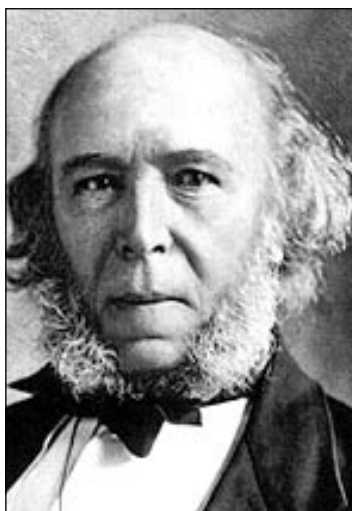
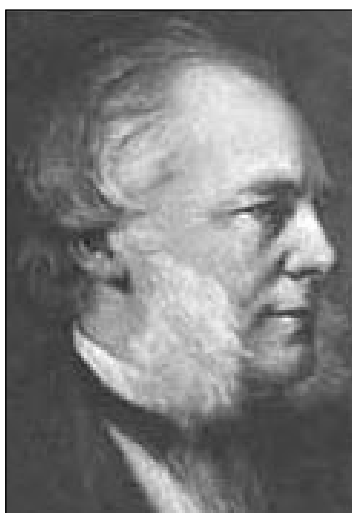


Dr James Taylor explores the origins of the corporate economy and assesses the implications for government policy in the twenty-first century.

PUBLIC



Samuel Smiles (1812–1904); Robert Lowe (1811–92); Herbert Spencer (1820–1903)

In recent years, we have become used to the idea that politicians should look to the private sector for inspiration for their policies. Underpinning much government behaviour in the past twenty-five years has been the profound belief in the superiority of business over state, of private over public. The Thatcher-Reagan mission of rolling back the frontiers of the state, and its continuation in barely altered form under more recent leaders, has been informed by this ideology. Streamlining government through private involvement in the provision of public services and encouraging participation by businessmen in the formation of policy are key means by which politicians have sought to infuse government with the dynamism and efficiency of the private sector.

Yet this objective is not of modern origin. Looking back 150 years, there is a striking parallel with the Liberal movement for administrative reform. The disastrous management of the Crimean War (1854–56) by Lord Aberdeen's coalition government, devastatingly exposed by William Russell's reports in *The Times*, fostered a massive outburst of public criticism of aristocratic government. Fresh from their triumph against the landowners in the 1846 repeal of the Corn Laws, Liberal reformers capitalised on public sentiment to put forward

their case for reorganising the way the state operated.

Central to their argument was the introduction of 'business principles' into the conduct of public affairs. Businessmen, they reasoned, possessed a superior grasp of the organisational skills needed to manage government business. Such skills, though lacking in the public sphere, abounded in the business world. While the nation's commerce had gone from strength to strength, the government, with the power to select the best men, and with practically unlimited means, had carried on the war effort in a disgracefully inept manner. The *Daily News*, a Liberal newspaper prominent in the campaign for administrative reform, asserted: 'every Englishman knows well enough that in most things which it undertakes Government is beaten by private enterprise.'¹

The movement had its successes: the government began to rely upon the contract system for aspects of the war effort, culminating in the employment of the contractor Samuel Morton Peto to construct the Balaklava railway. Sir Charles Wood, First Lord of the Admiralty, seemed sympathetic to the reformist ideology, conceding that 'You cannot find any adequate substitutes for the stimulus of private and individual interest.'²

But of more interest than the immediate impact of the move-

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ment is the insight it gives us into Victorian perceptions of private enterprise. For Victorians, it was the heroic entrepreneur, the noble industrialist, who symbolised British commerce. Illustrative of these attitudes was Samuel Smiles' famous work, *Self-Help*, first published in 1859, which offered the public inspiring pen portraits of giants of commerce, including Richard Arkwright, Josiah Wedgwood, and Robert Peel, father of the Conservative Prime Minister of the 1830s and 1840s. Such men combined energy, perseverance, and thrift, and these were the qualities that it was thought necessary to import into public life.

When Victorians thought of businessmen, they thought of men of this sort: rugged individualists achieving greatness through strength of character. These were the men who could teach the government a thing or two about organisational competence. Yet such a view was already in danger of becoming anachronistic, for British commerce was undergoing a dramatic institutional transformation. The intensive capital requirements of modern industrial enterprise were forcing a radical change in the way in which business was organised. While the Industrial Revolution had been spearheaded by small partnerships and sole traders, the business corporation was beginning to take on an added significance. First canals, then railways

– crucial elements in fostering Britain's competitive advantage – were formed not as partnerships but as joint stock companies. The capital of hundreds, sometimes thousands, of investors was drawn together into powerful agglomerations, under the control of elected boards of directors. The story was the same in other sectors: gas, water, insurance, banking, shipping, the telegraph. Wherever large sums of capital were needed, companies began to appear.

But this was not a process that occurred in isolation from the public sphere. For companies were not wholly private enterprises. Without the state's granting of a number of legal privileges, it was impossible in law to establish a body distinct from its members, such as a company. If a company wished to sue in the courts, it could not do so as an organisation, but only as a mass of individuals, making legal action practically impossible. Additionally, a company's shareholders were subject to unlimited liability: as the law did not recognise the company as a separate entity, its debts were its members' debts, so shareholders in a bankrupt concern could be sued by creditors for every penny they possessed.

In view of these problems, the state agreed to delegate public powers to companies whose existence was judged to be in the public interest. These favoured companies were incorporated

– made into corporations with a legal identity distinct from their members – permitting them to sue in the courts, to limit the liability of their shareholders, and to exist in perpetuity. The most typical early incorporations were of large trading companies such as the East India Company (1600) and the Hudson's Bay Company (1670). But the eighteenth and nineteenth centuries saw the incorporation of many domestic schemes.

Prior to the mid-nineteenth century, these powers were granted on a case-by-case basis. Companies wishing to be incorporated would apply either to Parliament or to the Board of Trade. The privileges of incorporation were not thought to be natural or inherent; rather, they were an artificial creation, and politicians, Liberal and Conservative alike, were wary of distributing them too freely. In this, they were simply following Adam Smith's line, as set out in his *Inquiry Into the Nature and Causes of the Wealth of Nations*, first published in 1776, but a set text for nineteenth-century statesmen.

Smith had warned that 'to exempt a particular set of dealers from some of the general laws which take place with regard to all their neighbours' was unreasonable, and could 'scarce ever do more harm than good'. Smith made exceptions for sectors where private capital was inadequate, or where the level

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of risk deterred private investors, citing canals, water works, insurance, and banking as examples. But wherever private capital was sufficient, companies had no business, for they would only promote monopoly. Records of parliamentary debates in the early nineteenth century are littered with condemnations of applications by joint stock companies for corporate privileges: to accede to such demands would 'destroy all competition', establishing 'baneful' monopolies, leaving consumers at their mercy.³

It was also widely feared that companies were displacing character from its central position in the world of commerce. Before the corporate age, firms were perceived as an outgrowth of the individual businessman's personality, while the system of partnership placed entrepreneurs in such a position of mutual trust and interdependence that partnerships were frequently likened to families. 'Partners were in some senses brothers who represented each other,' believed Sir William Holdsworth, the eminent legal historian.⁴ Companies, however, were entirely different: they were, according to *The Times*, 'societies in which friendship, ability, knowledge, education, character, credit, even monied worth is in a great measure disregarded, and money, the mere amount and value of the shares standing in the name of each, is the sole bond of connexion between the proprietors.'⁵

With the dilution of the importance of character in business came a deterioration of the standards of commercial behaviour. Direction by boards diminished the sense of individual responsibility for decision-making. The result, admitted one merchant, was that 'actions from which men would shrink as individuals, they will practise with impunity, when combined with others in a corporate capacity.'⁶

For these reasons, companies generated a degree of controversy which is difficult to appreciate today, when the existence of companies is taken for granted.

To try to secure popular acceptance, companies sought to ape the characteristics and behaviour of public institutions. Company boards were usually made up of men with a high local profile: members of the local municipal corporation, local magistrates, and other office-holders. These men were well placed to ensure that their companies were incorporated into local communities. Company offices, often very grand structures, would be built in prominent positions in the high street. Shareholder meetings would be held in local municipal halls or taverns. The official emblems of the town or county would be worked into company letterheads and seals.⁷

Furthermore, it was widely accepted that, in their operation, companies functioned as public bodies – 'little republics' in the words of Robert Lowe, a Liberal minister. Directors, elected by their shareholders just as politicians were elected by the public, described their shareholders as their 'constituents'. Boards were 'executives', appointed to carry out the wishes of their constituents. Some went further still, arguing that companies were models of direct representation, a more democratic system than the virtual representation which characterised the unreformed British state. Accountability and transparency would be ensured by face-to-face relations between directors and shareholders, and the vigilance of shareholders in monitoring the actions of their directors. In this sense, joint stock companies resembled the voluntary associations that were such an important feature of eighteenth- and nineteenth-century middle-class life.⁸

But many were sceptical about the democratic claims of joint stock companies, among them Herbert Spencer, the influential liberal philosopher. Spencer, who had an insider's knowledge of corporate culture, having worked as a railway engineer during the investment boom, or 'railway mania', of the 1840s, argued that

'the characteristic vices of our political state' were reproduced in every business corporation.⁹ Directors overstepped their powers and ruled their companies undemocratically: shareholders were cowed, and boards became closed bodies, completely out of touch with the opinions and needs of their constituents. Company meetings were a sham: directors were adept at manufacturing consent for their motions by a mixture of dissimulation and stealth, and once these motions were passed, the shareholders had no remedy, 'for in railway government there is no "second reading", much less a third.'¹⁰ But whatever views were expressed on companies' claims to embody a form of direct democracy, all were agreed in viewing companies as *public* bodies, which faced the same issues of representation and accountability as were faced by governments.

Furthermore, by mid-century, the public utility of joint stock companies was coming to be more widely accepted. While monopolies were still contentious (indeed, nineteenth-century governments toyed with the idea of nationalising railway companies), many came to argue that companies promoted rather than restricted competition. Received wisdom was turned on its head: whereas the granting of corporate privileges had been viewed as an interference with trade, now the withholding of these privileges came to be seen as the interference. The process by which companies applied to the state for incorporation was condemned as corrupt: vested interests could exert sufficient leverage with MPs to throw out a bill, or to persuade ministers to refuse incorporation. Few considered politicians to be sound and impartial judges of the worth of commercial enterprises.

Consequently, an Act of 1844 passed during Peel's second administration, and devised by William Gladstone at the Board of Trade, allowed companies to obtain incorporation on registration with the government. The

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grant was now automatic and no longer relied on the favour of parliament or individual ministers. But the Act excluded limited liability: if companies wished to trade with this privilege, they would have to go through parliament or the Board of Trade as before.

When company law reappeared on the political agenda in the 1850s, this issue divided Liberal opinion. Some, including Gladstone, thought that limited liability would encourage immoral and irresponsible speculation and would destabilise the economy. The economist J. R. McCulloch insisted that limited liability was an unnatural privilege which ran counter to sound rules of political economy. Others disagreed, arguing that the concession of limited liability was consistent with the recent course of commercial legislation towards non-interference. Lord Palmerston, with typical forthrightness, declared it was a simple 'question of free trade against monopoly'.¹¹

What decided the argument was the widespread enthusiasm in the 1850s for downsizing the role of the state, which was given a further boost by the exposure of the government's inept conduct of the Crimean War. The press, largely in favour of limited liability, exploited the revelation of administrative shortcomings to argue that the state should be stripped of its power to decide which businesses should be incorporated. The *Daily News* stated that it was wrong for the grant of corporate privileges to be 'dependent on the caprice of Government officials', a view endorsed by prominent businessmen before a royal commission on mercantile law.¹²

Opponents of limited liability had no answer. Even the President of the Board of Trade, Edward Cardwell, who had grave doubts as to the propriety of limited liability, thought the power invested in him to accept or refuse applications for incorporation 'invidious'. He confessed to the Cabinet that 'I heartily wish that the law

was self-acting, and that the power of incorporation did not belong to the Board of Trade.'¹³ The result was an Act of 1855, drafted by Palmerston's administration, which had replaced Aberdeen's discredited coalition, allowing companies to obtain limited liability on registration.

In hindsight, the Act is best viewed as a significant step along the road to what can be termed the conceptual privatisation of the company.¹⁴ Corporate powers had traditionally been viewed as privileges, granted only to those enterprises which could demonstrate that their contribution to the public interest warranted excusing them from the normal rules of commerce. The companies so privileged did their best to present themselves as semi-public institutions. But, as the numbers of companies receiving these powers grew, and their importance to the economy increased, so the powers previously granted as privileges became taken for granted and expected as rights which it was unnatural and unjustifiable for the state to withhold.

As companies grew in confidence, they were more inclined to present themselves as private entities with no responsibilities to the public. Company directors entered both Houses of Parliament in ever increasing numbers, and did their best to thwart attempts at state intervention in their companies' affairs, painting this as an interference in *private* enterprise.

There was thus an increasing divergence between the rhetoric of commerce and the realities of modern enterprise. The idealised entrepreneur, as glorified by Smiles, became less and less typical of the British economy, and was replaced by a different kind of capitalist, who, in dealing with administrative tasks of great complexity, and with large, sometimes unruly bodies of constituents, faced challenges more familiar to politicians than the entrepreneurs of the industrial revolution. The dividing line between public and private was blurred. Yet the rheto-

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ric insisting upon the primacy and distinctiveness of business remained constant, and the public origins of 'private' enterprise were entirely lost sight of.

Which leads us to the irony that today many are calling for the state to be modelled on institutions which themselves were originally modelled on the state. A lesson, perhaps, in the perils of forming policy in a historical vacuum.

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