THE RISE OF THE AMERICAN CORPORATE SYSTEM

Discuss the development of Standard Oil Company by John D. Rockefeller and show how the philosophy of Social Darwinism was applied to the company's development.

I. **Concept number one:** Discuss the early development of Standard Oil Company by John D. Rockefeller and show how the combination and use of "money power" and "brain power" allowed Standard Oil to conquer the oil industry.

A. Rockefeller, born in New York in 1839, came from a family with a Puritan (Baptist) background and was taught that wealth came as a result of God's will. God helps those who help themselves.

B. At the age of 20, Rockefeller went into a partnership with an Englishman by the name of M. B. Clark.

1. The two were wholesalers of grain, hay and meat in Cleveland and, during the Civil War the business flourished. Before the war ended, Rockefeller had accumulated a personal fortune of nearly $50,000.

2. In 1863, Rockefeller dissolved his partnership with Clark and set up an oil refinery with Sam Andrews, an experienced oil refining technologist. At first, there seemed little use for gasoline (the internal combustion engine had only just been developed), but kerosene, another major by-product of oil, would soon bring inexpensive illumination into almost every home.

C. Between 1863 and 1870, Rockefeller picked up additional partners. In 1870, he organized the Standard Oil Company with a capitalization of one million dollars.

1. The significance of the formation of the company was not only the combined resources—"money power", but also the coming together of the men who had the "brain power" to capture control of the oil market. Example: Henry Flagler was in charge of transportation and came up with the rebate and drawback tactics.

2. The "money power" or the capitalization of Standard Oil Company at one million dollars supplied the base for a triple attack on Rockefeller's competition.

   a. First, Rockefeller spent heavily to make his plant the most efficient in the country so he could undersell all competitors and still make a sizable profit. Often he would sell his products well below cost in selected markets in order to ruin a competitor and then recoup his
losses by charging higher prices than ever before once he had the market all to himself.

b. Second, as the volume of business steadily increased, Flagler approached the railroads with a demand that their company be permitted to pay lower freight rates than any of their competitors.

(i) Railroad rates normally were public and equal, but Flagler's scheme included a plan whereby the railroads would return to him secret rebates from the established charges.

(ii) Since railroad competition in Cleveland was so intense, those who wanted Rockefeller's business-- and everyone did--complied.

c. By these means, and with the introduction of phase three (the creation of the South Improvement Co.,) the Standard Oil Company almost eliminated all competition in Cleveland and gained control of about 20% of the refining facilities of the country.

d. Also, much of Rockefeller's success was based on his determination to "pay nobody a profit." Instead of depending on the products or services of other firms, Rockefeller undertook to make its own barrels, cans, staves, and whatever else it needed. In economic terms this was "vertical integration."

e. In line with this policy, Rockefeller set out also to control his transportation needs. By 1879 most of the pipelines in the Appalachian field had come under United Pipe Lines Company, a Standard subsidiary.

(i) With Standard owning most of the pipelines leading to railroads, plus the tank cars and the oil-storage facilities, it was able to dissuade the railroads from servicing eastern competitors.

(ii) Those competitors who insisted on holding out then faced a giant marketing organization capable of driving them to the wall with price wars.

II. Concept number two: Discuss the reasons for and the creation of the South Improvement and Standard Oil Trust Companies. In your discussion show how Rockefeller used the principles of Social Darwinism to conquer the oil industry.
A. Before we discuss the South Improvement Company, which Rockefeller created for Phase Three, let's discuss the reasons why it was created.

1. Intense competition threatened to cut down profits.
   a. In 1865, Rockefeller received an average of 58 3/4 cents per gallon for refined oil.
   b. In 1870, Rockefeller received 26 3/8 cents per gallon and had only 17 1/8 cents per gallon for his overhead (manufacturing, transportation, marketing, and barreling) and profit. Expenses had fallen, but so had the profit.

<table>
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<th>1865</th>
<th>1870</th>
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<td>15 3/4 cost of crude oil</td>
<td>9 1/4</td>
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<tr>
<td>43 cost to refine and profit</td>
<td>17 1/8</td>
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<tr>
<td>58 3/4 market price</td>
<td>26 3/8</td>
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c. The intense competition threatened to cut profits down still lower.

d. This was the laissez-faire economy at its best, a free-flowing economy with intense competition.

e. Rockefeller and his friends looked with dismay on lowering profits through gaining competition. Rockefeller felt competition led to a duplication of efforts and wasted resources—the human element destroys the balance which competition brings.

2. Another anxiety of the American refiners was the condition of the export trade to foreign countries.

   a. By 1870, oil had risen to fourth place in the exports of the U.S. Every year larger quantities were consumed abroad, but it was crude oil, not refined, which foreigners were beginning to demand.

   b. This was because foreigners found they could import crude oil from the United States, refine it at home, and sell it cheaper than they could buy American refined.

   c. Thus, a need to eliminate competition, both at home and abroad, brought about the need for the creation of the South Improvement Company in the fall of 1871.
(i) At this time, Rockefeller and some of his associates came up with a scheme. They would secretly bring together a large enough group of refiners and shippers to persuade all the railroads handling oil to give their new company special rebates and kickbacks on its oil.

(ii) If Rockefeller and the other refiners could get such rates it would be impossible for anyone outside of their combination to compete with them.

(iii) Once the competition had been eliminated, the company could then limit its output to actual demand, thereby, keeping the price up.

(iv) This done, they could then persuade the railroads to transport no crude oil for exportation, so that the foreigners would be forced to buy refined oil.

B. The South Improvement Company (SIC)

1. The South Improvement Company was reorganized as an oil company headed by Standard Oil chiefs.

   a. The company included 13 men who together controlled one-tenth of the country's refining business.

   b. The company controlled 4,600 of the 46,571 barrels that were produced nationally each day. (Standard Oil controlled only 1,500 barrels per day. Within 3 month Standard Oil controlled 10,000 barrels per day.

   Standard Oil Company Executives

   South Improvement Company

   1 (Std.) 2 3 4 5 6

   Stock Stock was given to companies Std Oil would buy
2. The South Improvement Company assured the railroads that it controlled the majority of the oil refinery business. As a result, SIC negotiated a contract with the three largest railroads—the Erie, the New York Central, and the Pennsylvania.

3. The South Improvement Company tried to take in every refiner who was willing. Again, keep in mind that the major goal was the elimination of competition, thereby controlling the price and the foreign market.

   a. Rockefeller went to the other owners of refineries and said:

      "You see, this scheme is bound to work. It means an absolute control by us of the oil business. There is no chance for anyone outside. But we are going to give everybody a chance to come in. You are to turn over your refinery to my appraisers, and I will give you Standard Oil Company stock or cash, as you prefer, for the value we put upon it. I advise you to take the stock. It will be for your good."

      Certain refiners objected. They did not want to sell. They did want to keep and manage their business. Mr. Rockefeller was regretful, but firm. It was useless to resist, he told them hesitating; they would certainly be crushed if they did not accept his offer, and he pointed out in detail, and with gentleness, how beneficent the scheme really was—preventing the creak refineries from destroying Cleveland, ending competition, keeping up the price of refined oil, and eliminating speculation. Really a wonderful contrivance for the good of the oil business.

   b. He stressed the benefits of the company, including, keeping prices up and eliminating speculation.

   c. Rockefeller warned them that if they resisted they would be crushed.

   d. The conversation took place after the refineries agreed to a secret pledge based upon their word as gentlemen.

   e. Certain refiners objected because they wanted to run their own businesses.

4. In the contract, the South Improvement Company negotiated with the railroads that the railroads were permitted to double their charges for hauling crude oil and oil products.
a. The South Improvement Company alone was not to be charged the increase.

b. The South Improvement Company, and not the railroads, was to receive as "drawbacks" most of the increases paid by the company's competitors.

c. In exchange, the railroads received a small part of the rate increases and the promise that the South Improvement Company would distribute its patronage as evenly as practical over the heretofore ruinously competitive railroad rates.

5. Under the combined threat and persuasion of the Standard Oil Company, which was armed with the South Improvement Company, Standard wiped out almost the entire independent oil interest of Cleveland in three month's time.

a. There were 29 refineries and 21 of them sold out at the rate of 45 to 55 cents on the dollar. (Alexander Scofield & Company put in $150,000 and Rockefeller paid $65,000.)

b. From a capacity of not over 1,500 barrels a day the Standard Oil Company rose in three month's time to 10,000 barrels.

c. By such maneuvering, the company soon controlled 20% of the country's refineries.

d. The next individual competitor was Stone & Fleming of New York, with 1,700 barrels.

6. The South Improvement Company was the vehicle by which Rockefeller made his big jump and although the company was in operation only three months, it did the job.

7. The business panic of 1873 also weakened the refiners, who had over-extended themselves trying to compete with Rockefeller. In the next few years, he was able to buy their plants at very low prices.

C. By 1879, Standard Oil had cornered about 90% to 95% of the refining capacity of the country and almost the entire would market for its products.

1. In order to consolidate scattered business interests under more efficient control, Rockefeller and his friends resorted to the legal device of the trust.
Long established in law to enable one or more people to manage property belonging to others, such as children or the mentally incompetent, the trust would now be used for centralizing control over a business.

2. Since Standard Oil of Ohio was not permitted to hold property out of state, it began in 1872 to place properties or companies acquired elsewhere in trust, usually with Henry Flagler. To get around this problem, in 1882 all of the thirty-seven stockholders (Rockefeller was by far the largest holder with 8,894 shares, nearly three times as much as any other person) in various Standard Oil enterprises conveyed their stock to nine trustees, getting "trust certificates" in return. This set up the first trust in the sense of a monopoly in American history.

3. This situation lasted until 1892, when the Ohio State Supreme Court declared the corporation illegal. At that time Standard Oil Trust was dissolved and reorganized into twenty companies.

   a. But by informal arrangement, unity of action was maintained among these twenty corporations until they were gathered into a holding company (Standard Oil of New Jersey) by Rockefeller in 1899.

   (i) This action, allowing one company to hold the stock of another, was taken by the State of New Jersey, in hopes of attracting new industry to the State.

   (ii) The ploy worked as trustees from Standard Oil Company began to transfer stock from the Ohio Corporation to the new Standard Oil of New Jersey--capitalized at $110 million.

   b. In 1906, the federal government filed suit under the Sherman Antitrust Act and in 1911, after nearly five years of litigation the U.S. Supreme Court forced a more complete dissolution of the corporation. The Court forbade the corporation to hold and control its thirty-seven subsidiary companies or to vote their stock.

III. **Concept number three:** Discuss the significance of John D. Rockefeller in American industrial history and give a general evaluation of his business tactics.

   A. The prime significance of Rockefeller's career lies in the fact that he was a bold innovator in American industrial history. The key to Rockefeller's success was the use of the horizontal business structure like the SIC or his trust company.
1. In the 1880's, 15 trust companies following the Rockefeller pattern appeared in other areas. Where combinations were along horizontal lines—the combination, for example, of all refiners of oil or all manufacturers of typewriters—it was easy to control production and prices.

2. Andrew Carnegie made a similar significant contribution, except his growth was along vertical lines. By 1885, Carnegie had established the first vertically integrated industrial empire in the United States, with the development of his iron and steel industry.

   a. Carnegie controlled the mines that produced the raw materials, the ships and railroads that carried them, and finally the fabricating plants that worked them into finished products.

   b. This method of organization gave a company a great deal of independence and power.

3. As already mentioned Rockefeller learned form Carnegie, and he implemented the practice of vertical integration into Standard Oil.

   a. As a result, Standard Oil owned wells, timberland, barrel and chemical plants, refineries, warehouses, pipelines, and fleets of tankers and oil cars.

   b. Standard Oil's marketing organization served as the model for other industrial developers, as it exported oil to Asia, Africa, and South America, and its five-gallon kerosene tin, was a familiar sight in the most distant parts of the world.

4. In a general evaluation of Rockefeller, Carnegie and the period as a whole, there was an expanding output for a national market by these individuals and a large number of competing firms.

   a. This development of a large number of firms led to over-production, which threatened to drive prices below costs.

   b. Rockefeller and the oil industry typified this situation as the price of refined oil dropped from 58 3/4 cents in 1865 to 26 3/8 cents per gallon by 1870.

   c. A free, unregulated economy made for over-production and waste, but it did lead to lower prices.
d. Herein lies the significance of Carnegie and Rockefeller: To halt this process of over-production and cut-throat competition, they formed numerous kinds of combinations.

e. These combinations tended to eliminate competition, and they removed many of the hazards of unregulated competitive production. They facilitated great advances in manufacturing, transportation, marketing, administration and thus made mass production of products at lower prices possible.

5. Rockefeller's reasons for this type of organizational structure was that he felt many of the forces and elements in our society were irrational and wasteful; thus, he wished to impose a more rational and efficient pattern on the business world.

B. Second, Rockefeller is also noted for his donations for philanthropic purposes. In 1897, it was estimated that his fortune was worth nearly $900 million. During his lifetime, it is estimated that he gave $600 million in cash and securities for charitable purposes.

1. These charitable contributions were made through The Rockefeller Foundation and the Rockefeller Institute for Medical Research. Rockefeller also donated $35 million to the University of Chicago in 1890.

2. John D. Rockefeller, Jr. is said to have given $400 million to charitable causes by the late 1950's---a total of $1 billion.

3. The aggregate benefactions of father and son are estimated at $2.5 to $3 billion.

C. Next, it is important to keep in mind that Rockefeller was a reflection of the values of the time. It is true that some of his methods are open to criticism; but, then it must be remembered that he used the weapons and implements of the time. Rockefeller is a perfect example of the forces of Social Darwinism in action.

D. The final result of Rockefeller's methods was that it made a lot of people realize that they were not rugged individuals and could not compete with people like Rockefeller. Consequently, there arose a desire for a change of values, in that people wanted the state or federal government to regulate society in order to provide protection and stability for them within society.