Corporations and Business Consolidation

Why corporations? Single proprietorships and partnerships proved inadequate to meet the needs of large-scale business. They were unable to raise sufficient sums of money, owners and partners had unlimited financial responsibility if suits were filed against the company, and the business could be disrupted with the death of an owner or partner.

Definition: A corporation is a form of business organization created by the grant of a state charter. The corporation enables a group of individuals to operate as a single "artificial legal person." The corporation can sue and be sued, hire and fire, buy and sell, manufacture and trade.

Advantages:

- $ Easier to raise large sums of money through sale of stock
- $ Liability of owners and stockholders limited to amount of stock owned
- $ Investors can transfer ownership through sale of stock
- $ Corporation not affected by the death of any one of the owners – shares transferable to heirs

Disadvantages:

- $ As a state-created entity, business and financial records must be public
- $ Corporation subject to taxes on its profits in addition to taxes paid by the stockholders on their dividends – known as double taxation
- $ Contact between ownership and workers and/or customers may be infrequent

Monopoly: the elimination of competition. For a monopoly to be effective there must be no practical substitutes for the product or service sold, and no serious threat of the entry of a competitor into the market. This enables the seller to control the price. This is frequently achieved through the combination of competing corporations in order to control prices, production, and sales territory. Profits usually increased at the expense of the consumer.

Monopolistic Combinations:

- $ The Pool – an agreement, usually secret, among competing companies to fix prices and output, or to divide sales territory. In the 1870s and 1880s competing railroad lines often formed pools. By the Interstate Commerce Act (1887), railroad pools were declared illegal.
- $ The Trust – a more permanent consolidation than the pool. Stockholders of competing companies turned their stock over to a board of trustees and in exchange received trust certificates. In

this way, the board of trustees gained full control and managed the member companies in such a way as to eliminate competition. The Standard Oil Company originated the trust arrangement with success and was imitated by other giant companies.

- $ The passage of the Sherman Anti-Trust Act (1890) drove many businessmen to abandon the trust and to seek other forms of combination.
- $ Horizontal Monopoly - involves bringing together firms in the same industry and at the same level in the production chain.
- $ Vertical Monopoly - involves merging firms at different stages of the production process into a single unit. Some of the oil companies, for example, own oil fields, refineries, transportation systems, and retail outlets.

Other forms of business combinations:

- $ The Holding Company – buys sufficient voting stock in different companies, called subsidiaries, to be able to control them. Some complex forms of the holding company have been declared illegal, but many holding companies legally exist today.

- $ The Interlocking Directorate – an arrangement in which one or more men serve on the boards of directors of several companies. Interlocking directorates are legal unless they tend to lessen competition.

- $ The Merger – the consolidation of two companies into a single corporation. The merger is legal unless it causes an unreasonable restraint of trade. It is the most common form of business consolidation today. Corporations that merge with companies from diverse fields are called conglomerates.

Advantages of Big Business:

Mass Production
Wide Distribution
Efficient Management

Abuses by Big Business:

Elimination of Competition
Power Over the Consumer
Exploitation of Workers
Influence Over the Government