to actions that affect the interests of all stockholders at one time, such as dissolution, or consolidation with another corporation.
Stockholders' meetings are usually held at the premises of the home office. The place of holding regular meetings may be specified in the charter or by-laws, or it may be left in the hands of the board of directors. In the latter case, notice of the place of holding a specific regular meeting must be given to all stockholders. A meeting improperly held as to place is binding on those who assent to it. In regard to the place of holding stockholders' meetings, some state statutes provide that all stockholders' meetings must be held inside the state of its creation, other state statutes require only the first meeting to be held in the home state.

At any meeting of stockholders a quorum must be present. Different quorums for various meetings are generally provided for by state statutes, corporate charter, or corporate by-laws. The quorum for special meetings are frequently set higher than those for regular meetings. Usually it is held that when a meeting opens with a quorum, the quorum is not thereafter broken if stockholders leave the meeting, even though those remaining would not have been sufficient to constitute a quorum originally. As a rule, no quorum is necessary at special or adjourned meetings held to elect directors who could not be chosen at the appropriate regular meetings.

There are several voting methods employed in stockholders' meetings. Ordinarily only those common stockholders whose names appear on the books of the corporation for a specified period of time before the meeting are entitled to vote.\textsuperscript{8} The preferred stockholders are

\footnotesize{\textsuperscript{8} Uniform Business Corporation Act, Section 28 (1).}
given contingent voting rights only—the right to vote under designated circumstances, such as a specified number of years having passed without dividend payments.9

In principle, stockholders are entitled to one vote for each voting share of stock. However, in order to protect small stockholders, some state statutes limit the number of votes allowed to each stockholder. In such situations, large stockholders are not given votes in proportion to the voting shares of stock that they own. On the other hand, a stockholder is not entitled to vote a fractional share.

To assure holders of comparatively small amounts of stock at least some representation on the board of directors, some statutes authorize the use of the cumulative voting method in the election of directors10 to replace the straight ballot plan. When the straight ballot plan is used in electing the directors, each vacancy is filled separately.11 Under the cumulative voting scheme, however, each stockholder has as many votes as the number of shares he owns multiplied by the number of directors to be elected, and he can distribute these votes as he sees fit.

When cumulative voting is used, a minority group can determine by means of the formula given below how many directors they can hope


10 Uniform Business Corporation Act, Section 28 (3).

11 Stockder, op. cit., p. 172.
to elect by judiciously voting a given number of shares of stock. They can also determine how many additional shares of stock they will need to control in order to elect a given number of directors.\textsuperscript{12}

\[ X = \frac{ac}{b + 1} + 1 \]

In this formula:
- \(a\) = Total number of voting shares of stock participating in the election.
- \(b\) = Total number of directors to be elected.
- \(c\) = The number of directors that the particular group wishes to elect.
- \(X\) = The number of shares of stock necessary to elect \(c\) out of \(b\) directors.

Another tactic employed in the stockholders' voting is termed voting by proxy. Proxy voting permits the stockholder to have another person represent him at the meeting of stockholders and to vote his stock for him. The person who acts for the absentee is called the proxy.\textsuperscript{13} In the absence of a provision to the contrary, any person may act as a proxy. In practice, however, the directors designate a proxy committee, or name a "dependable" person as the voter of proxies at the stockholders' meetings. The names of these persons who make up


\textsuperscript{13} Bonneville, \textit{op. cit.}, p. 79.
the proxy committee are printed on the so-called official proxy that is sent out to all stockholders. The stockholders are first asked to sign a blank proxy and return it to the management. The next step of management is to name a proxy committee to vote for the director nominees whom management itself has nominated. Thus management is able to control both the selection and election of directors; and, because of the apathy of stockholders, vested management composed of an entrenched minority succeeds in perpetuating itself in control.

In some cases the dissident stockholders have succeeded in getting control of a corporation through their own campaigns for proxies. But these are exceptions rather than an usual outcome of proxy fights. The expense involved in soliciting proxies usually constitutes a major deterrent to the organization of an opposition group as the dissident group must pay all such expenses. The expense of soliciting proxies on behalf of the management is borne by the corporation.

The Securities and Exchange Act of 1934 has prevented the abusive use of proxies to a great extent. The Act provides that those corporations whose securities are listed on registered exchanges must follow the rules of the Securities and Exchange Commission governing solicitation of proxies, such as that a written proxy statement must be furnished to each stockholder whose proxy is being solicited. Another rule provides that a periodical report showing the financial position and operations of the corporation must be enclosed with the written proxy statement if the proxy is solicited on behalf of management, and if it is related to a regular meeting at which the election of directors
will be held.\textsuperscript{14}

Generally the stockholders are allowed to enter into an agreement by which they concentrate their voting strength for the purpose of controlling the management, unless their agreement is fraudulent or oppressive as to other members. By agreement a group of stockholders, or all of the stockholders, may transfer their shares in trust to one or more persons called trustees, and thus form a voting trust. The trustees issue trustee certificates which represent the number of shares deposited by them to the stockholders entering the trust arrangement. Thereafter, the trustees are entitled to vote the stock for the stockholder until the expiration of trust agreement.\textsuperscript{15}

In order to enable each stockholder to maintain his equity in the surpluses of the corporation as well as his relative voice in control of the enterprise, each stockholder must be permitted to subscribe to new issues of common stock in proportion to their holding before the new shares may be offered to the investing public. Such priority right is termed pre-emptive right.\textsuperscript{16}

The dispersion and frequent transfer of stock ownership as well as the general apathy of stockholders make it virtually impossible for a


\textsuperscript{15} Stockder, \textit{op. cit.}, p. 175.

corporation to unite control with ownership. It is through the exercise of authority and power vested in the board of directors that the business corporation becomes a live entrepreneurial organization. The function of the board of directors is to manage the corporation and to direct its operation within the scope authorized by the stockholders and prescribed in the by-laws. This management function, coupled with custodianship of the property of the corporation, places the members of the board of directors in a position of trustees of the corporation; and, as such, they may have no interests adverse to those of their corporation. But the directors are not responsible for losses resulting from their management when they have acted in good faith and with due diligence, and have exercised reasonable care.

Some corporation laws provide that any person, including those who are not stockholders, is eligible for membership of the board of directors. This aims at wider election of capable men to the board of directors. Generally, however, it is required that all or some of the directors must be stockholders. The logic is that only those who have an ownership interest in the corporation can be expected to transact the corporate business earnestly and honestly. Moreover, Section 8 of the Clayton Act prohibits, among other things, any person from being at the same time a director in any two or more corporations, any one of which has a capital, surplus, and undivided profits aggregating more than $1 million, where the corporations are or heretofore have

17 Uniform Business Corporation Act, Section 31 (1).
been competitors to the extent that the elimination of competition by agreement among them will constitute a violation of antitrust laws.

Like the legislative actions of stockholders, legal corporate actions by directors can be taken only at proper meetings; unlike stockholders, directors are not allowed to vote by proxy. The meetings of boards of directors are also classified as regular meetings and special meetings. Regular meetings meet at certain intervals as prescribed in the by-laws. Special meetings are called from time to time as the needs arise. Unless the state statutes, the corporate charter, or the corporate by-laws provide otherwise, the meetings of the board of directors may be held outside the state. Directors who attend without objection meetings held at places other than that specified in the by-laws are bound to the decisions made at those meetings.

A majority of directors must attend the meetings in order to constitute a quorum; however, this requirement may be modified by the charter or by-laws unless the state statutes provide otherwise. In the determination of whether a quorum has been present, a director who has a personal interest in the matter before the board cannot be counted.

Usually the board of directors elects from its own membership the board chairman and the members of various committees. It is the duty of the board chairman to call and preside at the meetings of the

board of directors. The chairman is not only influential in the board of directors meetings, but frequently he also exercises a very important control over the entire corporation, especially in policies involving outside relations.

The number and kinds of committees employed by corporation vary according to the needs of the corporation. The most commonly used committees are the executive committee, the finance committee, and the proxy committee. The executive committee devotes its attention to the day-to-day management and to the formulation of general policies of the corporation. The finance committee is in charge of all financial operations of the corporation. The complexity of financial operations and their important effect on the welfare of the enterprise in general increases immensely the importance of this committee. The proxy committee, as previously noted, is a device for effecting corporation control. Some students of corporate enterprise have even stigmatized the proxy committee as an organism designed for concentration of power. It is noteworthy here, however, that the proxy committee is not necessarily composed of members of the board of directors, although usually it is.

The function of the corporate officers is primarily that of internal management. They are at one and the same time the agents of the board of directors and of the corporation. Generally they are directly responsible to the board of directors for all official actions and are absolutely controlled by the board. The board of directors appoints and removes the officers of the corporation and also controls them during their incumbency.\(^1\) The officers are liable for secret

profits made in connection with the business of the corporation. They are also liable for willful or negligent acts that cause losses to the corporation. On the other hand, if they have acted with reasonable prudence and skill, they are not liable for mere errors in judgment committed while exercising their discretion.

The officers are elected with a view to meeting the specific requirement of the corporation. Definite standard and criteria for the selection of corporate officers have not been established.

Every corporation has a president as its chief executive. He is responsible for supervising various departments, for preparing periodical reports on the corporation's affairs for the directors and the stockholders, and for other phases of internal management and operations. In large corporations, it is frequently found to be desirable to supply the president with one or more vice-presidents who may serve as his immediate assistants. The number of vice-presidents depends on the actual needs. When the vice-presidents are more than one, they may be officially designated by number, such as "first," "second," and "third," etc.; or by the duties of which they are in charge, such as "in charge of production," "in charge of finance," and "in charge of personnel," etc.

The president is held responsible to the board of directors for his official actions. He acts as the chairman instructs. He confines his activities to those corporate matters of internal nature. The relative spheres of activity of the chairman and of the president of a corporation are shown in the following diagram:
Diagram 2

Relative Lines of Activity of Chairman and President of Corporation

Large circle represents the corporation. Chairman supervises policies involving outside relations; President supervises internal management, and is in a position subordinate to the chairman.20

The treasurer, the comptroller, and the auditor make up the financial organism of a corporation. The treasurer is the custodian of the corporate funds, securities, and other valuable financial documents. He serves as the responsible agent of corporation in the disbursement of funds. He also participates in the execution of notes, checks and bonds.

The comptroller is the head of the accounting department. He supervises the bookkeeping and is responsible for the analysis and interpretation of the operational results. He is also in charge of tax matters and of preparing the annual budget.

The auditor examines the books of account to determine whether the funds have been properly used and handled. Audits may be made annually, semiannually, quarterly, or at other regular intervals. Special audits may also be made when the needs so arise. In Europe the auditing must be done by an independent auditor who is usually a government official.²¹ In this country the large corporations provide for the auditing to be done by a regular corporate officer entitled auditor. Small corporations employ certified public accountants to do their auditing. Both large and small corporations usually hire independent auditing firms to audit the work of their corporation auditors and/or accountants at least once a year.

The secretary usually serves as the secretary of the board of directors as well as the general secretary of the corporation, and the recording secretary at all meetings of stockholders. He has custody of the corporate seal, and it is his responsibility to affix the seal to all documents requiring the official signature of the corporation. The secretary is also required to preserve the certified copy of the charter of the corporation and to keep separate and distinct records,

²¹ Stockler, op. cit., p. 195.
such as the minute books, subscription list, stock certificate book, stock ledger and transfer books, and the dividend book.

The ever-increasing complexity of the legal aspects of tax and labor problems, and other business affairs has kept corporations constantly in need of legal advice to guide them through the labyrinth of laws. Most large corporations consequently include a counsel as one of their regular officers. The small corporations usually do without an official counsel, but retain an attorney to advise them as the needs arise.
CHAPTER IV

CORPORATION FINANCE

From the business finance point of view, the distinct advantage of the corporate form of business enterprise lies in its facility of financing through security markets. This does not, however, deter a corporation from using bank loans, credit purchases, sale of commercial paper, and other financing means which are used by other types of business organizations. Actually, financing through non-security channels is as important as financing through security markets in the corporate enterprises. The intelligent corporate management always makes an alternative use of various financing means to achieve the lowest financial cost.

The corporation is the most effective type of enterprise for combining individual contributions of funds into one massive capital structure. It may appeal for funds to people of every class and every place. A contribution may be quite large or it may be very small. The contributor may be a foreigner or he may be a local resident. These features are made possible by the device of transferable shares, and by the existence of security exchanges and their supporting machinery.1

Stocks and bonds are the two basic types of corporate securities. Stocks are the evidence of ownership; bonds the evidence of debt.2

Common stock and preferred stock are the two main categories of ownership type securities. Bonds may be subclassified in a variety of ways, depending on the criteria of classification used, such as purposes of issuance, duration of the period, and the manner of paying the principal and interest.

Common stock constitute the residual equity capital of a corporation. It is usually used to designate that stock which possesses the attributes of full ownership interest in the corporation's affairs. Common stock is the essential corporate security; a corporation cannot come into existence without common stock, and furthermore, a successful corporation may find it unnecessary to sell anything but common stock to investors. The common stockholder is an owner, a sharer of risks, and his fortune rises and falls with those of the corporation. Dividends need only be paid at the discretion of the board of directors, and there is little danger that the common stockholders will interfere in corporate affairs except by electing new directors.³

The preferred stock designates a class of stock that has some preference over common stock of the same corporation in enjoying the privileges of ownership. The chief preference is the right to stand first in line when dividends are passed out; preferred stock holders receive dividends up to a stipulated amount in each dividend period before the common stock holders get a dividend. Another preference is that of

sharing first in the assets in the case of dissolution of the corporation.\textsuperscript{4} It must be clear, however, that these preferences are also the limitations in that, unless the corporate charter or bylaws provide otherwise, no more than the stated rate of dividend would be paid in case of marked corporate success of operations, nor more than the par value of the shares would be given in the dissolution of a very successful corporate enterprise which might have piled up a very large surplus from earnings. Indeed, the preferred stocks are a limited-income type of security.\textsuperscript{5} Furthermore, the preferred stockholders are, with the exception of a few circumstances as specified in the charter or bylaws of the corporation, generally removed from voting power. Also, the preferred stocks are often subject to redemption by the corporation when their market prices go too high. In all of these respects, the preferred stock is more like a bond rather than a common stock, and yet before the law, preferred stock is an ownership security, and the preferred stockholders are thus deprived of the legal rights to which a creditor is entitled.

In fact, preferred stocks are a hybrid having many of the limiting features of bonds, yet without the legal standing of bonds.\textsuperscript{6} The preferred stockholder possesses many of the claims of the bondholder, but he lacks the legal superiority and primacy of the latter. In recognition of the fact that preferred stocks are associated with the disadvantages of common stocks and bonds,


\textsuperscript{5} Sauvain, op. cit., p. 214.

but with the advantages of neither, the corporations regularly include one or more provisions in favor of preferred stockholders in their charters and/or bylaws, possibly aiming at facilitating the sale of preferred stocks.

Among various provisions, the privilege of conversion of preferred stock into common stock is the most important one. By this provision, the preferred stockholders may, at their option, participate in the success of the corporation by converting preferred stock into common stock at an agreed ratio, usually established by vote of the directors when the preferred stock was sold. A less direct way of attracting the same interest on the part of investors that the conversion privilege arouses is granting to the preferred stockholders warrants with which they can purchase common stocks at an agreed price.

Cumulation of dividends is another important privilege of the preferred stockholders. A preferred stock is cumulative when the insurer contracts that any dividend not paid on schedule, or any unpaid part of the stipulated dividend, must be paid in the future before any dividend may be paid on the common stock of the corporation. It is noteworthy, however, that in the absence of a statement to the contrary, the preferred stock has the right to cumulate dividends.

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7 Gerstenberg, op. cit., pp. 36-37.

8 Ibid., p. 101.

9 Ibid., p. 92.
As noted previously, the conversion clause gives the preferred stockholders the privilege to participate in the success of the corporation. But having once converted, the holder must remain a common stockholder even in the event of later failure of the corporation. To avoid this, some corporations offer the participating privilege to their preferred stockholders. The participating preferred stock is a preferred stock which is permitted to participate with the common stock, after the latter has received dividends which yield a rate of return equal to that first received by the preferred stock, in the distribution of profit beyond its regular rate of amount. The right to participate must be expressly conferred by charter or stock certificate. 10

In some instances, the participating right is applicable to the distribution of the assets of the corporation when it is dissolved.

The bond is a corporate security used for aggregating borrowed capital. Most long-term borrowing by large corporations is done through the issuance and sale of bonds. The bond, in its many forms, is essentially a promise to repay a specific sum with stated interest, on a specific date. The holders of bonds are creditors of the corporation and possess the legal rights of creditors in enforcing the payments of both interest and principal. The extent or nature of the security given to back up such a corporate promise varies widely; it depends on the description contained in an agreement known as the bond indenture.

Other things being equal, the unsecured bond is the most undesirable one from the standpoint of investors. The loan, or debenture, is simply based on the good faith and general credit standing of the borrowing corporation.

The secured bonds may be classified as nonproperty secured bonds, personal property secured bonds, and real property secured bonds, according to the nature of the security given to back up the debt.

The loan represented by nonproperty secured bonds is based on the standing of the corporations that assume the liability or guarantee the debt of the issuing corporation, such as assumed bonds, guaranteed bonds and joint bonds.\(^\text{11}\)

As the name suggests, personal property secured bonds are bonds secured by such personal property as equipment and securities of other corporations. The personal property specified as security of the bond is usually deposited with an independent trustee. Collateral trust bonds and equipment trust bonds are illustrations of bonds that fall in this category.

The real property secured bonds are bonds secured by such real property as buildings and land. Bonds of this class are first mortgage bonds, general mortgage bonds, consolidated mortgage bonds, first and consolidated mortgage bonds. A mortgage gives to the lender the right of foreclosure and sale of specific property if the payment of interest

or principal are not made promptly or if other conditions of the loan are violated.

The various bond features reflect, in large measure, devices or means that are used to attract investors. At times, it may be felt that a mortgage bond is needed to obtain the desired response in the investment market; on another occasion, there may be complete dependence on the general credit of the issuing corporation. There may be still other attractions, such as the right of conversion of the bond into common stock. The conversion privilege attracts to an enterprise those investors who are not conservative enough to demand the highest security, and not adventurous enough at the time to buy common stock. Giving bondholders warrants to purchase common stocks for an agreed price at a later date is a less direct way of attracting the same interest on the part of investors that the conversion privilege arouses. Also, when investors are confronted with adjustments arising out of failure and reorganization, they are virtually compelled to take securities that are mainly the product of expediency. Tradition also plays a part in formulating judgment as to the type of bond to be issued.

From the standpoint of the issuing corporation, fixed assets are preferable to personal property as security for a bond issue. Fixed property offers a definite and permanent basis of support, while personal property is so mobile that specific property offered as security may easily disappear from among the assets of the corporation. Personal property is easily moved, has a temporary life, and is being converted constantly into the goods or service that the corporation sells. On the
other hand, in time of failure, the ready movability of personal property may prove to be an advantage because it adds to the property's marketability.

The right of the corporation to redeem the loan at its option is a real advantage to the corporation if the rate of interest should decline after the issuance of bonds, or if certain terms of the indenture are onerous. By calling the loan and paying a small premium to the bondholders, these disadvantages are immediately cleared away and a new loan may be made on better terms or a similar amount of capital may be contributed by stockholders.

The privilege of issuing additional bonds under the same indenture is a privilege of great value to the corporation which is constantly in need of new capital for expansion. This may be achieved by the use of an open-end mortgage. The open-end mortgage is one whose terms authorize an indefinite amount of bonds to be issued under the same mortgage. In practice, however, there are always some indenture provisions restricting the amount of additional issues, such as requiring adequate coverage of the fixed charges, and the limiting of new issues to a fair percentage of the value of property additions.\(^{12}\)

According to the distribution functions involved, the security markets may be classified as primary markets and secondary markets.

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The former refers to the markets where new issues of securities are first offered. The latter designates those markets which trade in securities already distributed to investors. 13

After determining the type of security that is to be issued, the corporate management must decide how to market the new issue. Currently, two methods are used in floating a new issue: one is by direct placement; the other is by public offering.

Direct placement of securities, also known as private sale of securities, refers to the practice that securities are sold directly to one or a limited number of investors, notably to life insurance companies. 14 Also, there may be cooperative arrangements among the financial institutions in which the banks take the shorter maturities of serial issues, while the life insurance companies buy the longer maturities, or the latter may issue a commitment to take over the obligations after a stated period of time.

The advantages of direct placement are: (1) The greater ease and convenience in dealing with a single or limited number of investors; (2) the quick determination of the certainty of getting the funds; (3) the facility of arrangement whereby not all of the funds are advanced at a single time; but, instead, are made available over a reasonable period of time, and (4) the lower issuing cost.

13 Sauvain, op. cit., p. 58.
14 Gerstenberg, op. cit., p. 293.
On the other hand, there are some deterrents of direct placement of securities. As indicated earlier, when the securities are sold directly to one or a limited number of investors, these investors are likely to be financial institutions. But the investments of certain financial institutions and trustees in some states are limited to security issues that meet certain specifications established by state statute. These specifications are designed primarily to exclude issues representing any large degree of financial risk. For this reason, corporations using the direct placement method in marketing new issues may be confronted with difficulty in finding buyers. This is especially true of corporations which do not have very high credit ratings. Another hindrance to private placement is the preemptive right of stockholders. It is a well-established principle of corporation law that, before a new issue of stock may be sold to the general public, the present stockholders must first be permitted to subscribe to the shares in proportion to their holding, thus making it impossible for an established corporation to market its new stocks by direct placement. One of the major considerations in determining the type of security to be issued is its possible effect on the control of corporation. Marketing common stocks by direct placement exposes the present corporate management to the danger of losing control to the new investors.

Public offerings of securities designates that the offerings of securities are open to the general public and the existing security

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15 Sauvain, op. cit., p. 162.
holders. The issuing corporations may enter the selling campaign directly but, in actuality, such sales are usually effected through investment bankers. Many advantages may be achieved by selling through an investment banker. Investment bankers are specialists in the business of floating corporation securities. For this reason, the corporation is able to sell its securities at lower cost by the assignment of the task to an investment banker. By engaging the services of an investment banker, the corporation may receive the advice of the banker's specialists regarding the best way to finance. The corporation may also receive the assistance of the investment banker's legal counsel in meeting the legal requirements concerning security issues. The most important advantage, however, is that, by selling securities through banking houses, the corporation is assured the provision of a certain amount of funds within a definite period.

The most common arrangement which the investment bankers make with the issuing corporations is outright purchase of an entire issue by the bankers, who, in turn, endeavor to resell it to individual investors at a profit. The purchases may be negotiated privately with the issuing corporations, or they may be accomplished by competitive bidding. This is usually termed regular underwriting to distinguish from standby underwriting discussed below.

Under the standby underwriting plan, the issuing corporation itself offers its new securities for sale directly to its own security holders. The investment bankers are simply called upon to purchase at an agreed price whatever portion of the issue is not taken up by
the existing security holders. There are two situations warranting this practice. The first situation takes place when a corporation issues new stock and offers the stock to its own stockholders who have pre-emptive rights to subscribe to it. The second situation takes place when a corporation refunds a bond issue prior to its maturity.16 When there is standby underwriting, the corporation is assured of success—the bankers may be stuck with sticky stocks or bonds.

As stated previously, the transactions subsequent to the first offerings of securities constitute the secondary markets. There are two categories of secondary markets, namely; the organized security exchanges, and the unorganized security markets, or the over-the-counter markets.

The organized security exchange is composed of individuals who come together to provide physical facilities for trading in securities and to make rules governing security transactions. Usually, a stock exchange is directed by a Board of Governors elected by its members, and is administered in part by a paid staff and in part by elected and appointed committees of members. There are nineteen organized security exchanges in the United States and its territories.17 The New York Stock Exchange, the American Exchange, and the Midwest Exchange are the


three largest organized exchanges.\textsuperscript{18} Other important regional exchanges are the Boston Stock Exchange, the Philadelphia Stock Exchange, the Baltimore Stock Exchange, and the San Francisco Stock Exchange.\textsuperscript{19} The function of the exchanges is to provide a meeting place for buyers and sellers of the listed securities. In actual practice, the trading is done through brokers or commission houses, who are members of the exchanges, and who act for the buyers and sellers. The exchanges do not buy or sell securities, nor do they fix the prices at which securities are sold. Their function is to report prices which have been established by the buyers and sellers. All of the exchanges outside of New York City trade in securities listed on the New York Stock Exchange in addition to listed local issues.

The unorganized security market is variously known as the over-the-counter market or the off-board market. The over-the-counter market is made up of investment banking houses, over-the-counter houses, exchange members, municipal bond houses, and government bond houses.\textsuperscript{20} Investment banking houses are dominant in the primary distribution of securities. In addition to underwriting new issues, they maintain trading departments for securities. Over-the-counter houses deal chiefly in marketing unlisted domestic and foreign corporate securities. Exchange


\textsuperscript{20} Ibid., p. 27.
members are those firms which are members of organized stock exchanges, but who also transact business in the over-the-counter market. Municipal bond houses specialize in municipal bond transactions in the over-the-counter market. Government bond houses are specialists in marketing of the United States government obligations.

Most bank stocks, Federal, state, and corporate bonds, and corporate stocks which have not been listed on the organized security exchanges are traded in the over-the-counter market. In actuality, the volume and number of bond issues dealt in the over-the-counter market exceeds that handled by the New York Stock Exchange and all other organized exchanges.

Like many other laws in this country, securities regulations may be classified as either Federal or state laws. Practically all states have legislation pertaining to security transactions. There are two types of state securities statutes. The first type requires the issuers to have the consent of some official body, commonly called blue sky commission, before the securities can be sold in the state. Securities of admitted strength, such as the issues of governmental agencies, offerings of railroads and public utilities which are subject to the approval by state regulatory bodies, and securities listed on the New York Stock Exchange and other registered exchanges are exempted from these requirements. The second type is based on anti-fraud acts. It is of a punitive character. No permit from the authorities is required.

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21 Ibid., p. 30.
to issue securities; but should fraud be discovered later, extensive investigation and severe punishment can be inflicted.

The most important Federal securities regulations are the Securities Act of 1933 and the Securities Exchange Act of 1934. The Securities Act requires that before new offerings of securities are made to the public by the use of mails or by the channels of interstate commerce they must be registered with the Securities and Exchange Commission. The registration statement must contain complete information about the issuing corporation which the Securities and Exchange Commission considers necessary in the interest of investors, usually including a description of the kind of business conducted, the services or products sold, the physical assets owned, the identity of the directors and officers, financial statements for the past three years, and the terms of the issuer's contract with investment bankers. Similar information must be disclosed in a prospectus which is to be delivered to each buyer.22 Some groups are exempted from the Act. Exempted securities include Federal and municipal obligations; railroad securities; securities of building and loan associations; securities of non-profit organizations; insurance policies and annuity contracts; receivers' certificates and securities issued in reorganization; and any issue under $300,000.23 The Securities Exchange Act provides, among other


23 Husband, op. cit., p. 374.
things, that all securities listed on registered security exchanges must be registered with the Securities and Exchange Commission. The Act also prohibits corporate insiders from profiting from information about the corporation which, because of their position, they received in advance of the ordinary stockholders. Manipulation of stock prices in any manner is outlawed. Short selling in the stocks of their corporation by the corporate directors, officers, and principal stockholders is not permitted.\footnote{Harold Koontz, and Richard W. Gable, \textit{Public Control of Economic Enterprise} (New York: McGraw-Hill Book Company, Inc., 1956), pp. 470-472.}

With regard to non-security financing, corporations follow the same pattern followed by other types of business organizations. In financing the business, a distinction must be made between working capital and long-term capital. The working capital is required for operation in the ordinary course of business. The need for long-term capital arises out of the expansion of an enterprise, or of modernization of a plant. A certain part of the working capital may be provided by short-term loans, while the long-term capital must be furnished by the contribution of owners, either as part of the original investment or through profits retained in the business, or by long-term borrowing, such as the sale of corporate bonds.

In addition to financing through the sale of stocks and bonds, a corporation may obtain long-term capital by reinvestment of its earnings, and by using the sale-and-lease-back method. A corporation
ordinarily does not pay out all of its earnings as dividends over any period of years. This practice of retaining earnings in the corporation as accumulated surplus affords a proper method for obtaining permanent capital. In the sale-and-lease-back method, a corporation can sell certain property to an institutional investor, and then lease back the same property for a term of twenty to fifty years. In the case of new buildings, the investor can build the structure to the specifications of the lessee. In the first instance, the corporation secures cash for working capital and other uses; in the second case, the corporation avoids the sinking of funds in fixed assets or the necessity of borrowing long-term capital. Under the commonest sale-and-lease-back arrangement, the corporation pays a fixed rental and assumes all operating expenses, including maintenance, insurance, and real estate taxes. 25

There are a variety of methods currently used in financing the working capital. Corporation may raise a part of its working capital by trade credit, which is extended by the concern from which raw materials, finished products, or supplies are purchased. The customary term runs from a few days to a few months, and it is the general practice of businesses to grant cash discounts for prompt payment. The commonest terms are 2 per cent 10, net 30 days. 26 However, the working capital


26 Husband, op. cit., p. 536.
raised by trade credit usually is offset by the volume of trade credit which must be extended to the corporation's own customers.

The corporation may make continuous use of the lending facilities of commercial banks. While bank borrowings should ordinarily be the source for a large portion of the extraordinary or seasonal working capital needs, they may also be used for obtaining a portion of the ordinary current financing. This has the advantage of developing established financial connections with the banks for use in times of emergency or having a ready means of reducing working capital during periods of extreme decline in the volume of business.

On the basis of the security which the banks receive from borrowers to back up their debt, the bank loans may be classified into unsecured bank loans and secured bank loans. The unsecured bank loans refer to loans which are obtained by giving the bank an unsecured promissory note. The sole security is the general credit standing of the borrowing corporation. When the position of the corporation is such that an adequate amount of unsecured bank loans cannot be obtained, the corporation may turn to the use of secured bank loans. Under the secured loan terms, banks only advance funds on notes which are secured by endorsement or co-makers; or by mortgage on inventories, equipment, plant, or other real estate.

There has developed a tendency for the banks to make loans regularly on a longer term basis. Generally this is referred to as term loans. A term loan may run from one to ten years, but in actuality such loans are frequently made for a five-year term. In general, term
loans made to small corporations are secured by mortgages on real estate or equipment. Term loans made to large corporations are usually unsecured, but arrangements are made between the bank and the borrowing corporation to prevent, during the life of the loan, the latter from pledging its fixed assets or making additional long-term borrowing. There may be a lump sum payment due at maturity, but it is more common for the term loan to consist of several notes having serial maturity.

The banks also have an important role in bankers' acceptances. A bankers' acceptance is a draft drawn by the seller upon the bank of the buyer. The seller does this under instructions of the buyer, who has, in turn, arranged with his bank to accept the draft upon its presentation. The bank accepted draft becomes high quality negotiable paper because it is an obligation of a bank and a contingent obligation of the drawer, and because it is an instrument arising out of an actual and self-liquidating transaction. As a result, the original seller of merchandise can discount the bankers' acceptance at an extremely low rate.

The commercial-paper houses are another source from which corporations may obtain working capital. The commercial house is a middleman specializing in purchasing the promissory notes of reputable corporations and businesses and reselling them to banks or other investors. Financing by selling promissory notes to the commercial paper houses offers favorable interest rates and also serves to advertise the existence of the borrowing concern through the often widespread ownership of its notes. On the other hand, there is the disadvantage that the borrowing relationship is strictly impersonal and the notes must be paid exactly on schedule.
A corporation may provide itself with working capital by discounting its accounts receivable with finance companies. Finance companies are variously classified as discount, accounts receivable, commercial credit, installment finance, and automobile finance companies. Irrespective of the different business areas in which they serve, all finance companies engage in financing the credit sales of other concerns or in providing funds for some other relatively short-term purpose. Where the borrowing corporation is financing its own credit sales, the usual arrangement is by means of discounting accounts receivable with the finance company or by the outright sale of any type of customers' installment contracts. Corporations that are inadequately financed may establish a continuing arrangement with a finance company wherein all accounts receivable will be assigned to the finance company in exchange for a cash payment equal to the face amount of the account less an agreed discount covering both the financing charge and possible loss.

Apart from discounting accounts receivable with a finance company, the corporations may sell their accounts receivable to a factoring company. The function of the factoring company is very similar to that of the finance company. It differs from the latter in that ordinarily it buys the accounts receivable outright from the selling or borrowing corporation and assumes any credit loss which may be experienced. Because of the fact that all credit loss is assumed,

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27 Gerstenberg, op. cit., p. 386.
the factoring companies may reserve the right to pass on credit before sales are made. This has the disadvantage to the borrowing corporation of using a credit manager who is interested in a zero credit-loss ratio rather than in allowing a few credit losses which permit the corporation to maximize net profit. In opposition to this disadvantage is the advantage that the cost of the credit department is transferred to the factoring company, and, therefore, the corporation is enabled to concentrate on its operation problems.

After the prolonged depression of the thirties, the automatic correction of economic adversity by voluntary action is no longer taken for granted, and governmental participation in the field of private business to preserve business prosperity has been accepted as an imperative necessity. The government has become a source of business capital. The Reconstruction Finance Corporation which was terminated in 1954,28 made the first landmark of direct financing of private business by the Federal government. Following the discontinuation of this governmental agency, the Small Business Administration was created to make loans to small business firms and victims of floods or other catastrophes on term loan basis.29 In addition, the Federal Reserve Banks are authorized to provide, under certain circumstances, an established industrial or commercial business with working capital for a period not

28 Koontz, op. cit., p. 619.
29 Ibid., p. 621.
exceeding five years,\textsuperscript{30} and to discount or purchase similar obligations
which may arise from loans of the type made by various financial institu-
tions.\textsuperscript{31}

Where the management is confronted with a number of ways
to finance its corporation, the management must develop a financial plan
to achieve the lowest financial costs. Usually this plan will be a
combination of different financing means, and the structure of such a
combination depends on the situation of the individual corporation as
well as on the status of the money and capital markets. In general,
the financial plan presents two problems: the capitalization and the
capital structure. Capitalization refers to the computation, appraisal,
or estimation of the total value of securities to be issued. Capital
structure refers to the types of securities that should make up the
capitalization and the proportionate amount of each.

The basis of capitalization lies in the theory that a profit-
making concern is worth what it will earn in a year divided by a rate
of return which must be high enough to attract capital to the particular
firm.\textsuperscript{32} Accordingly, it is necessary to arrive at an estimated annual
net earning and a fair rate of return before the capitalization can be
determined.

\textsuperscript{30} Federal Reserve Act, Section 13 (b) (a).
\textsuperscript{31} Ibid., Section 13 (b) (b).
\textsuperscript{32} Gerstenberg, \textit{op. cit.}, p. 188.
In the case of expansion of an existing corporation or of the consolidation of two or more established corporations, the past earnings adjusted by future tendency often offers the best basis upon which to estimate future earnings. When the case involves a new enterprise, the best basis is to study the earnings of concerns similarly situated in a similar business. In either situation, conservative estimates should be the guiding rule.

The capitalization rate or rate of return at which a concern is to be capitalized should always equal that return on the invested capital that would adequately compensate the investor for the use of his funds and the risk he undertakes. While there is no established rule to determine definitely what capitalization rate is appropriate for a particular concern, it is axiomatic that the greater the risk, the higher must be the capitalization rate. Also in estimating such a rate, a study must be made of what other corporations in the same industry and similarly situated are earning on their capital. Again, the rate at which the market is capitalizing earnings for such corporations must also be taken into account.

The capital structure deals with the problem of choosing the best types of securities to be issued and the proportionate amount of each. In determining the capital structure, attention should be devoted to the condition of an individual corporation as well as the condition of the general investment market.

With respect to the condition of the corporation, consideration must first be given to the stability of earnings. Bonds should be
issued only when future earnings are expected to be reasonably stable and well above the interest and sinking fund requirements. Preferred stocks may be issued when the average earnings over a period of years are expected to be well above the preferred stock dividend requirements. When earnings cannot be predicted with reasonable certainty, only common stocks should be issued.

The second consideration is the desire for control on the part of the promoters or present management. When it is a new corporation, the promoters may absorb such an amount of common stock as they believe is required for effective control, and offer the rest, together with non-equity securities, to the public. When it is an established corporation, the non-voting common stock, preferred stock, and bonds may be issued as a means of raising capital without jeopardizing the existing managerial control. Bonds do not carry the voting privilege, non-voting common stock and preferred stock have only a limited contingent voting rights. Attention should be called to the fact, however, that non-voting common stock cannot be listed on the New York Stock Exchange.33

Business must keep pace with the times, the manager of corporate financing operations should always think of the possibility of future growth when he undertakes any financing. Expansion may be financed through the plowing back of earnings into business. However, extensive expansion is likely to require new capital from the outside. If the corporation has already burdened itself with an excessive amount of

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33 Gerstenberg, op. cit., p. 49.
heavy fixed-charge senior securities, future financing may be difficult. It is wise that care be taken not to handicap progress in future years with heavy expenses in the earlier ones. When mortgage bonds are used, the closed-end mortgage term should be avoided whenever possible.

In addition to considering the condition of its own corporation, corporate management must extend its attention to the situation of the general investment market. Usually when the business cycle is on the upswing, investors are interested in equity securities; on the downswing of the cycle, they favor bonds. The financing of business is also affected by the prevailing financial styles and the accumulated financing pattern. It is difficult for a business to go too far out of line, no matter how sound its basic approach may be. A single structure can do little or nothing to offset the accumulated deficiencies of the surroundings. Similarly, a corporation is affected by its financial environment; and it is not entirely free to choose its own financial device. The demands of the corporation for capital must from necessity cater to the mode of the financial market; otherwise, it is compelled to pursue a costly course of justification for its own individuality.

The level of interest rates at the time that financing is planned is another major factor affecting the terms of securities to be issued. When interest rates are high, all financing is costly. To some extent, a corporation may overcome this handicap by issuing short-term bonds or by making bonds or preferred stocks redeemable; thus enabling the corporation to adjust its capital structure as soon as the interest rates become favorable to the corporation.
In planning to raise capital, the corporation's major concern is to obtain the funds it needs at the lowest cost in terms of interest, dividends, and the relationship of earnings to the price of the stock. Bonds are always a lower-cost security to a successful corporation than stocks. Also, the corporation can deduct the interest paid on bonds as a business expense in arriving at its income tax, thus further reducing the cost of this borrowed capital. If a corporation is reasonably sure it can consistently earn more on borrowed money than it pays out in the form of interest on the debt, it can profitably borrow. The reason for this conclusion is that the use of a large amount of borrowed capital or preferred stock in capitalizing the corporation works to the ultimate benefit of the common stockholders. It is noteworthy, however, that while the trading on the equity magnifies the profits, it also magnifies the losses.\(^3\)\(^4\) Borrowed capital should always be avoided where there is any danger that the interest cannot be met regularly. The rule is that fixed interest charges should never exceed the amount of operating revenue less the operating expenses even in the corporation's poorest year.

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Chapter V

Quasi-Public Corporations

And Public Control

A quasi-public corporation, which is also known as a public service corporation, is a private corporation furnishing service upon which the public is particularly dependent. Examples of this class of corporations are those operating railroads, canals, and bridges, and those supplying gas, electricity, and water. Such corporations are characterized by a huge proportion of total investment being sunk in fixed assets, and by being monopolistic in nature. Corresponding to these distinct features inherent in transportation and public utility corporations, the public policies in this respect have been developed to deter the ruinous competition on one hand, and to prevent the abuse of monopolistic power on the other hand. While the Federal and state governments devote their attentions to the removal of restraints from the freedom of doing business in most fields; extension of the monopoly principle in the public service areas is encouraged. Because it has been determined that the public interest in adequate service and reasonable rates lies in the monopolistic direction, the quasi-public corporations are usually given special franchises and powers; such as monopoly privilege; and, the right of eminent domain, which permits the taking of private land for corporate purposes upon making reasonable compensation.  

It is more important to remember, however, where restraint of trade is promoted and special privilege is granted, increased regulations to prevent injury to the public from monopolistic practices is a necessary concomitant.

Since transportation corporations have operated largely in interstate commerce, the control exercised by the Federal government has been far greater than that exercised by the states. The light, power, and water corporations which operate largely in intrastate commerce are controlled more extensively by the states rather than by the Federal government. Despite the difference in sovereigns exercising control, the measures employed to effect the control are virtually alike.

Generally, the governmental intervention comes as early as an individual quasi-public corporation is ready to begin business operations. In addition to receiving a charter, which is required of all corporations to carry on business, a quasi-public corporation must receive special permission from proper authorities before it can begin business. A certificate of convenience and necessity from state or Federal governments is usually required of common carrier transportation corporations. A utility corporation is required to obtain a certificate of convenience and necessity from state or Federal authorities, as well as a franchise from the local government. A certificate is issued as a privilege, while a franchise confers exclusive contractual rights. They are different

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in character, and yet both are designed to exclude competitors.

After the transportation or utility corporation begins operations, even more extensive and intensive regulations ensue. Wherever a monopoly is granted to a private corporation, the quality and quantity of product is ordinarily subjected to strict regulations. Those quality regulations applied to light and power corporations may be in terms of minimum and maximum voltage, interruptions of service, and accuracy of meters. Specified quality standards of service are also required of other public service corporations. The welfare of the public must be measured in terms of the quantity as well as the quality of the products which they consume. Those regulations governing the quantity of a product usually charge quasi-public corporations with the obligation to satisfy the demand whenever it arises in the areas they serve.

Products and/or services and rates are closely related. High quality may induce the public service corporations to raise their service rates unless the latter is safeguarded. It is often poor economy to insist upon high quality without fixing a ceiling on rates. To illustrate, a good product may be appraised as low quality when its exorbitant price is taken into consideration. Likewise, the public may actually be deprived of adequate service if the rates of service are too high to be afforded, although the producers assure ample supply of service. What constitutes a reasonable price involves the relativity of many factors. It relates to the prevailing rates of earnings of dissimilar and similar investments; to the pure interest rate; to what constitutes a fair evaluation of investment by the common carrier; and to what
constitutes a fair rate of return upon an agreed upon investment base. Other areas of compromise involved in rate making are what constitutes a fair rate of depreciation of fixed assets, and what shall be considered acceptable operating efficiency. It is within the power of the various states to prescribe reasonable rates for intrastate business. The state legislatures may, and usually do, delegate the power of rate-making to a commission. As far as interstate commerce is concerned, Congress has the power to prescribe rates. Pursuant to this power, Congress has created the Interstate Commerce Commission, which is authorized to regulate rates charged by interstate railroads, motor and water carriers. The Civil Aeronautics Board regulates interstate air rates. In the actual determination of rates, the authorities make an estimate of the annual sales of service units, and make an evaluation of the total investment. Then, the authorities figure out the total annual revenue which the corporation is entitled to receive on the basis that, after deducting operating costs, such revenue would yield a fair rate of return to the investment. The total estimated annual revenue divided by the total estimated units of service sold in the same period gives the rate of service per unit.

Since the operating cost is one of the determinants of price, control must extend further to be certain that the corporation in

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5 Civil Aeronautics Act, 1938, Section 403.
question has been efficiently managed and honestly financed. In the first place, this requires depreciation, which is the most important cost element of corporations in the public service field, to be charged at a rate and by a method approved by the supervising authorities. In the second place, this requires periodic reports as well as accurate, systematic, and uniform information about operating expenses and capital expenditures.6

The possession of monopolistic power makes it possible for a business to discriminate between its customers as to either price or service. To cure this demerit, a quasi-public corporation is required to serve and charge all alike without discrimination. The term discrimination is modified to include only that which is unreasonable, such as a telephone corporation charging two users in exactly the same position different rates. It is legal if price differentials to different purchasers make only due allowances for differences in the cost of manufacture, sale, or delivery resulting from different methods or quantities in which such commodities are to such purchasers sold or delivered.

The authorities impose not only limitation on the entry of quasi-public corporations into business, but also on their abandonment of service. In the public service field, a corporation may not withdraw from service whenever it wishes or to whatever extent it may desire. Because these corporations have embarked upon a business which the public regards as necessary, and for which no ready substitute is available,

in order to quit service; the public service corporations must receive permission from the administrative agency in charge of their regulation as well as follow the general dissolution procedures required of all corporation, so that the public service could not be interrupted.

A number of reasons may be cited to explain the desirability of government ownership of public service corporations. From the regulatory point of view, however, public ownership is often regarded as a means of establishing standards by which the efficiency of private ownership under regulation may be measured. Either private business is brought into line by the danger of government competition, or the supposed inefficiency or imprudence of private management is exposed by the government plant. The employment of public ownership as an efficiency yardstick encounters two limitations. In the first place, a comparison of rates is a legitimate basis for evaluating relative efficiencies only when the operating conditions are substantially the same; but usually the actual situations are not comparable. For example, if one of two transportation corporations serves a heavily populated urban area with high density of traffic, while the other has a more sparsely populated rural region to supply, differences in rates may be the result of differences in operating conditions rather than in efficiency. In the second place, a comparison of rates, to have any meaning, must be based on the same cost considerations.\(^7\) But the government-owned corporations are usually financed through public credit, and exempted from Federal

\(^7\) Pegrum, *op. cit.*, pp. 657-658.
taxes, and most of them are exempted from state taxes. In addition, publicly owned utilities are not required to pay for the franchises to the municipalities which they operate.\textsuperscript{8} Although the basis of comparison may be adjusted by evaluating the differences in operating conditions and in tax status, yet there is no assurance that such adjustments are objective in judgment and accurate in calculation.

Concomitant with the development of the areal frontiers during the nineteenth century in the United States was the development of various types of land and water transportation. The theory had developed that the private agencies supplying transportation were performing governmental functions under grants of authority to do so. It was on this basis that private firms were accorded the right of eminent domain. In addition, the legal theory also came to hold that when the owner of a private transportation enterprise assumed the obligation to serve all who applied, he could not renounce his responsibilities without public consent, and he became subject to the special common law rules for businesses affected with a public interest.\textsuperscript{9} All of these were apparently invented to cure the ill and to counter the threats of corporations whose functions were by nature monopolistic. The immediate connection of transportation with the political life of a country is another major consideration which has drawn the special attention of government

\textsuperscript{8} Ibid., pp. 656-657.

to transportation enterprises. Adequate transportation is essential to political unity, national defense, economic growth, and cultural development.\textsuperscript{10}

Thus, the foundations for modern regulation of quasi-public corporations were well established by the beginning of the nineteenth century, but it was not until the rise of railroads to their dominant position in inland transportation that positive regulations began. Regulation of railroad transportation was first attempted by state law-making bodies when the states of Illinois, Minnesota, Iowa, and Wisconsin enacted the granger acts between 1871 and 1874. These acts had common objectives and very similar provisions, such as: the establishment of maximum rates for freight and passenger charges; the avoidance of place discrimination by applying the pro rata principle to rate fixing; the preservation of competition by forbidding competing railroad lines to consolidate; and the introduction of mandatory commissions which were the prototypes of the present Interstate Commerce Commission.\textsuperscript{11} It was inevitable that there should develop conflicts between state and Federal regulatory authorities over the demarcation of control areas. In 1886, however, a border line between the jurisdiction of Federal and state governments was established in the Wabash case in which the United States Supreme Court held that when traffic fell exclusively within

\textsuperscript{10} Pegrum, \textit{op. cit.}, pp. 492, 514, 515.

the category of interstate commerce, only the Federal Government could exercise control.12

The history of Federal regulation of transportation among the states has been divided by some students of transportation history into two eras: the era prior to 1920 has been regarded as the era of exploratory legislation, while the years since 1920 are regarded as the era of modern legislation. In the era of exploratory legislation, transportation laws were primarily a matter dealing with the railroad and water carriers. Legislative actions were considered separately, and there was a lack of over-all guiding policy to be followed. In the era of modern legislation, motor and air transportation were introduced, and pipelines were used more extensively. The purposes of transportation regulation in this period have been to remedy what appeared to be the most obvious deficiencies of the exploratory laws passed to regulate railroads; to lay the basis for the development of an over-all national transportation policy; and to extend regulation, in the pattern of that applicable to railroads, to the other common carrier agencies.13

The basis of Federal control over domestic transportation in interstate commerce was the Act to Regulate Commerce (1887), which has been amended on numerous occasions and came to be known as the Inter-


13 Pegram, op. cit., p. 559.
state Commerce Act.\textsuperscript{14} Today, an Interstate Commerce Commission consisted of eleven members is in charge of enforcing this Act. The original Act to Regulate Commerce was made applicable to all railroad carriers engaged in interstate or international commerce. It did not apply to common carriers wholly by water, but it did include common carriers partly by water and partly by rail, where they were under common control or arrangement for continuous carriage or shipment. The Act required that all rates be just and reasonable, and that the schedule of rates and fares were to be printed, made available for public inspection, and filed with the Interstate Commerce Commission. Personal discrimination, and undue or unreasonable preference or advantage of any form to any person, place, or kind of traffic were outlawed. The Act also prohibited a common carrier from charging any greater compensation in the aggregate for transportation of passengers or like kind of property under substantially similar circumstance for a shorter than for a longer distance over the same line, in the same direction, the shorter being included within the longer distance.

The Elkins Act (1903) made the enforcement of the discriminatory provisions of the Interstate Commerce Act somewhat easier, because this Act made any willful departure from published charges a misdemeanor and thus rendered it unnecessary to prove that one shipper paid less than

another. \(^{15}\) Moreover, the Act made railroad corporations liable for any activities which, if committed by their officers or employees, would be misdemeanors and made fines for violations of the Interstate Commerce Act assessable against railroad corporations as well as against their officers and employees.

Under the Hepburn Act (1906), the jurisdiction of the Interstate Commerce Commission was extended to express companies, sleeping-car companies, pipelines other than water and gas, and accessorial services such as private-car companies. The interstate Commerce Commission was also granted the power to establish maximum rates, to regulate through routes and joint rates, and to require annual reports and uniform accounting procedures.

The jurisdiction of the Interstate Commerce Commission was extended even wider by the Mann-Elkins Act (1910). This Act placed telephone, telegraph, and cable companies engaging in interstate or international commerce under the control of the Interstate Commerce Commission. To aid the Interstate Commerce Commission in making a rate investigation, the Act included provisions for suspension of proposed changes in rates for an initial period not exceeding 120 days, and for a second period of six months if the first period was insufficient. This Act amended the Interstate Commerce Act by elimination of the phrase "under substantially similar circumstance and conditions," in the long-and-

short-haul clause. Henceforth, the long-and-short-haul prohibition was to apply under all conditions, unless the Interstate Commerce Commission specifically granted exceptions. The Act also required every carrier subject to the Act to designate an agent in Washington, D. C., on whom service of notices respecting proceedings before the Interstate Commerce Commission and the United States courts might be made.

The Panama Canal Act (1912) made it unlawful for any railroad to have any interest of any kind in common carrier by water with which it competed or might compete.

In order to furnish the Interstate Commerce Commission with some standard by which to test the reasonableness of railroad rates and the reasonableness of proposed changes in rates, the Valuation Act (1913) directed the Interstate Commerce Commission to investigate and evaluate in great detail the properties of railroad carriers. Valuations ascertained therefrom were to serve as prima-facie evidence of the value of the property in all proceedings arising under the Interstate Commerce Act.

Under the Shipping Act (1916), the United States Shipping Board was established. This Board was charged with supervision over rate discrimination and other discriminatory practices of water common carriers. The scope of the Act was limited to carriage on the high seas, on the Great Lakes, and in interstate coastwise traffic only.

The provisions included in the Transportation Act (1920) may be classified into four portions. The first portion dealt with the rate-making. The Interstate Commerce Commission was to prescribe such
rates as would permit the railroads as a whole to earn—under honest, efficient, and economical management—a fair return on the fair value of railroad property held for and used in service of transportation. Because such a uniform rule of rate-making would give some carriers more than a fair return and leave others with inadequate revenues, the "recaptive clause," was introduced. This clause provided that one half the earnings of a carrier in any year in excess of 6 per cent of the value of the property employed should be paid to the Interstate Commerce Commission and placed by it in a railroad contingent fund from which the Interstate Commerce Commission might make loans to weak lines. The Interstate Commerce Commission was also permitted to prescribe minimum rates to prevent ruinous competition, and to make control over discrimination more effective. An exact rate might be prescribed to replace the rate which the Interstate Commerce Commission found unlawful. The second portion of this Act regulated consolidations. The Act provided that the Interstate Commerce Commission should adopt a plan of consolidation in accordance with three conditions; (1) the preservation of competition, as fully as possible; (2) the maintenance of existing channels of trade and commerce, whenever practicable; and (3) the arrangement of the several systems so that the earning power of each would be approximately equal under uniform rates. After a final plan was adopted by the Interstate Commerce Commission, no consolidations were to take place that did not conform to the adopted plan. These provisions were an integral part of the rule of rate making, because the approximate equality of earning capacity of various companies could be achieved only by consolidating
the weak roads with strong ones, and this must be done with the least restraint on competition. The third portion of this Act provided that it would be unlawful for any railroad to issue securities or to assume obligations with respect to securities issued by other persons, unless the approval of the Interstate Commerce Commission had been obtained. The last portion of the Act related to the service of railroads. It gave the Interstate Commerce Commission extensive power to regulate the quality and regularity of railroad service. The Interstate Commerce Commission was also given the power to control the construction and abandonment of railroad mileage to prevent overconstruction and ruinous competition.

Federal regulation of air transportation was established by the Air Commerce Act (1926). This Act was designed to foster and govern the safe and technical growth of aeronautics rather than to regulate the financial and economic aspects of air commerce. Its provisions covered such matters as the registration of aircrafts; the periodical examination of aircrafts; the airworthiness of aircrafts; and the traffic rules for aircraft navigation. Seven agencies of the Federal Government were given functions relative to the carrying out of the provisions of the Act. They were the Department of Commerce; the President; the Secretary of Treasury; the Secretary of Labor; the Secretary of Agriculture; the Secretary of War; and the Bureau of Standards. Among these seven agencies, the Department of Commerce assumed the major responsibility.

The Emergency Railroad Transportation Act (1933) was enacted primarily to meet the railroad emergency at that time.\(^{17}\) However, the amendments to the rate-making provision of the Interstate Commerce Act were of a permanent nature. The Act provided that, in exercising the power to prescribe just and reasonable rates, the Interstate Commerce Commission should, among other factors, give due consideration to three conditions: (1) the effect of rates on the movement of traffic; (2) the public need of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and (3) the need of revenues sufficient to enable the carriers, under honest, economical and efficient management, to provide such service.

In the field of motor transportation, reliance was placed on state regulation until 1935 when the Motor Carrier Act was passed by the Congress.\(^{18}\) The underlying theory of this legislation was that motor transportation was to be regulated in the same pattern as were the railroads.\(^{19}\) However, distinct and inherent features of motor transportation made imperative the modification of this pattern to some extent.

Unlike the railroads where all carriage can be brought under the rubric of "common carrier," the motor carriers fall into three categories: the common carrier; the contract carrier; and the private carrier.\(^{20}\)

\(^{17}\) Ibid., p. 160.


\(^{19}\) Pegrum, *op. cit.*, p. 560

\(^{20}\) *Motor Carrier Act, 1935*, Section 203 (a) (14), (15), (17).
Each type has to be considered separately. Moreover, the proportion of fixed investment of motor carriers is not so large as that of railroad carriers. The capital turnover for the former is once every four months, while the capital turnover for the latter is once every three years. The motor carriers use publicly-owned highways; the railroad carriers must build and pay for the tracks they use, and, in addition, must pay ad valorem taxes on their roadbeds.

The Motor Carrier Act required the motor common carriers to secure certificates of convenience and necessity. The contract carriers were required merely to secure permits to operate. These are not so difficult to obtain as are certificate of convenience and necessity, and the obligations imposed thereon are less rigorous. The Interstate Commerce Commission was given power to fix minimum and maximum rates as well as the precise rates for motor common carriers. The Interstate Commerce Commission also had control over the minimum rates and actual rates of contract carriers. All the private carrier has to do is to obtain a license, and, since the private carrier is supplying transportation service to its owner only, no rate issues arise. The Interstate Commerce Commission has authority over consolidations, mergers, and all other forms of control of motor carriers under its jurisdiction. The criteria are that only those combinations that are consistent with public interest can be approved. Also the issuance of securities by motor common carriers and motor contract carriers are subject to the

21 Pegrum, op. cit., pp. 530-531.
approval of the Interstate Commerce Commission. To enforce this Act, the Motor Carrier Division was established under the Interstate Commerce Commission. Because of the intrastate nature of so large a portion of this industry, the Act provided for the establishment of joint boards when both Federal and state interests are involved. These boards consist of a representative from each state commission affected and representatives of the Interstate Commerce Commission.

The functions of the United States Shipping Board which was created by the Shipping Act (1916), were transferred to the Department of Commerce in 1933. The Merchant Marine Shipping Act (1936) again established an independent agency, the United States Maritime Commission, to perform the duties formerly assigned to the United States Shipping Board. The terms of this Act related primarily to the expansion of the United States merchant marine; ship construction; subsidies; ocean mail service; ship personnel; labor relations; insurance on ships; cargoes; and crew members.

The Civil Aeronautics Act (1938) was an amendment and expansion of the Air Commerce Act (1926). The pattern of this Act was similar to that for railroads and motor carriers. The Civil Aeronautics Board composed of five members appointed by the President with the advice of the Senate was established to administer this Act. Air carriers are

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the only mode of interstate transportation over which the Interstate Commerce Commission has no control.²⁴ The authority of the Civil Aeronautics Board was limited to common carriers and other carriers of mail. A air common carrier must receive a certificate of public convenience and necessity. It is within the jurisdiction of the Board to certify United States air carriers for overseas and foreign commerce, and to grant or to deny, subject to the approval of the President, permits to foreign carriers desiring to provide service to the United States. The provisions governing rate-making are similar to those prescribed in the Interstate Commerce Act, and confined the rate-making authority of the Civil Aeronautics Board to common carriers engaging in domestic service, or between the United States and its possession. The Board has no power over the rates to or from foreign countries. The Board has complete control over consolidations or mergers of common carriers by air and of the corporate relations with any other common carrier, or any manufacturer of aircraft.

Under the Transportation Act (1940), the Board of Investigation and Research was established to study transportation problems as an aid to Congress in formulating national transportation policy, and in developing additional legislation.²⁵ Such studies included an investigation and evaluation of the relative economy and fitness of carriers by railroad, motor carriers, and water carriers which it may consider important to investigate for the improvement of transportation conditions.

²⁵ Pegrum, op. cit., p. 563.
This Act provided that railroad consolidations no longer needed to comply with a Commission-made plan as prescribed in the Transportation Act of 1920. Henceforth, the Interstate Commerce Commission could sanction any proposed consolidation at their discretion. This Act eliminated land grant rates except those that applied to the transportation of military and naval property and personnel. Land grant rates are special rates on government shipments made over the lines of railroads which received free grants of land from the government. In 1945, Congress released railroads of the obligation to transport even military and naval property and personnel at reduced rates. The Act also provides that the Interstate Commerce Commission has jurisdiction over water common carriers, as well as contract carriers, engaged in interstate commerce. Basically the pattern of the regulation that applies to motor carriers also applies to water carriers.

The Transportation Act (1958) was passed in response to a rapidly mounting railroad crisis arising from a decline in railroad traffic together with the difficulties faced by the railroads in securing new capital. The Act authorized the Interstate Commerce Commission to guarantee loans to railroads to enable the railroads to finance capital investment in roads and equipment and for maintenance work. The Act modified the rate-making provisions of the Interstate Commerce Act by providing that rates of a carrier should not be held up to a particular level to protect the traffic of any other mode of transportation. This intended to prevent the use of the rate-making power by the Interstate Commerce Commission to protect one mode of transportation against the fair competition by another mode.
The industries that fall into the category of public utilities are water supply and sanitation, electric light and power, gas, and telephone and telegraph. They are peculiar in their economic and technological structure and in the nature of the services which they provide.

On the one hand, the public utilities present the unique situation of insulated and isolated monopolies, in that each enterprise can be confined in its economic activity to a specifically delimited geographic area, which confines both the producer and consumer. On the other hand, the public utilities supply a particular product or service which is a necessity and for which no ready substitute is available. The public utilities are so intimately connected with the public that their services have become an integral part of daily life. This is especially true in the urban areas. Public regulation of public utilities stems from the desire to prevent ruinous competition and to protect the public interest from exploitation. Prior to 1874, the control of public utilities was usually restricted to occasional judicial and legislative regulation and to the granting of franchises and charters.26 Today, public utility regulation is largely in the hands of state and Federal regulatory commissions. Regulation by commission is a matter of recent origin. Modern public service commissions have developed since 1874 when the legislature of Illinois conferred mandatory control of rates upon its railroad com-

mission. Massachusetts which created a Board of Gas and Electric Light Commissioners in 1885 was the first state to establish a commission with jurisdiction over a public service other than railroad transportation.\(^{28}\)

As noted previously, the control of public utilities is primarily intrastate in nature. But the extent and the scope of the jurisdiction of state regulatory commissions varies from state to state. Roughly the state regulatory commissions may be classified as either weak or strong. The regulatory commissions of the states of Delaware, Minnesota, Iowa, South Dakota, Florida, Mississippi, and Texas are the examples of the weak type.\(^{29}\) Their jurisdictions are very limited. The strong type is illustrated by the regulatory commissions of the states of California, Massachusetts, and Wisconsin.\(^{30}\) The regulatory commissions of these states have developed into regulatory bodies of high competence and full integrity, with the wide authority parallel to that of commissions of Federal level. In such states, the regulatory commissions enjoy wide discretionary powers within the boundaries of legislative and judicial interpretation. For example, the laws provide that public utility rates should be just and reasonable, but the determination of actual rates that are just and reasonable is left to the discretion of regulatory commissions,

\(^{27}\) Ibid., p. 15.

\(^{28}\) Ibid.,


subject to the review by the courts. In order to aid in determining what constitutes just and reasonable charges, the commissions are authorized to ascertain the value of the property of all enterprises under their jurisdiction. The commission may require that the enterprise follow a prescribed accounting system. Moreover, the commissions may hear cases on their own motion or on complaint. Also, the consumer may complain to the commissions for redress.

The need for Federal regulation of public utilities arose out of the increasing volume of interstate operations which tended to place the public service corporation farther and farther beyond the limits of state jurisdiction. The phenomenal growth of the industries in the public utility field in the period following World War I, with their extension across state lines, and the rapid development of public utility holding companies in the 1920's made Federal intervention inevitable. As noted earlier, the Federal government first entered the area of public utility regulation through the Interstate Commerce Commission which was given jurisdiction over telephone, telegraph, and cable companies engaging in interstate or international commerce by the Mann-Elkins Act (1910).

The Federal authority over the public utilities was further extended by the Federal Communications Act (1934). The Federal Communications Act is a broad regulatory measure covering all interstate and international communication by wire or by radio. The Act created the Federal Communications Commission upon which was conferred control over communication utilities similar to the control exercised by the Interstate Commerce Commission over railroad, motor, and water carriers. All
common communication carriers are required to provide adequate service upon reasonable request. Charges must be just and reasonable. The Federal Communications Commission is empowered to fix minimum, maximum, and precise rates. Interlocking directorates and unjust discrimination are forbidden. Certificates of convenience and necessity must be obtained before the construction of a new line, or the extension of an old one can be effected. Part of the provisions of the Act are applicable to radio communications and broadcasting only. In respect to radio communications, no person is permitted to operate a radio station without a license issued by the Commission. The Federal Communications Commission was also authorized to regulate such technical matters as the prevention of interference, the assignment of frequencies, the location of stations, and the time for operation. In respect to broadcasting, the Federal Communications Commission was required to maintain an equitable distribution of broadcasting facilities throughout the country. The Commission was further required to control broadcasting programs. The criterion is public interest, and in no case should freedom of speech be restrained. Another authority of the Commission with respect to broadcasting is to combat monopoly by maintaining broadcasting as a separate institution free from newspaper control and by preventing the creation of chain broadcasting systems.31

The Federal Water Power Commission was created by the Federal Power Act (1920). The duties of the Commission were to collect data on

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31 Wilson, op. cit., p. 510.
the utilization of water power resources and the power industry such as electricity and gas. The commission was authorized to license and supervise power projects and water power development on navigable streams or waters on the public lands of the United States. The Federal Power Commission has jurisdiction over rates and services on interstate commerce transactions. The authority of the Federal Power Commission was broadened by the Public Utility Act (1935). This Act provided that interstate transmission of electricity was subject to the control of the Commission. Another portion of the Public Utility Act (1935) dealt with holding companies in the gas and electricity industry. The Act applied to holding companies, their subsidiaries, and their affiliates, and mutual-service companies. Enforcement of this part of the Act was placed in the hands of the Securities and Exchange Commission. The Act defined that any company which controlled 10 percent or more of the outstanding voting securities of a public utility company was a holding company. 32 A subsidiary company was defined as any company, 10 percent or more of whose outstanding voting securities were controlled by the holding company, 33 and control of 5 percent of the voting stock of a public utility company by a holding company was sufficient to make it an affiliate of the holding company. 34 All holding companies were required to register with the Securities and Exchange Commission by December 1, 1935, in order to do any interstate business and to use the mails to issue or

32 Public Utility Act, 1935, Section 2 (a) (7).
33 Public Utility Act, 1935, Section 2 (a) (8).
34 Ibid., Section 2 (a) (11).
sell any securities, or to exercise any privilege with respect to voting. The most important provisions of this Act were; however, that, after January 1, 1938, holding companies were limited to a single, integrated public utility system and to such other business as was reasonably incidental, or economically necessary, to the operation of the system.

The Natural Gas Act (1938) was designed to provide for Federal regulation of the natural gas industry in the areas beyond the control of states. The Federal Power Commission was charged with the enforcement of this Act. Although the Act was designed to deal with natural gas, it does include cases where any mixture of natural and artificial gas is involved. The scope of this Act is limited to the transportation of gas in interstate commerce and to sale for resale for final consumption. In other words, the Act has no authority over the production and local distribution of gas. The authority which the Federal Power Commission exercises over the natural gas companies is very similar to that which the Federal Power Commission exercises over the electrical utilities; namely, just and reasonable rates; elimination of undue discrimination; establishment of an uniform accounting system; and submission of comprehensive financial statements and reports.
Corporations have generally pursued a policy of isolationism. They were deemed to be entities seeking to advance their own interests; simultaneously, it was believed that this self-advancement automatically contributed to the welfare of the entire society. Largely as a result of thriving business over a long period of years, this developed into a sort of tradition. But the emergency created by the depression in 1930's, followed by the emergencies caused by World War II and the tension of the postwar period, brought the feeling that a free system of business enterprise could not be trusted to meet the problems of want and security. Such events of recent times have tended to break through the shell of business isolationism and to cause several questions to be raised about the responsibility of business toward the whole society. Especially is this true as it relates to the large corporations. Actually, such large corporations as exist in this country today have been a way of life for the many people associated with it. In this sense, the large corporation is a social institution. The investing public; employees; customers; suppliers; the community; the government—all have certain expectations from corporate management. The managers of today's giant corporations should not be mere profit-chasers any longer. They should be "career men." These are

...men who can never hope to own any large portion of the enterprise of which they are a part; men who realize that the bonanza
days of the old captains of industry are over; men who see in business something more than the mere making of money; men who are imbued with a deep sense of social stewardship; men who are keenly sensible of the fact that they are the trustees of other people's money with heavy responsibilities to discharge to the employees and the public as well as to stockholders; men who find deep spiritual satisfaction in the direction of their brains and energy toward the creation of a better and more abundant life for all of their fellow human beings.1

An investor may be a bondholder or a stockholder. Either of them is governed by the corporate management—a private and invisible government.2 A bondholder is a governed per se. Even the common stockholders at large, as a result of the separation of ownership from control today, are to receive rather than to manage. The common stockholder in the modern corporate situation has surrendered a set of definite rights for a set of indefinite expectations. It is the corporate management who dominates such savings that were carefully accumulated by the stockholders and bondholders. Too many instances are on record where the few on the inside capitalized on their favored position at the expense of the larger group which furnished the capital and carried the real risk.

If the directors or officers of the corporation have only a small ownership interest in the corporation, they have more to gain for themselves by employing the assets in ways other than those which will maximize returns to the owners. The small ownership interest makes the control group less concerned to maximize dividend returns than to augment their own personal income by using the corporate assets in other ways. They may cause the corporation under their management to sell things at


lower prices to, or buy things at extortionate prices from the firms in which they have more direct interests.

The control groups of some corporations siphon off the bulk of profits into their pockets by employment of profit-sharing and bonus plans. Until recently these plans were not made known to stockholders nor the investing public in general.

Moreover, the corporate management groups are inclined to fix their salaries at such a high level that it is far from being proportionate to their contribution, and to use the money of corporations recklessly when they are on business expense accounts. These excessive salaries and fat expense accounts of management constitute still another instance of abuse of the corporation by insiders.

Management groups when requesting funds from the public are in a position both to misrepresent their expectation by word and phrase and by supporting data, and then to use the funds obtained for purposes other than those announced. Proper investment is not only essential to the interests of the investing public, it also has an effect on wage levels and on stability of employment.3

Also, the corporate directors or officers may speculate in the shares of the corporation under their jurisdiction in such ways as to make unjust profits because of their superior knowledge of present conditions and future policies of the corporation.4


4 John Maurice Clark, Social Control of Business (Chicago: The University of Chicago Press, 1933), p. 239.
Enlargement of the supervisory powers of government is an important approach to fixing the responsibility of management to investors. The immobilized state of investors has largely prevented the investors from exercising their rights; the mobilized force of government is more likely to induce the application of such rights. The passage of the Securities Act of 1933 and the Securities Exchange Act of 1934 marked the first general steps of the Federal government to protect the investing public by charging the corporate management with the duty of disclosing detailed information about the corporation, and by outlawing any manipulation of security prices by corporate insiders. Yet, the soundness of investing environment still depends very much on the integrity of corporate management.

A majority of investors depend, partially or wholly, upon investment income for their living. The management should, therefore, maintain a healthy corporation and make regular payments, when earned, of sufficient dividends to assure income stability to owners. The corporate management should fully disclose their thinking on reinvestment of earnings and regularly explain the corporation's long-term plans and expectations. In determining the dividend rate to earnings, management must take into account both a short-term and long-term evaluation of the national economy. In order to show the investors the whole corporate picture and to discharge their responsibility to stockholders, the

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management should provide stockholders with proper accounting and financial statements of their corporation.

Also management should make a reduction of the payment to themselves, because the extremely high pay to top management is not in accord with their contribution, it is merely a reflection of business custom or tradition. Moreover, the corporate officials should forego their fat expense accounts. No longer should the president of a corporation spend $120 a day on a suite of rooms at a hotel when he goes to a business convention.6

The employees, as the citizens of a country, are subjected to all rules promulgated by their government. But the rules that most intimately affect their lives are those made by their employers. The benefits of a country's economic development plan seems to be uncertain and remote, while a word from the boss may have an effect on family happiness at the evening dining table.

The rules made by the employer determine for the individual worker where he shall work, when he shall work, what he shall do, who will give him orders, who will take orders from him, his promotion and discipline, the amount of pay he will get, and the time and duration of his holidays and vacations.

The influence of employees is weak compared with that of the corporation which makes and enforces the rules affecting them. Originally,

the transfer of job was the only weapon available to employees for countering employers. The current position of employees has been strengthened by the Federal and state employment laws and strong trade unions.

Just as the true strength of the customer in the apparently unequal negotiation with the business corporation rests in the ability of the customer to go elsewhere to do his business; so too the strength of the employee rests in his ability to get another job from another employer. Obviously, in view of the scarcity of job opportunities, the employee cannot do much to counterbalance the power of his employer by quitting the job. Employees tend to realize that the power of quitting a job is an illusion to reality and therefore they are reluctant to transfer. The employment laws set up a framework in which the management must confine its own regulations and decisions. Laws such as the Federal Labor Standard Act, Hours of Service Act, Safety Appliance Act, and Employers' Liability Act are illustrations of Federal regulation in this field. Fair employment practice acts and workmen's compensation statutes enacted by state legislatures also contribute greatly toward evening the relative strength of employee and employer.

Like the employment laws, the trade unions establish minimum working conditions for employees in various classifications of employment. The unions also strengthen the position of the individual worker in disputes where flagrant injustice might result if decisions of administrative officers were made without the restrictive influence of unions.

The union movement in this country may be traced back to 1792 when a local union was formed by some shoemaker of Philadel-
Philadelphia. In 1835-1836, two so-called national unions of shoemakers and printers made their appearance. The first period of intensive national organization of labor was, however, from 1863 to 1873. During these years some twenty-six national unions were formed. The Knights of Labor was the first important federation of national unions. There is now one comprehensive organization of labor: the American Federation of Labor and Congress of Industrial Organizations. The Wagner Act of 1935 provides that the employees are entitled to organize at their own choice and to bargain collectively. The Taft-Hartley Act of 1947 provides that collective bargaining is the obligation of trade unions as well as of employers.

Neither employment laws nor trade unions, however, can do more than provide the broad framework of conditions of employment and occasional protection to the individual in extreme cases of maladministration. The free choice of jobs is more theoretical than practical. So the improvement of the welfare of employees still depends very much on the employer. No longer is it enough for the employer to give a worker a day's pay for a day's work and then forget him.

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8 Ibid., p. 41.

9 Wilcox, op. cit., p. 526.

10 National Labor Relations Act, Section 7.

11 Labor Management Relations Act, Section 8 (a), (b).
It is a recognized fact that business corporations today must participate in providing for the various contingencies which give rise to insecurity. Unemployment insurance, provision for old age, and various forms of compensation insurance are already in common use, being financed through joint action of government and private enterprise or by business directly. Thus in the case of the Federal security program, a tax is paid by the individual worker and the employer. The taxes paid by the individual worker are withheld from the employee's wage and paid for him by the employer. When the present program is in full operation, this tax will amount to 9 per cent of the payroll—4½ per cent to be borne by the employer and 4½ per cent by the employee. Also many large corporations provide private pension plan for their employees directly. In addition to a genuine desire to care for the superannuated, there are a variety of reasons which warrant this practice; such as, the paying of pensions would provide the corporation with a device which will enable the corporation to clear its working force of older employees without arousing bitterness on the part of its workers and resentment on the part of the general public; and, that the paying of pensions tends to create emotional and economic attachment of employees to their employers and thus make them less likely to join unions.

Other fringe benefit provisions; such as paid vacation, free medical treatment, free lunch, employee's publication are also frequently found in corporate employment contracts. As corporations get larger,

an employee's future is often determined more by an impersonal administrative process than by the free play of the labor market; thus making it possible for an able man to be buried in the lower levels of employment. To avoid this, the corporation should select the right kind of people in the first place to fit easily into the corporation and its special needs; expose the employees to as varied experience as possible in order to keep the best people moving upward; give the employees the maximum possible autonomy and authority, advice often preached but little practiced; and let the employees know what the corporation is doing, and why, thus securing their cooperation and encouraging their ambition.

In a pure competition economic system, each individual enterprise must compete for consumer favor. The best interests of the enterprise coincidentally are the best interests of the consumer. This means the self-advancement of individual business automatically contributing to the welfare of the entire society. The traditional logic of the business enterprise is to maximize returns to the owners, and to pursue this aim will contribute to the general good, because the maximization of profit means producing such goods and services as the consumers desire. In other words, the maximum profits of the individual business arrive when its marginal cost equals marginal revenue (market price) and average cost, and, since the average cost arrives at its lowest point when it coincides with the marginal cost, the consumers get maximum satisfaction when the profits of the individual business are maximized.13

But when the enterprise is corporate in form, the situation may be different. In the large business corporations nowadays, the control groups have not the same incentive to maximize profits as formerly; therefore, there is no assurance that the operation of business corporations will be towards the maximization of returns to the owners, and hence, there is no guarantee that the best interests of consumers are being served.

Pure competition rarely existed. As some corporations grew to be giants, competition became even more imperfect. Although in imperfect competition the consumers are still able to exercise their strength by getting a good or service in another place; by finding something else that will do; by postponing their buying; or by outright restraining their wants. Yet it is obvious that the consumers are at a greatly disadvantageous position compared with the position of corporations. There has been a consumer cooperative movement, but its strength is by far inferior to that of corporations. The nationwide advertising of corporation is so skillfully designed that the potentiality of choice of the consumer is substantially curtailed; the corporation's monopolistic powers are so tremendous that consumers are actually in the position of being without choice. The individual consumer appears to be subjected to the decision of business management as to what shall be offered, where and when he can get it, and how much he will have to pay for it. The following are some of the possible approaches to correcting some of the undesirable activities of corporate enterprises.
The employment of formal and informal controls has been advocated frequently. These include public regulation and public opinion, as well as religious and educational influences. These also imply cooperation among the many constituents of society. For example, a publisher should not accept an advertisement of doubtful honesty.

On the part of business corporations, the corporate managements should give continuing attention to technical progress in the stages of both production and distribution. Distribution processes are desirable so far as the creation of time utility and place utility are concerned, but the distribution processes add nothing to the intrinsic value of articles. Economical distribution methods should be developed so that the benefits achieved in production are not dissipated by costly distribution. The consumer's interest is evaluated on the basis of the retail selling price, not the price at which the manufacturer sells to the distributors. Also, the corporation should not take advantage of its superior position to charge an extortionate price.

The ultimate aim of production is to satisfy the people's wants. Customer preference must be taken into account by the producers. A variety of commodities should be supplied to meet the different needs of consumers. The corporation should supply the wants in the area of its production. Where the community has come to rely on a corporation for steel, oil, automobiles, or cigarettes; the corporation is obliged to meet reasonable demands. The supplying of adequate goods and services to its consumers is the duty as well as the right of a corporation.

The more informed consumers are the better customers they will be. The corporation should keep the consumers well informed through
full and honest disclosure of merchandise characteristics and through
detailed catalog copy and informative labels.

For a giant corporation responsibility to suppliers is a special
trust as thousands of small suppliers depend largely or even wholly on
it for their very existence.

Small suppliers of raw materials and semi-finished goods often
find that a giant corporate manufacturer is the sole prospective
customer of their products and thus suffer from the abuse of monopolistic
bargaining power by the latter, because only this manufacturer owns the
facilities and equipment which are required to turn those raw materials
or semi-finished goods into finished products.

Small suppliers of finished goods often find that they could not
exist were they not affiliated with a corporate retailer. Such manu-
facturers are too small to have the resources to create a consciousness
on the part of the public of their goods, nor can they compete success-
fully with the vast resources and enormous power of the large manu-
facturer. This means that the small manufacturers must depend upon the
large corporate retailer to create the kind of product and publicity
which will constitute their bid for consumer preference.

The rules made by giant corporations to apply to vendors cover
all the specifications made by the purchaser on the things that are
purchased, the price that will be paid; when it will be paid; the
quantities; qualities; and nature of the things supplied; the date of
delivery; provisions for return of damaged or unwanted goods; restrictions
on the sale to others; and all the rest. To lessen the squeeze that
could be put on the suppliers, the long-term contract, namely five years
or longer, should be used. The long-term contract gives the suppliers some stability. Long-term affiliations bring benefits in terms of decreased cost and improved production from newer equipment and more advanced techniques that are far greater than any temporary advantages which might be gained by shrewed short-term bargaining. Moreover, in these long-term contracts, profit margins are specified, based essentially on a reasonable ratio of profits to investment. Billing prices are tentative only. At the end of the year a determination of actual costs and profits is made and any savings made are shared. The long-term contract also permits a firm foundation for joint long-term planning by both parties and insures that fruits of research will be available to either side. A supplier can install new equipment and techniques when a long-term contract is in his pocket.

Increasingly the community has put the touch on business to contribute money, managerial time, and managerial talent to community affairs.¹⁴ Many giant corporations have separate public relations departments headed by vice presidents or assistants to the president. These departments are in charge of general public relations as well as relations with investors, customers, suppliers, and government.

Business organizations, especially the large ones, have become one of the main pillars of charitable giving. In this country, corporate giving increased steadily over the opulent years since World War II and climbed to $415 million in 1955, broke the half billion

mark in 1956, and hit $520 million in 1957.\textsuperscript{15} There is no question that corporate donations are one of the biggest sources of collections by Community Chests and United Funds. While in gifts to college operating funds, the corporations are second only to religious denominations.\textsuperscript{16} Generally, large corporations have set up foundations to handle their giving, and continue their contributions to those foundations even in lean years. For the corporation there are definite advantages to lumping all of its giving into one sum, and then letting the foundation parcel out the money among assorted educational, welfare, health, and other agencies. It saves the corporation trouble, and saves it the embarrassment of saying no. In good years for the corporation, the foundation will get a large sum of money, large enough so that it can hold some over for future calls. Some corporations even fund their foundation with stock, whose dividends in good years add to this reservoir.

The corporations that have not set up foundations—including the vast majority of the smaller firms—indicate little likelihood of maintaining the pace of giving set by the foundations. For the individual givers; a steep dip in profits is bound to be reflected in donations.

Most national corporations are as much concerned with their standing before the national public as they are before the immediate community surrounding their operations. One way to approach this greater public is through programs directed specifically toward various

\textsuperscript{15} "Business Giving Stays High," \textit{Business Week}, September 27, 1958, p. 65.

\textsuperscript{16} Ibid.
segments of it. The processes are, first, to find out what the public considers is its own best interest and then to shape the corporation’s policies and conduct so that the public’s interest will be served best.\textsuperscript{17} Medical care is one of the major areas of general public interest in this country. A substantial part of corporate donations is used in this area with the emphasis being placed on the encouragement of a better distribution of medical care, namely from urban to rural areas.\textsuperscript{18} Another major area of general public interest is education. The annual donations by corporations to education are tremendous, especially to higher education. Notably, there is a clear tendency to allot more money to educational institutions. In 1950 only 17 per cent of the total giving went to education; in 1956 the figure jumped to 34 per cent.\textsuperscript{19}

Business firms have long known the profitability of research work and have increasingly established not only laboratories but also research villages that are the envy of universities. These corporations conduct research in their own super laboratories and, when necessary, send their own employees back to the universities for formal training.\textsuperscript{20}

Public speaking is an interesting and valuable public relations tool which seems to have gained popularity recently. Speeches are made either by members of the public relations department or by any qualified

\textsuperscript{17} Wright, \textit{op. cit.}, p. 29.


\textsuperscript{19} "Business Giving Stays High," \textit{Business Week}, September 27, 1958, p. 65.

corporate executive. Some corporations have formed pools from which they draw speakers as needed. Others have regular speakers' clinics by which they attempt to improve the general quality of public speaking for their organization. Preparation of speeches for the top corporate executives when they are called upon for such addresses has become part of the responsibilities of the public relations men. Demands for speakers arise from numerous sources, such as business and professional meetings, women's clubs, school assemblies, and the meetings of church and fraternal groups.

Participation in the community work and fund drives constitutes still another approach to good community relations. The corporation should take more than a passive interest in community affairs; the corporation should be active in cooperating with the community. These desirable activities include participation in Red Cross; Community Chest; hospital; and other charitable campaigns; the joining in the activities of Y. M. C. A.; Parent-Teachers organizations; Chambers of Commerce; and other service clubs.\(^{21}\)

Government today is the most powerful and pervasive institution in the society, and has a more potent influence on business and economic life than any other force. A major share of business income, as well as that of the personal income of the businessmen, goes to government in the form of taxation. The fiscal policies of government have a profound influence on business activity. The individual business freedom of the few may properly be curtailed if by so doing freedom for

\(^{21}\) Wright, *op. cit.*, p. 113.
the many is enhanced. In addition to increasing total economic freedom, it is the general belief that the subjection of individual business to governmental controls is a prerequisite of successful functioning of the economic system in the interest of full employment, stable prosperity, and national defense.

The greatest governmental intervention in business has emerged in time of depression and war. Then the market function has been largely superseded by authoritarian controls. Laws have been piled upon laws, orders upon orders. Administrative agencies have multiplied. All of the available methods of control have been put to use; all of the usual sanctions employed.

In the depression of 1930's, code by code under the National Industrial Recovery Act of 1933, which was declared to be unconstitutional by the Supreme Court in 1935, were designed to control the terms of sales, prices, markets, production, capacity, and the channels of distribution. 22

In time of war, or threat of war, production has been diverted from civilian to military purposes; prices and wages have been fixed; consumer goods rationed; materials and manpower allocated among competing demands; and the seizure of productive facilities has been used repeatedly. The first law authorizing seizure was enacted by Congress during the Civil War, and others during the two World Wars and the Korean

conflict. These laws have authorized the President to take possession of power plants, mines, steel mills, transport and communications facilities, and other basic industries in the event of war or other national emergency, in order to insure the continued production of essential goods and services during wage disputes.23

Moreover, if government seeks to socialize an existing private business whose owners do not wish to sell, it may do so by exercising the sovereign right of eminent domain. The only limitations are that the property must be taken for public use, and that just compensation must be paid.

Also, as a responsibility comparable to that of a private citizen, the corporations should actively initiate rather than merely passively receive the government's social, fiscal, and economic legislation.

Corporations should involve themselves actively in the political life of the country, because ultimately it is the stresses and strains of practical politics that shape the policies and determine the course of government. Involvement of businessmen in the political activities is not merely a matter of assuring business a voice in political councils; more important, it is a matter of bringing to political affairs the strength, the experience, and the special skills of businessmen, which would not be achieved should the business fail to assume its full share of the burdens of political responsibility. Moreover, in assuming

23 Ibid., p. 27.
political responsibility, it is not enough for an individual corporation merely to follow the recommendations of an organized business group; it is sounder to reason from the concrete facts in specific cases and to formulate conclusions which will be based on such facts and interpreted in the light of the general rule. Indeed, corporations should take more initiative in sponsoring measures for dealing constructively with problems of general concern than they have been.

There has been the fear of the growth of corporate size and corporate power which had stemmed from the belief that the corporation was but an artificial personality and, therefore, did not have a soul or a conscience. Lacking a conscience, it could have no morals and was prima facie dangerous. As a result, welfare and high wages for employees are explained in terms of the increase of workers' efficiency. Rational plant architecture is for the sole purpose of good relations to the general public. Promotion of liberal education by a corporation is similar to help given to the church bazaar by the local grocer. Even the spending of money for research in pure science may in the long run show profits for business. The corporation, having unlimited life, simply is in a position to take long view.

However, many corporate activities cannot be explained in this fashion. The uncertainty and remoteness of benefits from these activities, as well as the unlikelihood of seeing them converted into

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cash, disclaim the profit-maximizing explanations given for all the activities of a modern corporation.

Other students of business hold that the preservation of the firm, and not the maximization of profits, is the goal of the big corporation. In other words, the corporation regards public relations work as a self-defensive measure. To these students, soulful activities of the corporation are viewed as an attempt to assure a place for the corporation in the enlightened future.

Those who view all actions of big business with suspicion, see the corporation's new cloak of generosity as a sort of disguise or as a combined product of the growth of labor union's strength and the increase of public pressure which ultimately caused government's regulatory actions in business, and feel that self-righteousness is another aspect of new corporations. To this point of view, again it may be argued that the corporation's generosity is a product of neither the strength of labor unions nor the actions of government, but rather, of the growth of the wealth and power of corporations. It is difficult to image a firm fighting for its existence in a purely competitive situation and at the same time giving handsomely of its resources for the furtherance of liberal education. Only the big and powerful corporation can afford to be soulful in such a generous manner.

While the motive of corporation generosity continue to be a matter of argument, there is at least agreement that the corporations

CHAPTER VII

CONCLUSIONS

The business corporation is a form of enterprise that is growing in harmony with the development of economic society. The origin of business corporation is commonly dated from the turn of the seventeenth century when the English East India Company came into existence. During the early period of its history, the business corporations were in reality governmental as well as commercial, having their main interest in the development of overseas trading and in colonization. The business corporations sought the government for protection, and the government expected the corporations to bring advantages to the nation in return. The second period of the history of business corporation ran from the industrial revolution to the turn of the current century, the corporation as a form of business enterprise refined its structure and magnified its importance. In this second period of corporate development, captains of industry made their appearance. They were men who dealt ruthlessly with the public, men who exploited the community as much as they could, men who never hesitated to utilize every available means to promote their own personal and affiliated interests.¹ The philosophy of laissez faire resulted in the enactment of general incorporation laws by governments and in the restriction of governmental control to the minimum of requiring

the submission of an application for incorporation. The third period of the history of business corporation, dating from the beginning of this century, is one of increasing governmental intervention. This is especially true in the areas of transportation, public utilities, and other industries bearing extensive public interest. The consciousness of social responsibility on the part of the business corporation has become a new aspect of corporate history.

The contribution of the corporate form of business to the economic advancement, especially in the latest hundred years, has proved the corporation to be a business organization with a wide range of adaptability for individual uses and economic advantages. It is reasonable to anticipate that the corporate enterprise will continue to be the most valuable form of business organization for future economic development.

It is noteworthy, however, that the business corporation is capable of both great use and great abuse. Alongside the business corporations which gather capital for production and transportation are those formed to benefit promoters of new corporations and liquidators of bankrupt corporations at the expense of investors and creditors. With every new wave of investment there rises a crest of overoptimism, speculation, and promotion for promotion's sake.

Prevention of the abuse of corporate powers and privileges without hampering efficient operation is the direction in which the collaboration of lawyers, economists, journalists, sociologists, political scientists, and the general public should be guided.
This aim may be approached by two ways: one is more complete governmental supervision over business corporations; the other is the further development of social consciousness on the part of corporate management.

Expansion of existing regulatory commissions is a prerequisite to the extension of governmental supervision over business corporations. The budgets and staffs of such regulatory bodies as the Interstate Commerce Commission, the Federal Trade Commission, and the Securities and Exchange Commission have been inadequate for competent discharge of the multi-farious tasks currently assigned to them. It would be improbable that they could discharge any additional function successfully without a corresponding increase of budget and expansion of staff.

In addition to facilitating the performance of their regular functions, sufficient funds and adequate staff enable the regulatory commissions to initiate research and investigation work. The findings of such study, when made public, would serve as a guide to the public for their investment and consumption activities, and as an aid to Congress in formulating national economic policy and in developing additional legislation.

Many methods have been advocated to make the corporate management social conscious. These include the influence of education, religion, community, and public opinion. The corporate management should make themselves the trustees of society and their corporations the social institutions.

The consciousness of social responsibility on the part of corporate management does not imply that the self-advancement concept,
which is an indispensable incentive in the private enterprise economic system, should be totally repudiated. It does mean, however, that the corporate management must be aware of the fact that their self-interest seeking could not be perpetuated unless, simultaneously, they contribute to the welfare of entire society.
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