Oil tycoon who used horizontal integration

The post-Civil War inventors generated ideas that transformed the economy, but they were not big businessmen. The evolution from technical innovation to massive industry took place at the hands of the entrepreneurs whose business gambles paid off, making them some of the richest Americans of their day. Steel magnate Andrew Carnegie, oil tycoon John D. Rockefeller, and business financier J. P. Morgan were all businessmen who grew their respective businesses to a scale and scope that were unprecedented. Their companies changed how Americans lived and worked, and they themselves greatly influenced the growth of the country. Andrew Carnegie, steel magnate, has the prototypical rags-to-riches story. Although such stories resembled more myth than reality, they served to encourage many Americans to seek similar paths to fame and fortune. In Carnegie, the story was one of few derived from fact. Born in Scotland, Carnegie immigrated with his family to Pennsylvania in 1848. Following a brief stint as a “bobbin boy,” changing spools of thread at a Pittsburgh clothing manufacturer at age thirteen, he subsequently became a telegram messenger boy. As a messenger, he spent much of his time around the Pennsylvania Railroad office and developed parallel interests in railroads, bridge building, and, eventually, the steel industry. Ingratiating himself to his supervisor and future president of the Pennsylvania Railroad, Tom Scott, Carnegie worked his way into a position of management for the company and subsequently began to invest some of his earnings, with Scott’s guidance. One particular investment, in the booming oil fields of northwest Pennsylvania in 1864, resulted in Carnegie earning over $1 million in cash dividends, thus providing him with the capital necessary to pursue his ambition to modernize the iron and steel industries, transforming the United States in the process. Having seen firsthand during the Civil War, when he served as Superintendent of Military Railways and telegraph coordinator for the Union forces, the importance of industry, particularly steel, to the future growth of the country, Carnegie was convinced of his strategy. His first company was the J. Edgar Thompson Steel Works, and, a decade later, he bought out the newly built Homestead Steel Works from the Pittsburgh Bessemer Steel Company. By the end of the century, his enterprise was running an annual profit in excess of $40 million ([link]). Andrew Carnegie made his fortune in steel at such factories as the Carnegie Steel Works located in Youngstown, Ohio, where new technologies allowed the strong metal to be used in far more applications than ever before. Carnegie’s empire grew to include iron ore mines, furnaces, mills, and steel works companies. Although not a scientific expert in steel, Carnegie was an excellent promoter and salesman, able to locate financial backing for his enterprise. He was also shrewd in his calculations on consolidation and expansion, and was able to capitalize on smart business decisions. Always thrifty with the profits he earned, a trait owed to his upbringing, Carnegie saved his profits during prosperous times and used them to buy out other steel companies at low prices during the economic recessions of the 1870s and 1890s. He insisted on up-to-date machinery and equipment, and urged the men who worked at and managed his steel mills to constantly think of innovative ways to increase production and reduce cost. Carnegie, more than any other businessman of the era, championed the idea that America’s leading tycoons owed a debt to society. He believed that, given the circumstances of their successes, they should serve as benefactors to the less fortunate public. For Carnegie, poverty was not an abstract concept, as his family had been a part of the struggling masses. He desired to set an example of philanthropy for all other prominent industrialists of the era to follow. Carnegie’s famous essay, The Gospel of Wealth, featured below, expounded on his beliefs. In it, he borrowed from Herbert Spencer’s theory of social Darwinism, which held that society developed much like plant or animal life through a process of evolution in which the most fit and capable enjoyed the greatest material and social success. Andrew Carnegie on Wealth Carnegie applauded American capitalism for creating a society where, through hard work, ingenuity, and a bit of luck, someone like himself could amass a fortune. In return for that opportunity, Carnegie wrote that the wealthy should find proper uses for their wealth by funding hospitals, libraries, colleges, the arts, and more. The Gospel of Wealth spelled out that responsibility. Poor and restricted are our opportunities in this life; narrow our horizon; our best work most imperfect; but rich men should be thankful for one inestimable boon. They have it in their power during their lives to busy themselves in organizing benefactions from which the masses of their fellows will derive lasting advantage, and thus dignify their own lives. . . . This, then, is held to be the duty of the man of Wealth: First, to set an example of modest, unostentatious living, shunning display or extravagance; to provide moderately for the legitimate wants of those dependent upon him; and after doing so to consider all surplus revenues which come to him simply as trust funds, which he is called upon to administer, and strictly bound as a matter of duty to administer in the manner which, in his judgment, is best calculated to produce the most beneficial results for the community—the man of wealth thus becoming the mere agent and trustee for his poorer brethren, bringing to their service his superior wisdom, experience and ability to administer, doing for them better than they would or could do for themselves. . . . In bestowing charity, the main consideration should be to help those who will help themselves; to provide part of the means by which those who desire to improve may do so; to give those who desire to use the aids by which they may rise; to assist, but rarely or never to do all. Neither the individual nor the race is improved by alms-giving. Those worthy of assistance, except in rare cases, seldom require assistance. The really valuable men of the race never do, except in cases of accident or sudden change. Every one has, of course, cases of individuals brought to his own knowledge where temporary assistance can do genuine good, and these he will not overlook. But the amount which can be wisely given by the individual for individuals is necessarily limited by his lack of knowledge of the circumstances connected with each. He is the only true reformer who is as careful and as anxious not to aid the unworthy as he is to aid the worthy, and, perhaps, even more so, for in alms-giving more injury is probably done by rewarding vice than by relieving virtue. —Andrew Carnegie, The Gospel of Wealth Social Darwinism added a layer of pseudoscience to the idea of the self-made man, a desirable thought for all who sought to follow Carnegie’s example. The myth of the rags-to-riches businessman was a potent one. Author Horatio Alger made his own fortune writing stories about young enterprising boys who beat poverty and succeeded in business through a combination of “luck and pluck.” His stories were immensely popular, even leading to a board game ([link]) where players could hope to win in the same way that his heroes did. Based on a book by Horatio Alger, District Messenger Boy was a board game where players could achieve the ultimate goal of material success. Alger wrote hundreds of books on a common theme: A poor but hardworking boy can get ahead and make his fortune through a combination of “luck and pluck.” Like Carnegie, John D. Rockefeller was born in 1839 of modest means, with a frequently absent traveling salesman of a father who sold medicinal elixirs and other wares. Young Rockefeller helped his mother with various chores and earned extra money for the family through the sale of family farm products. When the family moved to a suburb of Cleveland in 1853, he had an opportunity to take accounting and bookkeeping courses while in high school and developed a career interest in business. While living in Cleveland in 1859, he learned of Colonel Edwin Drake who had struck “black gold,” or oil, near Titusville, Pennsylvania, setting off a boom even greater than the California Gold Rush of the previous decade. Many sought to find a fortune through risky and chaotic “wildcatting,” or drilling exploratory oil wells, hoping to strike it rich. But Rockefeller chose a more certain investment: refining crude oil into kerosene, which could be used for both heating and lamps. As a more efficient source of energy, as well as less dangerous to produce, kerosene quickly replaced whale oil in many businesses and homes. Rockefeller worked initially with family and friends in the refining business located in the Cleveland area, but by 1870, Rockefeller ventured out on his own, consolidating his resources and creating the Standard Oil Company of Ohio, initially valued at $1 million. Rockefeller was ruthless in his pursuit of total control of the oil refining business. As other entrepreneurs flooded the area seeking a quick fortune, Rockefeller developed a plan to crush his competitors and create a true monopoly in the refining industry. Beginning in 1872, he forged agreements with several large railroad companies to obtain discounted freight rates for shipping his product. He also used the railroad companies to gather information on his competitors. As he could now deliver his kerosene at lower prices, he drove his competition out of business, often offering to buy them out for pennies on the dollar. He hounded those who refused to sell out to him, until they were driven out of business. Through his method of growth via mergers and acquisitions of similar companies—known as horizontal integration —Standard Oil grew to include almost all refineries in the area. By 1879, the Standard Oil Company controlled nearly 95 percent of all oil refining businesses in the country, as well as 90 percent of all the refining businesses in the world. Editors of the New York World lamented of Standard Oil in 1880 that, “When the nineteenth century shall have passed into history, the impartial eyes of the reviewers will be amazed to find that the U.S. . . . tolerated the presence of the most gigantic, the most cruel, impudent, pitiless and grasping monopoly that ever fastened itself upon a country.” Seeking still more control, Rockefeller recognized the advantages of controlling the transportation of his product. He next began to grow his company through vertical integration, wherein a company handles all aspects of a product’s lifecycle, from the creation of raw materials through the production process to the delivery of the final product. In Rockefeller’s case, this model required investment and acquisition of companies involved in everything from barrel-making to pipelines, tanker cars to railroads. He came to own almost every type of business and used his vast power to drive competitors from the market through intense price wars. Although vilified by competitors who suffered from his takeovers and considered him to be no better than a robber baron, several observers lauded Rockefeller for his ingenuity in integrating the oil refining industry and, as a result, lowering kerosene prices by as much as 80 percent by the end of the century. Other industrialists quickly followed suit, including Gustavus Swift, who used vertical integration to dominate the U.S. meatpacking industry in the late nineteenth century. In order to control the variety of interests he now maintained in industry, Rockefeller created a new legal entity, known as a trust. In this arrangement, a small group of trustees possess legal ownership of a business that they operate for the benefit of other investors. In 1882, all thirty-seven stockholders in the various Standard Oil enterprises gave their stock to nine trustees who were to control and direct all of the company’s business ventures. State and federal challenges arose, due to the obvious appearance of a monopoly, which implied sole ownership of all enterprises composing an entire industry. When the Ohio Supreme Court ruled that the Standard Oil Company must dissolve, as its monopoly control over all refining operations in the U.S. was in violation of state and federal statutes, Rockefeller shifted to yet another legal entity, called a holding company model. The holding company model created a central corporate entity that controlled the operations of multiple companies by holding the majority of stock for each enterprise. While not technically a “trust” and therefore not vulnerable to anti-monopoly laws, this consolidation of power and wealth into one entity was on par with a monopoly; thus, progressive reformers of the late nineteenth century considered holding companies to epitomize the dangers inherent in capitalistic big business, as can be seen in the political cartoon below ([link]). Impervious to reformers’ misgivings, other businessmen followed Rockefeller’s example. By 1905, over three hundred business mergers had occurred in the United States, affecting more than 80 percent of all industries. By that time, despite passage of federal legislation such as the Sherman Anti-Trust Act in 1890, 1 percent of the country’s businesses controlled over 40 percent of the nation’s economy. John D. Rockefeller, like Carnegie, grew from modest means to a vast fortune. Unlike Carnegie, however, his business practices were often predatory and aggressive. This cartoon from the era shows how his conglomerate, Standard Oil, was perceived by progressive reformers and other critics. The PBS video on Robber Barons or Industrial Giants presents a lively discussion of whether the industrialists of the nineteenth century were really “robber barons” or if they were “industrial giants.” Unlike Carnegie and Rockefeller, J. P. Morgan was no rags-to-riches hero. He was born to wealth and became much wealthier as an investment banker, making wise financial decisions in support of the hard-working entrepreneurs building their fortunes. Morgan’s father was a London banker, and Morgan the son moved to New York in 1857 to look after the family’s business interests there. Once in America, he separated from the London bank and created the J. Pierpont Morgan and Company financial firm. The firm bought and sold stock in growing companies, investing the family’s wealth in those that showed great promise, turning an enormous profit as a result. Investments from firms such as his were the key to the success stories of up-and-coming businessmen like Carnegie and Rockefeller. In return for his investment, Morgan and other investment bankers demanded seats on the companies’ boards, which gave them even greater control over policies and decisions than just investment alone. There were many critics of Morgan and these other bankers, particularly among members of a U.S. congressional subcommittee who investigated the control that financiers maintained over key industries in the country. The subcommittee referred to Morgan’s enterprise as a form of “money trust” that was even more powerful than the trusts operated by Rockefeller and others. Morgan argued that his firm, and others like it, brought stability and organization to a hypercompetitive capitalist economy, and likened his role to a kind of public service. Ultimately, Morgan’s most notable investment, and greatest consolidation, was in the steel industry, when he bought out Andrew Carnegie in 1901. Initially, Carnegie was reluctant to sell, but after repeated badgering by Morgan, Carnegie named his price: an outrageously inflated sum of $500 million. Morgan agreed without hesitation, and then consolidated Carnegie’s holdings with several smaller steel firms to create the U.S. Steel Corporation. U.S. Steel was subsequently capitalized at $1.4 billion. It was the country’s first billion-dollar firm. Lauded by admirers for the efficiency and modernization he brought to investment banking practices, as well as for his philanthropy and support of the arts, Morgan was also criticized by reformers who subsequently blamed his (and other bankers’) efforts for contributing to the artificial bubble of prosperity that eventually burst in the Great Depression of the 1930s. What none could doubt was that Morgan’s financial aptitude and savvy business dealings kept him in good stead. A subsequent U.S. congressional committee, in 1912, reported that his firm held 341 directorships in 112 corporations that controlled over $22 billion in assets. In comparison, that amount of wealth was greater than the assessed value of all the land in the United States west of the Mississippi River.