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THE
MODERN CORPORATION
AND
PRIVATE PROPERTY

By

ADOLF A. BERLE, JR.
FACULTY OF LAW, COLUMBIA UNIVERSITY

and

GARDINER C. MEANS
COLUMBIA UNIVERSITY

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BOOK IV

REORIENTATION OF ENTERPRISE

**Effects of the Corporate System on Fundamental
Economic Concepts**

CHAPTER I

The Traditional Logic of Property

The shifting relationships of property and enterprise in American industry here described, raise in sharp relief certain legal, economic, and social questions which must now be squarely faced. Of these the greatest is the question in whose interests should the great quasi-public corporations (now representing such a large proportion of industrial wealth) be operated. This problem really asks in a different form the question, who should receive the profits of industry?

It is traditional that a corporation should be run for the benefit of its owners, the stockholders, and that to them should go any profits which are distributed.¹ We now know, however, that a controlling group may hold the power to divert profits into their own pockets. There is no longer any certainty that a corporation will in fact be run primarily in the interests of the stockholders.² The extensive separation of ownership and control, and the strengthening of the powers of control, raise a new situation calling for a decision whether social and legal pressure should be applied in an effort to insure corporate operation primarily in the interests of the "owners" or whether such pressure shall be applied in the interests of some other or wider group.

The lawyer answers this question in no uncertain terms by applying to the quasi-public corporation the traditional logic of property. The common law, extended

¹ Bonus schemes are usually undertaken with an aim of *increasing* the profit remaining and available to be distributed as dividends. For this reason they must, in general, be regarded as a cost to the stockholders rather than as a sharing or distribution of profit.

² While there are other possible groups,—the employees, the consumers, etc., in whose interest a corporation might be run, discussion of them can best be delayed.

to meet the new situation, logically demands the award of the entire profit to the security holders, and in particular to the stockholders. According to this logic a corporation should be operated primarily in their interests.

The legal argument is largely historical; but it has been built up through a series of phases which make this conclusion inevitable. From earliest times the owner of property has been entitled to the full use or disposal of his property,³ and in these rights the owner has been protected by law. Since the use of industrial property consists primarily of an effort to increase its value—to make a profit—the owner of such property, in being entitled to its full use, has been entitled to all accretions to its value—to all the profits which it could be made to earn. In so far as he had to pay for the services of other men or other property in order to accomplish this increase in value, these payments operated as deductions; the profit remaining to him was the difference between the added value and the cost of securing these services. To this difference, however, the owner has traditionally been entitled. The state and the law have sought to protect him in this right.

From earliest times, also, the stockholder in the corporation has posed both as the owner of the corporation and the owner of its assets. He was removed slightly from legal ownership in the assets in that he did not have legal "title" to them—that was vested in the corporation; but collectively the stockholders, through their participations were entitled to the whole of corporate assets and to the whole of any corporate profits which could be made. The corporation was theirs, to be operated for their benefit.

In the development of the corporation, constantly widening powers over the management of the enterprise have been delegated to groups within the corporation. At first these powers concerned mainly the technical (profit-making) activity of the enterprise. Later, powers were delegated which had to do with the distribution of profits and interests among the security holders. With

³ Except as impaired by the exercise of police power by the state.

the separation of ownership and control, these powers developed to a stage permitting those in control of a corporation to use them against the interests of ownership. Since powers of control and management were created by law, in some measure this appeared to legalize the diversion of profit into the hands of the controlling group.

Following the traditional logic of property, however, it is clear that these powers are not absolute. They are, rather, powers in trust. The controlling group is, in form at least, managing and controlling a corporation for the benefit of the owners. While insertions might be made in corporation statutes and in corporate charters apparently giving power which could be used against the interests of the owners, these were, in the light of the common law, only grants of power to the controlling group, the better to operate the corporation in the interests of its owners. The very multiplication of absolute powers, including power to shift interests in the corporate assets and profits from security holders to those in control threw into bold relief the tacit (but by no means fictitious) understanding that all these powers were designed for the benefit of the corporation as a whole, and not for the individual enrichment of the management or control. While the law fumbled in application of this principle, and developed through a series of rules, sometimes inconsistent and often not clear in application, not a single case on record denies the ultimate trusteeship of the controlling group, nor even faintly implies that such a group may use its power for its individual advantage. Fact-situations can be "rigged" whereby the individual profit of this group is made to appear an advantage to the corporation as a whole; advantage may be taken of emergencies in which the management and control present the security-holding group with the alternative of permitting profit to the "control" on the one hand or inviting disaster on the other. Sometimes the courts, shielding themselves behind a consideration of the advantage to the "corporation as a whole," have overlooked the fact that apparent advantage to the mythical corporate entity may mean staggering loss to its separate own-

ers; and that it is often necessary to trace *what group within the corporation* receives the ultimate advantage. Despite these situations, in many of which the controlling group is able, first, to seize a portion of the corporate profits and, second, to hold them against legal attack, the theory of the law seems clear. All the powers granted to management and control are powers in trust.

Tracing this doctrine back into the womb of equity, whence it sprang, the foundation becomes plain. Whether one man or a group of men entrusted another man or group with the management of property, the second group became fiduciaries. As such they were obliged to act conscientiously, which meant in fidelity to the interests of the persons whose wealth they had undertaken to handle. In this respect, the corporation stands on precisely the same footing as the common-law trust. Since the business problems connected with trusts were relatively restricted, a series of fairly accurate regulations could be worked out by the equity courts constraining the trustee to certain standards of conduct. The corporation, which carried on any and every kind of business, raised a set of problems of conduct infinitely more varied, and calling for expert business judgment which courts were not equipped to render. Fixed standards of conduct, therefore, became impossible of development in the corporate situation; such rigid standards as were worked out, (for instance, the standard that no stock must be issued unless first offered preemptively to existing shareholders) became arbitrary or inapplicable in the complex corporate structure of today. But though definite rules could not be laid down, the courts have maintained a supervisory jurisdiction; the fundamental principle of equitable control remains unimpaired; and the only question is how it should be applied in each case. Inability to answer these questions has given ample latitude to the control to absorb a portion of the corporate profits. This does not mean, however, that the law concedes them a right to such absorption. It merely means that legal machinery may not be sufficiently developed to accomplish a remedy.

Underlying all this is the ancient preoccupation of the common law with the rights of property. Primarily, the common law did not undertake to set up ideal schemes of government. It aimed to protect men in their own. Only where the property interests conflicted with some very obvious public policy did the law interfere. Its primary design was protecting individual attributes of individual men,—their right to property, to free motion and locomotion, to protection of individual relationships entered into between them. In this aspect the corporation was merely one more bit of machinery by which the property of individuals was managed by other individuals; and the corporate management took its place in the picture alongside of agents, trustees, ship captains, partners, joint adventurers, and other fiduciaries. As the power of the corporate management has increased, and as the control of the individual has sunk into the background, the tendency of the law has been to stiffen its assertion of the rights of the security holder. The thing that it has not been able to stiffen has been its regulation of the conduct of the business by the corporate management. And this omission has resulted, not from lack of logical justification, but from lack of ability to handle the problems involved. The management of an enterprise is, by nature, a task which courts can not assume; and the various devices by which management and control have absorbed a portion of the profit-stream have been so intimately related to the business conduct of an enterprise, that the courts seem to have felt not only reluctant to interfere, but positively afraid to do so.

The result accordingly is that the profits of the enterprise, so far as the law is concerned, belong to the security holders *in toto*. Division of these profits among the various groups of security holders is a matter of private agreement, but they, between them, have the complete right to all of the profits which the corporation has made. Not only that: they are entitled to those profits which the management in reasonable exercise of its powers ought to make. They have further a right that no one shall become a security holder except upon a suitable

contribution to the corporate assets—that is, that the security holding group shall be a group of persons who have committed actual property to the administration of the management and control of the corporation.

Such is the view which the law has developed by extending to the new situation the traditional logic of property. The control group is not in a position openly to combat this logic. Constant appeals are made both to this ideology and to its legal basis when corporations go into the market seeking capital. The expectation of the entire profit is the precise lure used to induce investment in corporate enterprises. The possibilities of the situation are continuously stressed by investment bankers who, in turn, act for the corporate management and control when the latter are bidding for the public investor's savings. Whatever their private views or actual practice, the control groups within corporations have estopped themselves from maintaining any other view. The legal hypothesis has been too much the basis of the financial structure of today.

Yet, while this conclusion may result inevitably when the traditional logic of property is applied to the new situation, are we justified in applying this logic? In the past, the ownership of business enterprise, the only form of property with which we are here concerned, has always, at least in theory, involved two attributes, first the risking of previously collected wealth in profit-seeking enterprise; and, second, the ultimate management of and responsibility for that enterprise. But in the modern corporation, these two attributes of ownership no longer attach to the same individual or group. The stockholder has surrendered control over his wealth. He has become a supplier of capital, a risk-taker pure and simple, while ultimate responsibility and authority are exercised by directors and "control." One traditional attribute of ownership is attached to stock ownership; the other attribute is attached to corporate control. Must we not, therefore, recognize that we are no longer dealing with property in the old sense? Does the traditional logic of property still apply? Because an owner who also exer-

cises control over his wealth is protected in the full receipt of the advantages derived from it, must it necessarily follow that an owner who has surrendered control of his wealth should likewise be protected to the full? May not this surrender have so essentially changed his relation to his wealth as to have changed the logic applicable to his interest in that wealth? An answer to this question cannot be found in the law itself. It must be sought in the economic and social background of law.

CHAPTER II

The Traditional Logic of Profits

The economist, approaching the problems growing out of the shifting relationship of property and enterprise which we have examined, must start from a different background and with a set of interests differing essentially from those of the law. His interest is not primarily in the protection of man in his own, but in the production and distribution of what man desires. He is preoccupied, not with the rights of property, but with the production of wealth and distribution of income. To him property rights are attributes which may be attached to wealth by society and he regards them and their protection, not as the inalienable right of the individual or as an end in themselves, but as a means to a socially desirable end,¹ namely, "a plentiful revenue and subsistence" for the people.

The socially beneficent results to be derived from the protection of property are supposed to arise, not from the wealth itself, but from the efforts to acquire wealth. A long line of economists have developed what might be called the traditional logic of profits. They have held that, in striving to acquire wealth, that is, in seeking profits, the individual would, perhaps unconsciously, satisfy the wants of others. By carrying on enterprise he

would employ his energy and wealth in such a way as to obtain more wealth.² In this effort, he would tend to make for profit those things which were in most demand. Competition among countless producers could be relied upon in general to maintain profits within reasonable limits while temporarily excessive profits in any one line of production would induce an increase of activity in that line with a consequent drop of profits to more reasonable levels. At the same time it was supposed that the business man's effort to increase his profits would, in general, result in more economical use of the factors of production, each enterprise having to compete with others for the available economic resources. Therefore, it has been argued that by protecting each man in the possession of his wealth and in the possession of any profits he could make from its use, society would encourage enterprise and thereby facilitate the production and distribution of goods desired by the community at reasonable prices with economic use of labor, capital, and business enterprise. By protecting property rights in the instruments of production, the acquisitive interests of man could thus be more effectively harnessed to the benefit of the community.

It must be seen that under the condition just described, profits act as a return for the performance of two separate functions. First, they act as an inducement to the individual to risk his wealth in enterprise, and, second, they act as a spur, driving him to exercise his utmost skill in making his enterprise profitable.³ In the case of a private enterprise the distinction between these two functions does not assume importance. The owner of a private business receives any profits made and performs the functions not only of risk taking but of ul-

¹ Adam Smith treated property as a "natural right" (following the teachings of Locke) and its protection as a "law of nature." At the same time he analyzed the beneficent results which might be expected to flow from making actual conditions conform to this "law of nature," i. e., from protecting property. The Nineteenth Century has seen the atrophy of the idea of "natural law" and the shift of emphasis to the advantages of the protection of property. See Adam Smith, "Wealth of Nations," Book I, Chap. X, Pt. II.

² Since this study is concerned with property rights in the instruments of production, we need not here consider the process of acquiring wealth in the form of wages and salaries or in the form of interest.³ These two functions have been recognized in the current literature on profits. Some writers have maintained that profits are primarily a return for the taking of risk while others have maintained that they are primarily a return for exercising business judgment and enterprise. See S. H. Nerlove, "Recent Writings on Profits," The Journal of Business of the University of Chicago, Vol. II (1929), p. 363.

mate management as well.⁴ It may be that in the past when industry was in the main carried on by a multitude of small private enterprises the community, through protecting property, has induced a large volume of risk-taking and a vigorous conduct of industry in exchange for the profits derived therefrom.

In the modern corporation, with its separation of ownership and control, these two functions of risk and control are, in the main, performed by two different groups of people. Where such a separation is complete one group of individuals, the security holders and in particular the stockholders, performs the function of risk-takers and suppliers of capital, while a separate group exercises control and ultimate management. In such a case, if profits are to be received only by the security holders, as the traditional logic of property would require, how can they perform both of their traditional economic roles? Are no profits to go to those who exercise control and in whose hands the efficient operation of enterprise ultimately rests?

It is clear that the function of capital supplying and risk-taking must be performed and that the security holder must be compensated if an enterprise is to raise new capital and expand its activity just as the workers must be paid enough to insure the continued supplying of labor and the taking of the risks involved in that labor and in the life based on it. But what if profits can be made more than sufficient to keep the security holders satisfied, more than sufficient to induce new capital to come into the enterprise?⁵ Where is the social advantage in setting aside for the security holder, profits in an amount greater than is sufficient to insure the continued

⁴ Even though he employs a manager to carry on the immediate activities of the business, his desire for profits presumably induces him to select the most efficient manager available and so require of him a high standard of performance.

⁵ "Profits sufficient to keep the security holders satisfied," etc., is a vague expression and not easily defined. In practice, however, it is not necessarily so vague. Dissatisfaction among stockholders is presumably not important if it does not make itself known; and inability to raise new capital with ease is likely to be all too evident to a controlling group.

supplying of capital and taking of risk? The prospect of additional profits cannot act as a spur on the security holder to make him *operate* the enterprise with more vigor in a way to serve the wants of the community, since he is no longer in control. Such extra profits if given to the security holders would seem to perform no useful economic function.

Furthermore, if all profits are earmarked for the security holder, where is the inducement for those in control to manage the enterprise efficiently? When none of the profits are to be received by them, why should they exert themselves beyond the amount necessary to maintain a reasonably satisfied group of stockholders? If the profit motive is the powerful incentive to action which it is supposed to be, and if the community is best served when each enterprise is operated with the aim of making the maximum profit, would there not be great social advantage in encouraging the control to seize for themselves any profits over and above the amount necessary as a satisfactory return to capital? Would not the prospect of this surplus profit act as an incentive to more efficient management by those in control? Certainly, one cannot escape the conclusion that if profits have any influence as a motivating force, any surplus which can be made over a satisfactory return to the investor would be better employed when held out as an incentive to action by control than when handed over to the "owners," who have surrendered control.

This conclusion is somewhat modified by the fact that the separation of ownership and control has not yet become complete. While a large body of stockholders are not in a position to exercise any degree of control over the affairs of their corporation,⁶ those actually in control are usually stockholders though in many cases owning but a very small proportion of the total stock. It may be that the prospect of receiving one or two per cent of the total added profit which could be produced by their own more

⁶ Except under the most unusual conditions as for instance in case of a proxy fight, when the bulk of the stockholders play the role of the populace supporting or refusing to support a palace revolution.

vigorous activity would be sufficient inducement to produce the most efficient operation of which the controlling group are capable. It remains true, however, that profits over enough to keep the remaining stockholders satisfied and to make possible the raising of new capital would still involve an economically wasteful disposal. Only the one or two per cent of profits going to the controlling group would perform both roles traditionally performed by profits.

The traditional logic of profits, when thus applied to the modern corporation, would indicate that *if profits must be distributed either to the owners or to the control, only a fair return to capital should be distributed to the "owners"; while the remainder should go to the control as an inducement to the most efficient ultimate management.* The corporation would thus be operated financially in the interests of control, the stockholders becoming merely the recipients of the wages of capital.

This conclusion runs directly counter to the conclusion reached by applying the traditional logic of property to precisely the same situation—and is equally suspect.

CHAPTER III

The Inadequacy of Traditional Theory

When such divergent results are obtained by the application of the logic of two major social disciplines to a new fact situation, we must push our inquiry still further back into the assumptions and concepts of those disciplines.

Underlying the thinking of economists, lawyers and business men during the last century and a half has been the picture of economic life so skillfully painted by Adam Smith. Within his treatise on the "Wealth of Nations" are contained the fundamental concepts which run through most modern thought. Though adjustments in his picture have been made by later writers to account for new conditions, the whole has been painted in the colors which he supplied. Private property, private enterprise, individual initiative, the profit motive, wealth, competition, ~~these are the concepts which he employed in describing the economy of his time and by means of which he sought to show that the pecuniary self-interest of each individual, if given free play, would lead to the optimum satisfaction of human wants.~~ Most writers of the Nineteenth Century built on these logical foundations, and current economic literature is, in large measure, cast in such terms.

Yet these terms have ceased to be accurate, and therefore tend to mislead in describing modern enterprise as carried on by the great corporations. Though both the terms and the concepts remain, they are inapplicable to a dominant area in American economic organization. New terms, connoting changed relationships, become necessary.

When Adam Smith talked of "enterprise" he had in mind as the typical unit the small individual business in which the owner, perhaps with the aid of a few appren-

ties or workers, labored to produce goods for market or to carry on commerce. Very emphatically he repudiated the stock corporation as a business mechanism, holding that dispersed ownership made efficient operation impossible. "The directors of such companies . . ." he pointed out, "being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. It is upon this account that joint stock companies for foreign trade [at the time he was writing the only important manifestation of the corporation outside of banks, insurance companies, and water or canal companies] have seldom been able to maintain the competition against private adventurers. They have, accordingly, very seldom succeeded without an exclusive privilege, and frequently have not succeeded with one. Without an exclusive privilege they have commonly mismanaged the trade. With an exclusive privilege they have both mismanaged and confined it."

Yet when we speak of business enterprise today, we must have in mind primarily these very units which seemed to Adam Smith not to fit into the principles which he was laying down for the conduct of economic activity. How then can we apply the concepts of Adam Smith in discussing our modern economy?

Let us consider each of these concepts in turn.

Private Property

To Adam Smith and to his followers, private property was a unity involving possession. He assumed that ownership and control were combined. Today, in the modern corporation, this unity has been broken. *Passive prop-*

¹ Adam Smith, "The Wealth of Nations." Everyman's Library edition, Vol. II, p. 229.

erty,—specifically, shares of stock or bonds,—gives its possessors an interest in an enterprise but gives them practically no control over it, and involves no responsibility. *Active property*,—plant, good will, organization, and so forth which make up the actual enterprise,—is controlled by individuals who, almost invariably, have only minor ownership interests in it. In terms of relationships, the present situation can be described as including:—(1) "passive property," consisting of a set of relationships between an individual and an enterprise, involving rights of the individual toward the enterprise but almost no effective powers over it; and (2) "active property," consisting of a set of relationships under which an individual or set of individuals hold powers over an enterprise but have almost no duties in respect to it which can be effectively enforced. When active and passive property relationships attach to the same individual or group, we have private property as conceived by the older economists. When they attach to different individuals, private property in the instruments of production disappears. Private property in the share of stock still continues, since the owner possesses the share and has power to dispose of it, but his share of stock is only a token representing a bundle of ill-protected rights and expectations. It is the possession of this token which can be transferred, a transfer which has little if any influence on the instruments of production. Whether possession of active property,—power of control over an enterprise, apart from ownership,—will ever be looked upon as private property which can belong to and be disposed of by its possessor is a problem of the future, and no prediction can be made with respect to it.² Whatever the answer, it is clear that in dealing with the modern corporation we are not dealing with the old type of private property. Our description of modern economy, in so far as it deals with the quasi-public corporation, must be in terms of the two forms of property, active and passive, which for the most part lie in different hands.

² Such would be the case, for instance, if by custom the position of director became hereditary and this custom were given legal sanction.

Wealth

In a similar way, the concept "wealth" has been changed and divided. To Adam Smith, wealth was composed of tangible things,—wheat and land and buildings, ships and merchandise,—and for most people wealth is still thought of in physical terms. Yet in connection with the modern corporation, two essentially different types of wealth exist. To the holder of *passive property*, the stockholder, wealth consists, not of tangible goods,—factories, railroad stations, machinery,—but of a bundle of expectations which have a market value and which, if held, may bring him income and, if sold in the market, may give him power to obtain some other form of wealth. To the ~~the~~ *possessor of active property*, the "control",—wealth means a great enterprise which he dominates, an enterprise whose value is for the most part composed of the organized relationship of tangible properties, the existence of a functioning organization of workers and the existence of a functioning body of consumers.¹ Instead of having control over a body of tangible wealth with an easily ascertainable market value, the group in control of a large modern corporation is astride an organism which has little value except as it continues to function, and for which there is no ready market. Thus, side by side, these two forms of wealth exist:—on the one hand passive wealth,—liquid, impersonal and involving no responsibility, passing from hand to hand and constantly appraised in the market place; and on the other hand, active wealth,—great, functioning organisms dependent for their lives on their security holders, their workers and consumers, but most of all on their mainspring,—"control." The two forms of wealth are not different aspects of the same thing, but are essentially and functionally distinct.

¹ The concept of the consumer as a functioning part of a great enterprise is one which may at first be difficult to grasp. Yet, just as a body of members is essential to the continued existence of a club, so a body of consumers is essential to the continued existence of an enterprise. In each case the members or consumers are an integral part of the association or enterprise. In each case membership is obtained at a cost and for the purpose of obtaining the benefits. The advertising slogan, "Join the Pepsi-Cola Family," is perhaps unintended recognition of this fact.

Private Enterprise

Again, to Adam Smith, private enterprise meant an individual or few partners actively engaged and relying in large part on their own labor or their immediate direction. Today we have tens and hundreds of thousands of owners, of workers and of consumers combined in single enterprises. These great associations are so different from the small, privately owned enterprises of the past as to make the concept of private enterprise an ineffective instrument of analysis. It must be replaced with the concept of corporate enterprise, enterprise which is the organized activity of vast bodies of individuals, workers, consumers and suppliers of capital, under the leadership of the dictators of industry, "control."

Individual Initiative

As private enterprise disappears with increasing size, so also does individual initiative. The idea that an army operates on the basis of "rugged individualism" would be ludicrous. Equally so is the same idea with respect to the modern corporation. Group activity, the coordinating of the different steps in production, the extreme division of labor in large scale enterprise necessarily imply not individualism but coöperation and the acceptance of authority almost to the point of autocracy. Only to the extent that any worker seeks advancement within an organization is there room for individual initiative,—an initiative which can be exercised only within the narrow range of function he is called on to perform. At the very pinnacle of the hierarchy of organization in a great corporation, there alone, can individual initiative have a measure of free play. Yet even there a limit is set by the willingness and ability of subordinates to carry out the will of their superiors. In modern industry, individual liberty is necessarily curbed.

The Profit Motive

Even the motivation of individual activity has changed its aspect. For Adam Smith and his followers, it was possible to abstract one motive, the desire for

personal profit, from all the motives driving men to action and to make this the key to man's economic activity. They could conclude that, where true private enterprise existed, personal profit was an effective and socially beneficent motivating force. Yet we have already seen how the profit motive has become distorted in the modern corporation. To the extent that profits induce the risk-taking of capital by investors, they play their customary role. But if the courts, following the traditional logic of property, seek to insure that all profits reach or be held for the security owners, they prevent profits from reaching the very group of men whose action is most important to the efficient conduct of enterprise. Only as profits are diverted into the pockets of control do they, in a measure, perform their second function.

Nor is it clear that even if surplus profits were held out as an incentive to control they would be as effective an instrument as the logic of profits assumes. Presumably the motivating influence of any such huge surplus profits as a modern corporation might be made to produce would be subject to diminishing returns. Certainly it is doubtful if the prospect of a second million dollars of income (and the surplus profits might often amount to much larger sums) would induce activity equal to that induced by the prospect of the first million or even the first hundred thousand. Profits in such terms bear little relation to those envisaged by earlier writers.

Just what motives are effective today, in so far as control is concerned, must be a matter of conjecture. But it is probable that more could be learned regarding them by studying the motives of an Alexander the Great, seeking new worlds to conquer, than by considering the motives of a petty tradesman of the days of Adam Smith.

Competition

Finally, when Adam Smith championed competition as the great regulator of industry, he had in mind units so small that fixed capital and overhead costs played a role so insignificant that costs were in large measure determinate and so numerous that no single unit held an

important position in the market. Today competition in markets dominated by a few great enterprises has come to be more often either cut-throat and destructive or so inactive as to make monopoly or duopoly conditions prevail. Competition between a small number of units each involving an organization so complex that costs have become indeterminate does not satisfy the condition assumed by earlier economists, nor does it appear likely to be as effective a regulator of industry and of profits as they had assumed.

In each of the situations to which these fundamental concepts refer, the Modern Corporation has wrought such a change as to make the concepts inapplicable.* New concepts must be forged and a new picture of economic relationships created. It is with this in mind that at the opening of this volume the modern corporation was posed as a major social institution; and its development was envisaged in terms of revolution.

* It is frequently suggested that economic activity has become vastly more complex under modern conditions. Yet it is strange that the concentration of the bulk of industry into a few large units has not simplified rather than complicated the economic process. It is worth suggesting that the apparent complexity may arise in part from the effort to analyze the process in terms of concepts which no longer apply.

capital, those of the workers who "create," those of the consumers who give value to the products of enterprise, and above all those of the control who wield power.

Such a great concentration of power and such a diversity of interest raise the long-fought issue of power and its regulation—of interest and its protection. A constant warfare has existed between the individuals wielding power, in whatever form, and the subjects of that power. Just as there is a continuous desire for power, so also there is a continuous desire to make that power the servant of the bulk of the individuals it affects. The long struggles for the reform of the Catholic Church and for the development of constitutional law in the states are phases of this phenomenon. Absolute power is useful in building the organization. More slow, but equally sure is the development of social pressure demanding that the power shall be used for the benefit of all concerned. This pressure, constant in ecclesiastical and political history, is already making its appearance in many guises in the economic field.

Observable throughout the world, and in varying degrees of intensity, is this insistence that power in economic organization shall be subjected to the same tests of public benefit which have been applied in their turn to power otherwise located. In its most extreme aspect this is exhibited in the communist movement, which in its purest form is an insistence that *all* of the powers and privileges of property, shall be used only in the common interest. In less extreme forms of socialist dogma, transfer of economic powers to the state for public service is demanded. In the strictly capitalist countries, and particularly in time of depression, demands are constantly put forward that the men controlling the great economic organisms be made to accept responsibility for the well-being of those who are subject to the organization, whether workers, investors, or consumers. In a sense the difference in all of these demands lies only in degree. In proportion as an economic organism grows in strength and its power is concentrated in a few hands, the possessor

CHAPTER IV

The New Concept of the Corporation

Most fundamental to the new picture of economic life must be a new concept of business enterprise as concentrated in the corporate organization. In some measure a concept is already emerging. Over a decade ago, Walter Rathenau wrote concerning the German counterpart of our great corporation:

"No one is a permanent owner. The composition of the thousandfold complex which functions as lord of the undertaking is in a state of flux. . . . This condition of things signifies that ownership has been depersonalized. . . . The depersonalization of ownership simultaneously implies the objectification of the thing owned. The claims to ownership are subdivided in such a fashion, and are so mobile, that the enterprise assumes an independent life, as if it belonged to no one; it takes an objective existence, such as in earlier days was embodied only in state and church, in a municipal corporation, in the life of a guild or a religious order. . . . The depersonalization of ownership, the objectification of enterprise, the detachment of property from the possessor, leads to a point where the enterprise becomes transformed into an institution which resembles the state in character."¹

The institution here envisaged calls for analysis, not in terms of business enterprise but in terms of social organization. On the one hand, it involves a concentration of power in the economic field comparable to the concentration of religious power in the mediaeval church or of political power in the national state. On the other hand, it involves the interrelation of a wide diversity of economic interests,—those of the "owners" who supply

¹"Von Kommenden Dingen," Berlin, 1918, trans. by E. & C. Paul, ("In Days to Come"), London, 1921, pp. 120, 121.

of power is more easily located, and the demand for responsible power becomes increasingly direct.

How will this demand be made effective? To answer this question would be to foresee the history of the next century. We can here only consider and appraise certain of the more important lines of possible development.

By tradition, a corporation "belongs" to its shareholders, or, in a wider sense, to its security holders, and theirs is the only interest to be recognized as the object of corporate activity. Following this tradition, and without regard for the changed character of ownership, it would be possible to apply in the interests of the *passive* property owner the doctrine of strict property rights, the analysis of which has been presented above in the chapter on Corporate Powers as Powers in Trust. By the application of this doctrine, the group in control of a corporation would be placed in a position of trusteeship in which it would be called on to operate or arrange for the operation of the corporation for the sole benefit of the security owners despite the fact that the latter have ceased to have power over or to accept responsibility for the *active* property in which they have an interest. Were this course followed, the bulk of American industry might soon be operated by trustees for the sole benefit of inactive and irresponsible security owners.

In direct opposition to the above doctrine of strict property rights is the view, apparently held by the great corporation lawyers and by certain students of the field, that corporate development has created a new set of relationships, giving to the groups in control powers which are absolute and not limited by any implied obligation with respect to their use. This logic leads to drastic conclusions. For instance, if, by reason of these new relationships, the men in control of a corporation can operate it in their own interests, and can divert a portion of the asset fund of income stream to their own uses, such is their privilege. Under this view, since the new powers have been acquired on a quasi-contractual basis, the security holders have agreed in advance to any losses which they may suffer by reason of such use. The result

is, briefly, that the existence of the legal and economic relationships giving rise to these powers must be frankly recognized as a modification of the principle of private property.

If these were the only alternatives, the former would appear to be the lesser of two evils. Changed corporate relationships have unquestionably involved an essential alteration in the character of property. But such modifications have hitherto been brought about largely on the principle that might makes right. Choice between strengthening the rights of passive property owners, or leaving a set of uncurbed powers in the hands of control therefore resolves itself into a purely realistic evaluation of different results. We might elect the relative certainty and safety of a trust relationship in favor of a particular group within the corporation, accompanied by a possible diminution of enterprise. Or we may grant the controlling group free rein, with the corresponding danger of a corporate oligarchy coupled with the probability of an era of corporate plundering.

A third possibility exists, however. On the one hand, the owners of passive property, by surrendering control and responsibility over the active property, have surrendered the right that the corporation should be operated in their sole interest,—they have released the community from the obligation to protect them to the full extent implied in the doctrine of strict property rights. At the same time, the controlling groups, by means of the extension of corporate powers, have in their own interest broken the bars of tradition which require that the corporation be operated solely for the benefit of the owners of passive property. Eliminating the sole interest of the passive owner, however, does not necessarily lay a basis for the alternative claim that the new powers should be used in the interest of the controlling groups. The latter have not presented, in acts or words any acceptable defense of the proposition that these powers should be so used. No tradition supports that proposition. The control groups have, rather, cleared the way for the claims of a group far wider than either the owners or the control.

They have placed the community in a position to demand that the modern corporation serve not alone the owners or the control but all society.

This third alternative offers a wholly new concept of corporate activity. Neither the claims of ownership nor those of control can stand against the paramount interests of the community. The present claims of both contending parties now in the field have been weakened by the developments described in this book. It remains only for the claims of the community to be put forward with clarity and force. Rigid enforcement of property rights as a temporary protection against plundering by control would not stand in the way of the modification of these rights in the interest of other groups. When a convincing system of community obligations is worked out and is generally accepted, in that moment the passive property right of today must yield before the larger interests of society. Should the corporate leaders, for example, set forth a program comprising fair wages, security to employees, reasonable service to their public, and stabilization of business, all of which would divert a portion of the profits from the owners of passive property, and should the community generally accept such a scheme as a logical and human solution of industrial difficulties, the interests of passive property owners would have to give way. Courts would almost of necessity be forced to recognize the result, justifying it by whatever of the many legal theories they might choose. It is conceivable, indeed it seems almost essential if the corporate system is to survive,—that the "control" of the great corporations should develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity.

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In still larger view, the modern corporation may be regarded not simply as one form of social organization but potentially (if not yet actually) as the dominant institution of the modern world. In every age, the major con-

centration of power has been based upon the dominant interest of that age. The strong man has, in his time, striven to be cardinal or pope, prince or cabinet minister, bank president or partner in the House of Morgan. During the Middle Ages, the Church, exercising spiritual power, dominated Europe and gave to it a unity at a time when both political and economic power were diffused. With the rise of the modern state, political power, concentrated into a few large units, challenged the spiritual interest as the strongest bond of human society. Out of the long struggle between church and state which followed, the state emerged victorious; nationalist politics superseded religion as the basis of the major unifying organization of the western world. Economic power still remained diffused.

The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state—economic power versus political power, each strong in its own field. The state seeks in some aspects to regulate the corporation, while the corporation, steadily becoming more powerful, makes every effort to avoid such regulation. Where its own interests are concerned, it even attempts to dominate the state. The future may see the economic organism, now typified by the corporation, not only on an equal plane with the state, but possibly even superseding it as the dominant form of social organization. The law of corporations, accordingly, might well be considered as a potential constitutional law for the new economic state, while business practice is increasingly assuming the aspect of economic statesmanship.

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