

1) The rise of the corporation

Solution to problems encountered by partnership

Medieval institution for cities and local groups . Merges with the financial techniques of  
Ship shares to produce public interest corporation in the seventeenth century and business  
corporation in the 18<sup>th</sup>. But all of these handed out by special permission (from  
legislature or the executive)

Then rise of general incorporation between 1840 and 1870 in many places in  
Europe and North America.

What is a corporation

Firm with at least one owner that specifies income and control rights: individuals own  
shares. Shares give rights to income (dividends and liquidation returns) and to decision  
making (votes).

There may be different category of shares with different voting or income rights.

Shares are tradable but investors cannot force the firm to reimburse their investment..

Control is centralized (shareholders vote for the board of directors who chooses  
management).

Firm is shielded from the fate of its owners—shares are transferred as part of individual  
estates. Individuals are shielded from the fate of the corporation.

2) The value of he corporation

Avoids the problems of the partnership

Industrialization requires 'big' firms and if everyone is going to share in the gains from growth then its good to have many owners. Partnership not feasible

Allows entrepreneurs to raise capital from a broad range of investors. (innovation in finance

Allows investors to hold diversified portfolio of equities

Creates a market for control (innovation in management)

### 3) The Costs of the corporation

(1) If there are going to be small investors then the separation of ownership and control is inevitable

(2) But the separation of ownership and control creates problems of minority oppression.

(3) So the only way to get dispersed ownership is to solve the problem of minority oppression

Hilt:

The U.S. is often the pointed to as the country where the separation of ownership and control is greatest to day. True but where does this come from?

(1) Its there at the birth of the capital markets

(2) Berle and Means and many that have followed have assumed that the dispersed stockholder corporation was an 'invention' of the later 19<sup>th</sup> century. As capital markets got more sophisticated

(3) The result of the great merger movement of the late 19<sup>th</sup> century

(4) The result of the regulatory services performed by the SEC

Hilt looks at early NY corporation and offers some answer

TABLE 1  
GOVERNANCE PROVISIONS: INDUSTRY MEANS, 1790–1825

	All Corps, 1790– 1825 ( <i>N</i> = 812)	Banks ( <i>N</i> = 43)	Bridges ( <i>N</i> = 86)	Insurance and Finance ( <i>N</i> = 74)	Manu- facturing ( <i>N</i> = 221)	Turnpikes ( <i>N</i> = 304)	All Others ( <i>N</i> = 84)
Election of directors							
Voting by proxy	0.82	1	0.21	0.97	0.97	0.89	0.56
Voting rights categories:							
One vote per share	0.48	0.63	0.55	0.93	0.91	0.01	0.53
Graduated voting rights	0.45	0.26	0.41	0.03	0.02	0.98	0.23
One vote per shareholder	0.02	0	0.01	0.01	0	0	0.18
Not specified	0.05	0.12	0.03	0.03	0.07	0.02	0.07
Index of voting rights ( $V_i$ )	0.63	0.74	0.70	0.96	0.99	0.23	0.76
Actions required							
Mandatory dividends	0.40	0	0.20	0	0	0.98	0.13
Annual financial reports	0.14	0.40	0.23	0.41	0.13	0.01	0.18
Composition of the board							
Number on board	9	13	6	20	5	8	8
Local residency req.	0.04	0.35	0.01	0.05	0.01	0.01	0.10
Shareholding req.	0.78	0.93	0.88	0.90	0.46	0.99	0.61

Hilt: Early when the legal framework business corporations is largely derived from the ‘public purpose corporation’

Three types of corporations

Public utilities (bridges & turnpikes)

Financial institutions (Banks and insurance companies)

Manufacturing firms

A. Voting rights.

B. ownership concentration

TABLE 3  
OWNERSHIP STRUCTURE, INDUSTRY MEANS

	All Firms	Banks	Bridges	Insurance Finance	Manu- facturing	Turnpikes	All Others
Shareholders <sup>a</sup>							
Total number of shareholders	74	252	59	132	17	69	59
% with surname in common	0.26	0.33	0.27	0.24	0.27	0.30	0.22
% held by other corporations	0.04	0.15	0	0.07	0.01	0	0.08
Concentration of ownership <sup>b</sup>							
% held by top 10 percent							
Ownership stakes	0.48	0.61	0.49	0.46	0.42	0.54	0.55
Voting rights	0.44	0.55	0.45	0.44	0.42	0.37	0.50
Gini coefficient							
Ownership stakes	0.57	0.71	0.55	0.59	0.47	0.62	0.67
Voting rights	0.52	0.64	0.50	0.57	0.46	0.45	0.65
Geographical distribution <sup>c</sup>							
Counties in which stock held	5	8	3	5	3	5	4
% held in New York City	0.34	0.37	0.08	0.76	0.23	0.12	0.44
% held outside NY State	0.10	0.16	0.08	0.10	0.07	0.09	0.08

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Do voting rights affect ownership concentration

Do voting right affect voting concentration? Does it matter?

Are they related to stock market returns (issue of signaling)?

TABLE 4  
MANAGERIAL VOTING RIGHTS, INDUSTRY MEANS

	All Firms	Banks	Insurance Finance	Manu- facturing	Turnpikes	All Others
Total managerial ownership stake	0.42	0.20	0.39	0.57	0.28	0.47
Shares held directly	0.28	0.11	0.22	0.56	0.27	0.21
Shares held indirectly	0.14	0.08	0.17	0.01	0.01	0.26
Total managerial voting rights	0.39	0.18	0.38	0.57	0.19	0.40
Votes of outside blockholders	0.07	0.09	0.04	0.21	0.05	0.02
Margin of managerial control	0.32	0.10	0.34	0.36	0.14	0.38

*Notes:* The total number of firms for which data on managerial ownership could be obtained was 51. *Total managerial ownership stake* includes shares held directly and indirectly by the members of the board. *Shares held indirectly* includes shares held in trust, shares held by another corporation in which a board member is also a director, shares held by a partnership in which a director is a member, and shares held in the name of the president of the company or the company itself. The *votes of outside blockholders* is the total percentage of the votes to which all holders of 5 percent or more of the shares who are not on the board are entitled, given the voting rights specified in the charter or certificate of incorporation. The *margin of managerial control* is the difference between the voting rights of management, and the voting stake of outside 5 percent blockholders