INDUSTRY, SOCIETY, AND CHANGE

A CASEBOOK • JOHN F. STEINER

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ABOUT THE COVER

The Lackawanna Valley was painted by American artist George Inness (1825–1894). In 1855, Inness was given a commission of $75 by the president of the Delaware, Lackawanna & Western Railroad to paint a new roundhouse near Scranton, Pennsylvania. Inness was offended when he was required to add more tracks than existed. Even so, the work has such poetic beauty that it has become a masterpiece of American landscape painting. Note that *The Lackawanna Valley* is not a wilderness landscape. Rather, it is what Inness called a "civilized landscape," or a landscape in which nature was shaped to human purpose. Its dawning light captures an image of the fresh, enterprising spirit of nineteenth century industrialization. The relaxed onlooker near the tree is unconcerned about the changes being wrought. This is a moment in time when the themes of industry, society, and change—the elements in the title of this book—are joined in lyric harmony. The innocence of this moment was, of course, short-lived.

PREFACE

The landscape of every modern society is shaped in large measure by the interaction between industry and social institutions. As industrial activity continues over time, the landscape changes. The title of this book, *Industry, Society, and Change,* acknowledges this reality.

There are thirteen case studies here. Each illustrates an important dimension of the field of business and society by telling the story of a specific company, industry, product, or industrial process. The business and society field is broad and eclectic. So no short collection of cases can completely encompass it. Hence, these cases are windows into a larger subject area; they are verbal portraits of a larger whole.

The cases recount incidents and events that will engage all readers with imagination and curiosity about the business world. Each contains central issues raised by the interaction between industry and society as both struggle toward mutual accommodation. The drama of these issues is interwoven with factual material on public policy, law, ethics, history, sociology, or science pertinent to each case. This didactic material serves as a backdrop for the narrative, just as scenery in a painting situates the subject matter in proper perspective.

There are many topics that could have been taken up in this book. But only a few are. Those selected have in common a focus on the interaction between managerial decisions and the social setting. And they illustrate the two great themes of this interaction: (1) the presence of trade-offs between profit making and the preservation of enduring social values such as truth, justice, virtue, love, and environmental quality; and (2) the sculpting of corporate strategic choice by historical forces and social mechanisms.

Within these broad themes the cases cover a range of issues. The lives of John D. Rockefeller and Huey Long are recounted to show how the industrial development of America after 1850 shaped the modern business environment. The ethical questions raised by Rockefeller's career are still central to the field of business ethics today. And the populist aspect of Huey Long's career still defines the basic themes of today's critics of business. The story of the deregulation of the airline industry illustrates the complex nature of business-government interaction today. The study of animal agriculture shows how new technology and widely divergent views about animals in society are complicating the environment of one of the world's oldest industries. Two cases, one on global warming trends and the other on environmental protesters, illustrate just how powerful the impact of business has been on the physical environment. Business-employee relations are at issue in stories about the Supreme Court affirmative action case, *Johnson v. Transportation Agency,* and paper-and-pencil honesty tests which raise questions about the ethics of both employers and employees. Consumer issues are discussed in the story of a Maryland man who sued the manufacturer of a handgun after being shot in a holdup and in "Selling Tobacco," a study of the power of advertising. The story of the KKR-RJR leveraged buyout, the largest of its kind to date, raises concerns over the future of our capitalist system. And the social responsibilities of multinational corporations are taken up—the role of U.S. corporations in world society is examined in a discussion of corporate involvement in South African society and in "Union Carbide and the Bhopal Plant Gas Leak."

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John F. Steiner

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CASE **1**

JOHN D. ROCKEFELLER AND THE STANDARD OIL TRUST

This is the story of John D. Rockefeller, founder of the Standard Oil Company. It is the story of a small-town boy who dominated the oil industry by dint of brilliant strategic insight and ruthless, methodical execution. He became the richest man in America and, for a time, one of the most hated.

Rockefeller's life spanned ninety-eight years. When he was born, Martin Van Buren was president, Andrew Jackson was the nation's preeminent hero, and settlers followed the Oregon Trail in covered wagons. He lived to see *Franklin Roosevelt's New Deal, watch the rise of the Nazi party in Germany,* and hear Frank Sinatra and *The Lone Ranger* on network radio.

The historical backdrop of this lifetime is an economy gripped by the fever of industrial progress. Rockefeller built his fortune in an era that lacked many ethical norms and legal restraints characteristic of contemporary business. Even so, his actions thrust business ethics into the realm of public debate for the first time in industrialized America. Revisiting Rockefeller at the helm of the Standard Oil Company is simultaneously a nostalgic historical adventure and a rediscovery of the origins of central questions that define the field of business ethics to this day. These are: (1) Is there a distinction between business and personal ethics? (2) What are the ethical consequences of competitive strategy? and (3) Does social responsibility exceed normal business productivity?

Since biographers characteristically seek auguries of future greatness in the early experiences of the famous, the story here begins with his boyhood.

THE FORMATIVE YEARS

John Davison Rockefeller was born on July 8, 1839, in the small village of Richford in southern New York. He was the second of six children and the oldest boy. His father, William Rockefeller, was an itinerant quack doctor and jack-of-all-trades who often left the family and traveled the country selling elixirs and patent medicines. On his business card he promised: "All Cases of Cancer CURED Unless Too Far Gone And Then They Can Be Greatly BENEFITED!"[1] In addition to his healing activities "Doc" Rockefeller engaged in a wide variety of businesses, including horse trading, lumbering, and moneylending. He had the jovial, irreverent personality of a slick operator; in business he was shrewd and cunning. He made enough money to keep the family in handsome style and always carried at least $1,000 on his person, a huge sum in those days.

John D.'s mother, Eliza, was opposite in temperament. She was a somber, religious woman who gave her children a strict upbringing emphasizing manners, church attendance, and the work ethic. As a fundamentalist Baptist she believed in literal interpretation of the Bible and a just God who rained fire and brimstone upon sinners. She exercised harsh discipline. Once she began to whip young John D. with a birch switch for misdeeds at school of which he was innocent. His protests finally convinced his mother he was not guilty, but she proceeded with the whipping anyway, explaining: "We have started on this whipping, and it will do for the next time."[2] She preached homilies such as "Willful waste makes woeful want." And she taught charity to the children; from an early age John D. made regular contributions to worthy causes.

When he was four, the family moved to the nearby village of Moravia. His father started a log hauling business and stayed at home until he was indicted by a local court for the rape of a young woman hired to work in the Rockefeller home. He fled the county to avoid arrest and visited only rarely and in the dark of night until moving his family to Owego, New York, in 1850, when John D. was eleven. With his family ensconced in a spacious house William Rockefeller resumed his traveling ways, returning home infrequently and for short periods. As the oldest boy, John D. had increased responsibility during his father's absences.

As a child John D. was not precocious. In school he was smart and hardworking, but never an exceptional student. His boyhood finances were ordinary. He was paid small sums for chores and once raised a flock of turkeys, which he sold. He exhibited notable thrift by saving money in a blue china bowl kept on the mantle. At the age of twelve he loaned $50 to a farmer at 7 percent interest and was impressed by the resultant income of $3.50, for which he did no physical labor. His older sister Lucy once remarked on his acquisitive dimension, saying: "When it's raining porridge you'll always find John's bowl right side up."[3]

[1]John K. Winkler. *John D.: A Portrait in Oils*. New York: Vanguard Press, 1929, p. 12.

[2]John D. Rockefeller. *Random Reminiscences of Men and Events*. New York: Arno Press, 1973, p. 34. This book was originally published in 1909 by Doubleday.

[3]Peter Collier and David Horowitz. *The Rockefellers: An American Dynasty*. New York: New American Library, 1976, p. 11.

During this period William Rockefeller taught his son the principles of business conduct. He reinforced his lessons with firsthand experience. To illustrate that sentimentality must not influence business transactions he loaned his sons money at the highest legal interest rate. "I cheat my boys every chance I get," he once said. "I want to make 'em sharp. I trade with the boys and skin 'em and I just beat 'em every time I can."[4] Apparently John D. took to the lessons because he later wrote: "By the time I was a man—long before it—I had learned the underlying principles of business and the rules of business as well as many men acquire them by the time they are forty.[5]

In 1854, when he was sixteen, John D. left home and moved into a boardinghouse in Cleveland, Ohio, where he attended Central High School for one year. There he showed himself to be a tenacious but uninspired student, little interested in books and ideas but willing to work hard. He had grown into a somber, intense lad nicknamed "the Deacon" by his classmates because of his faithful attendance at the Erie Street Baptist Church and his penchant for memorizing hymns. At the end of his first year he dropped out of high school, never to finish. That summer, with his father paying the tuition, he attended a three-month course at Folsom's Commercial College, where he learned accounting principles and the rudiments of banking and commercial law.

Upon graduation in September 1855 John D. hit the streets determined to place his feet on the first rung of the career ladder. In addition to his formal training he carried the contradictory temperaments of his parents—the wily, self-assured boldness of his father and the exacting, pietistic character of his mother. He internalized both, and the combination was to prove formidable. Here was a man with the precision of an accountant and the cunning of Cesare Borgia.

EARLY BUSINESS CAREER

Rockefeller's first job was that of assistant bookkeeper at Hewitt and Tuttle, a commodity brokerage firm in Cleveland. He worked in the main office, where he acquired some wisdom from the conversations of the partners. Put in charge of billing and collections, he worked tirelessly. He prided himself in detecting errors, and every bill and payment was meticulously audited. When he visited a neighboring business one day, he observed a local plumber present a long bill which was paid without inspection. But when the same plumber presented a bill to Rockefeller's company, he found several mistakes and corrected the man. There was no outward sign of avariciousness, but one day when Hewitt and Tuttle collected a $4,000 bank note, he repeatedly opened the office safe to gaze at it in wonderment.

His social life revolved around the Erie Street Baptist Church, where he

[4]Winkler, op. cit., p. 14.

[5]David Freeman Hawke. *John D.: The Founding Father of the Rockefellers.* New York: Harper & Row, 1980, p. 13.

spent Sundays and evenings listening to sermons. He began to keep the church's books and taught its largest Sunday school class. One Sunday the minister alarmed the congregation by announcing that the church's $2,000 mortgage was in danger of foreclosure. After the service Rockefeller stationed himself by the exits, notebook in hand, and asked each member to pledge money to save the church. He raised enough to pay the mortgage and when he became twenty-one was named one of the five church trustees, an unusual sign of respect for a young man.

At this time the thrifty Rockefeller began recording his personal income and expenditures in a small account book he called Ledger A. Its pages show that he saved most of his $25-a-month salary, paying $1 a week for board and $9.09 for clothing over a six-month period. His one extravagance was a pair of fur gloves costing $2.50. Despite his frugality he recorded continuous charitable contributions, giving away 10 percent of what he earned in his first four months of employment. Some of the entries included $0.10 for missionaries, $0.20 for the church poor, $0.25 to "a poor man in the church," and $0.50 to "a poor woman in the church." Ledger A, which became a cherished object in his old age, foreshadowed the coexisting parsimony and generosity that later characterized the millionaire.

In 1859, after $3\frac{1}{2}$ years at Hewitt and Tuttle, Rockefeller was earning $700 a year. Calculating exactly his worth to the company, he asked for a $100 raise. When he was turned down, he formed a partnership in the produce commission business with two others. He invested $2,000 in this enterprise—$1,000 borrowed from his father and $1,000 he had saved. Rockefeller kept meticulous books and records and calculated the exact value of the business at the end of each day, a practice he continued through his days with the Standard Oil Trust. He was also an intense negotiator of sales and commissions, once described by an acquaintance as a person "who can walk right up on a man's shirt bosom and sit down."[6]

The business was a success from the start due partly to the business boom brought about by the Civil War. The partners did a business of $450,000 in their first year supplying produce to the Union Army. Although in his early twenties at the time, the steady, unemotional lad was never touched by patriotic fervor. In those days the law permitted any man of means to pay for sending someone else to serve in his place, and this he did. Later in life Rockefeller claimed that he had outfitted as many as thirty soldiers to fight for the Union Army.

Profits from the produce business were so high that Rockefeller sought promising new investments. He soon found one—a petroleum refinery.

BEGINNINGS OF THE OIL BUSINESS

Petroleum production and refining at the time was an infant industry. In Rockefeller's youth the vast beds of liquid hydrocarbons beneath the earth's

[6]Jules Abels. *The Rockefeller Billions.* New York: Macmillan, 1965, p. 35.

surface lay untapped. The internal-combustion engine lay far in the future, and industry was powered by coal, wood, and muscle. Petroleum was collected from surface pools and used mainly in patent medicines of the kind sold by Rockefeller's father.

In 1854 a chemistry professor at Yale reported that the black oil freely oozing from the ground in northwest Pennsylvania could be refined into kerosene and lubricants.[7] Informed by this report, a group of investors hired an ex-railroad conductor, Edwin Drake, to drill for oil in the region. Drake borrowed technology from artesian well drillers and struck oil in Pennsylvania in 1859.

The major use for the newly discovered petroleum was home illumination. At the time, many people still used candles for household light after sunset. In the early 1700s huge whaling fleets had been built to capture sperm whales and refine their blubber for whale oil for use in lamps. Whale oil was expensive, however, and at the time of Rockefeller's birth only the wealthy used oil lamps. In the 1840s a process for distilling oil from coal was developed. This led to the marketing of a highly volatile kerosene that was only slightly less expensive, dangerously explosive, and prone to foul lamp wicks. Hence, before the discovery of underground petroleum deposits most Americans still rose with the sun and went to bed at nightfall. This simple pattern of life would soon seem primitive, its ancient premises overwhelmed by an industrializing society awash in oil.

The first oil strike set off a frenzied oil boom in rural Pennsylvania. Overnight the value of sleepy farmland skyrocketed. Flimsy drilling shacks crowded into pastures and refineries were built to process crude oil into kerosene, naphtha, lubricating oil, and petroleum jelly. The typical refinery of that day consisted of several large wooden vats for the stills in which crude oil was heated, a network of pipes, and some barrels to fill with the commercial products. It required only a small financial investment. In the heyday of the oil boom in the 1860s it was also a dangerous workplace, prone to fire and explosion.

THE RISE TO DOMINANCE

At this time the first oil refineries were set up in Cleveland, and Rockefeller invested $4,000 in a partnership with a young refinery operator and one of his partners from the produce business. He did not even want his name on the company—Andrews, Clark and Company—because he considered it a sideline. Soon, however, the refinery became his central interest, and he devoted his full energy to the oil business, dominating his partners through force of will and conforming the firm to his principles of parsimony. One of his basic principles was to avoid paying a profit to anyone where possible. For example, instead of buying barrels and paying the cooper $2.50 each, Rockefeller set up

[7]B. Silliman, Jr. *Report on the Rock Oil, or Petroleum, from Venango Co., Pennsylvania: With Special References to Its Use for Illumination and Other Purposes*. New Haven: J. H. Benham's Steam Power Press, 1855.

his own barrel-making factory and made them for $0.96. He even purchased a tract of forest and made the staves from his own trees. Another basic principle was methodical cost cutting. Lumber for barrel staves was kiln-dried before shipment to the cooperage plant, and because water evaporated from the wood, it became lighter and transportation costs were lower. Business consumed his life; success was his joy. An acquaintance told this story:

> The only time I ever saw John Rockefeller enthusiastic was when a report came in from the Creek that his buyer had secured a cargo of oil at a figure much below the market price. He bounded from his chair with a shout of joy, danced up and down, hugged me, threw up his hat, acted so like a madman that I have never forgotten it.[8]

During this period Rockefeller married Laura Spelman, a former classmate at Central High. The story of their courtship is told in his ledger, which contains entries for three courting bouquets at $0.50 cents each and $1.75 for a horse-drawn cab in which the couple rode one weekend. He entered $15.75 as the cost of a wedding ring. The couple married on September 8, 1864, and Rockefeller was back in the office the next day.

Though obsessed with details and small economies, Rockefeller also proved aggressive in larger plans. He borrowed heavily from banks to expand the refinery, taking risks that scared Maurice Clark, one of his partners. The two quarreled, and he bought out Clark in 1865, releasing one counterbalance on his audacity. Thus freed, he borrowed more to build a second refinery in Cleveland, and he incorporated an export sales company in New York.

Competitive and Economic Forces Shaping the Oil Industry

By the late 1860s the youthful industry was in a chaotic state. A basic cause was overproduction in the oil regions of Pennsylvania, which were the only source of crude oil. Prices fluctuated wildly as a consequence of overproduction. The price for a 42-gallon barrel of crude was $20.00 early in 1860 but fell to $0.10 by December. It rose to $14.00 in July 1864 and then fell to $4.00 in August 1865 and to $1.35 in December 1866. It went to $7.00 early in 1869 but fell as low as $2.70 in 1870.[9]

There were efforts to form producers associations to cut production at the wellhead, but successes were short-lived because of incentives to cheat. As prices fell, many drillers increased output to compensate. Since nobody knew how much oil was underground, many also feared that if they stopped pumping, neighboring wells would drain whole oil formations. The motive of most oil investors at the time was to get rich quickly before the oil fields dried up. During periods of oversupply, hired thugs roamed the oil fields beating up clandestine oil pumpers, but supply never stabilized.

[8]Ida M. Tarbell. *The History of the Standard Oil Company*. Gloucester, Mass.: Peter Smith, 1963, vol. I, p. 43.

[9]Abels, op. cit., p. 58.

Before the advent of refining methods that required expensive fractioning equipment, every drop in crude oil prices encouraged construction of new refineries. Hence, by the late 1860s refining capacity was three times greater than oil production, and refiners engaged in vicious price wars. The margin of profit on each gallon of refined oil dropped steadily from $1.00 in 1860 to as low as $0.16 early in 1869.[10] Because of technical innovations and cost cutting, Rockefeller's refineries were making money. But the workings of the free market were inexorably reducing profits.

An important cost to refiners was transportation. Refiners had to pay the railroads to ship in crude oil and ship out refined products such as kerosene and lubricating oil. In the 1860s the railroads were growing rapidly, borrowing money to lay new track, and fighting each other for business. Freight rates were altered to meet market conditions, and published rates were often only the starting point for negotiations. There were no regulatory restraints on railroad rates, and whatever the ethics of the situation, railroads in those days were under no legal obligation to serve as common carriers affording equal access and freight charges to all shippers.

Railroads often granted *rebates* to shippers; that is, they returned part of their freight charge after shipment. These rebates were usually secret and granted in return for the guarantee of future shipping business. The rebate system provided an incentive to increase volume, since larger shippers could always extract the highest rebates from the railroads. In the 1860s oil refineries often received rebates, and Rockefeller's firm was no exception. In 1868, for example, the Lake Shore Railroad gave Rockefeller a rebate of $0.65 cents a barrel on its regular rate of $2.40, reducing his shipping costs to $1.75.

Rockefeller's Competitive Strategies

Rockefeller was using a number of commonplace competitive strategies. He became a low-cost, high-volume producer. He used debt financing to expand. He also attempted to make his refined petroleum products of high and consistent quality, since fly-by-night refiners turned out inferior distillates, and cheap kerosene with a low ignition point had burned many a home after exploding in a wick lamp. In 1870 he reorganized the limited partnership by incorporating as the Standard Oil Company of Ohio; the name was intended to imply a "standard oil" of uniformly good quality. He engaged in vertical integration by making wooden barrels, thereby performing an operation earlier in the chain of production. As time went on, he also bought storage facilities and a fleet of tank cars. In furtherance of these strategies he used tactics common to the commercial environment of that time, including secret rebates.

He is described by biographers as being a prepossessing man with penetrat-

[10]These figures are from U.S. Bureau of Corporations. *Report of the Commission on the Petroleum Industry,* part II, "Prices and Profits." Washington, D.C.: Government Printing Office, 1907, p. 84, and ibid., p. 51.

ing eyes who drove a hard bargain. He would take the measure of a man with a withering stare, and few were his match. He was formidable in negotiations because he was invariably informed in detail about the other's business. But he was still a pious churchgoer who read the Bible every night before retiring and said that he never cheated anyone.

Late in 1871 Rockefeller hatched a brazen plan for stabilizing the oil industry at the refining level. In a series of clandestine meetings he worked out a rebate scheme between a few major refiners and the three railroads that connected to the oil regions in Pennsylvania. This was the South Improvement Plan. Under this plan the railroads agreed to a huge increase in rates for hauling oil. But Rockefeller's Cleveland refineries and a small number of major refineries in other states would be given large rebates on every barrel shipped. For example, the regular rate between the oil regions and Cleveland would be $0.80 a barrel and between Cleveland and New York $2.00 a barrel. It would cost a total of $2.80 per barrel for any other refinery in Cleveland to bring in a barrel of crude oil and ship a barrel of refined oil to New York for sale or export. Rockefeller, on the other hand, would be charged $2.80 but receive a rebate of $0.90. The other conspiring refineries got similar rebates.

In addition, the refineries participating in the South Improvement Plan received *drawbacks*, or payments made on the shipment of oil by competitors! Thus Rockefeller would receive a drawback of $0.40 on every barrel of crude oil his competitors shipped into Cleveland and one of $0.50 on every barrel of refined oil shipped to New York. Under this venal scheme the more a competitor shipped, the more Rockefeller's transportation costs were lowered. While competitors paid $2.80 for this critical transportation route (Pennsylvania oil regions–Cleveland–New York), Rockefeller paid only $1.00. Also nefarious was the requirement that railroads give the conspirators waybills detailing competitors' shipments—a more perfect espionage system could not be imagined.

Why did the railroads agree to this scheme? There were several reasons. First, it removed the uncertainty of cutthroat competition. Oil traffic was guaranteed in large volume and apportioned so that, for example, the Pennsylvania got 45 percent of eastbound shipments from the oil regions, the Erie 27.5 percent, and the New York Central 27.5 percent. Second, the refiners agreed to provide services to the railroads, such as tank cars, loading facilities, and insurance. And third, railroad executives were offered stock in the participating refineries. This gave them a large stake in their success.

The consequences of the South Improvement Plan were predictable. Nonparticipating refineries would face unreasonably high transportation costs and be noncompetitive with the conspirators. They would have two choices. Either they could sell to Rockefeller and his cohorts, or they could stand on principle and go bankrupt. The appeal of the former would encourage horizontal integration, the acquisition of other firms at the refining level. Refinery capacity would be limited and price stabilization would occur because a combi-