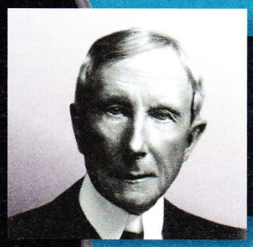
networks

*There's More Online!*

- BIOGRAPHY Andrew Carnegie
- BIOGRAPHY J.P. Morgan
- BIOGRAPHY John D. Rockefeller
- CHART/GRAPH U.S. Businesses
- INFOGRAPHIC Steel Mill
- VIDEO Big Business
- INTERACTIVE SELF-CHECK QUIZ



# LESSON 3
# Big Business

**ESSENTIAL QUESTION** • *How did the United States become an industrialized society after the Civil War?*

## Reading HELPDESK

CCSS

**Academic Vocabulary**

- distribution
- consumer

**Content Vocabulary**

- corporation
- economies of scale
- monopoly
- holding company
- trust

**TAKING NOTES:**

***Key Ideas and Details***

**Organizing** As you read about the rise of corporations in the United States, use the following graphic organizer to identify the steps big businesses took to weaken or eliminate competition.

Slashed prices temporarily → [ ] → [ ] → [ ]

## It Matters Because

***Following the Civil War, large corporations developed that could consolidate business functions and produce goods more efficiently. Retailers began using new techniques to attract consumers.***

## The Rise of Big Business

**GUIDING QUESTION** *What advantages do large corporations have over small businesses?*

By 1900, big business dominated the economy, operating vast complexes of factories and **distribution** facilities. The **corporation**, an organization owned by many people but treated by law as though it were a person, made big business possible. Stockholders own corporations through shares of ownership called stock. Selling stock allows a corporation to raise money while spreading out the financial risk.

Before the 1830s, few corporations existed because entrepreneurs had to convince state legislatures to issue them charters. In the 1830s, however, states began allowing companies to become corporations and issue stock without a charter from the legislature.

With the money raised from selling stock, corporations could invest in new technologies, hire large workforces, and purchase machines. This greatly increased their efficiency. They achieved **economies of scale**, in which the cost of manufacturing is decreased by producing goods quickly in large quantities.

All businesses have fixed costs and operating costs. *Fixed costs* are costs a company pays even if it is not operating (loans, mortgages, and taxes). *Operating costs* are incurred when running a company (wages, shipping costs, buying raw materials). Small manufacturers usually had low fixed costs but high operating costs. If sales dropped, it was cheaper to shut down temporarily. Big manufacturers, however, had the high fixed costs of building and maintaining a factory, while operating costs were low. Operating costs, such as wages, were such a small part of total costs that it made sense to continue operating, even in a recession.

PHOTOS: (l to r) SuperStock/SuperStock, Library of Congress

In these circumstances, big corporations had several advantages. They could produce more goods at a lower cost and could stay open in bad economic times by cutting prices to increase sales. Rebates from the railroads further lowered their operating costs. Eventually, small businesses that could not compete with large corporations were forced out of business.

**READING PROGRESS CHECK**

***Explaining*** How do economies of scale affect corporations?

# Consolidating Industry

**GUIDING QUESTION** *What new business strategies allowed businesses to weaken or eliminate competition?*

Falling prices benefited **consumers** but cut into manufacturers' profits. Many companies organized pools or other arrangements to keep prices at a certain level. Pools interfered with competition and property rights. Companies that formed pools had no legal protection and could not enforce their agreements in court. Pools generally did not last long, as one member inevitably cut prices to steal market share from the others.

**distribution** the act or process of being given out or disbursed to clients, consumers, or members of a group

**corporation** an organization that is authorized by law to carry on an activity but treated as though it were a single person

**economies of scale** the reduction in the cost of a good brought about especially by increased production at a given facility

**consumer** a person who buys what is produced by an economy

## Andrew Carnegie and Steel

The remarkable life of Andrew Carnegie illustrates the rise of big business in the United States. A Scottish immigrant, Carnegie went to work at age 12 in a textile factory. He worked his way up to become secretary to Thomas Scott, a superintendent of the Pennsylvania Railroad. When Scott was promoted, Carnegie became the new superintendent.

Carnegie bought shares in iron mills and factories that made sleeping cars and railroad locomotives, as well as a company that built railroad bridges. By his early 30s, he quit his job to concentrate on his investments. In 1875 Carnegie opened a steel mill near Pittsburgh. He began using the Bessemer process to make high-quality steel quickly and cheaply. He often boasted about how cheaply he could produce steel:

**TYPES OF BUSINESS ORGANIZATIONS** — CHARTS/GRAPHS

| | Sole Proprietorship | Partnership | Corporation |
|---|---|---|---|
| **Who owns the business?** | One owner who often manages the business | Two or more owners who usually manage the business | Shareholders, whether private or public<br>Managers are hired |
| **How is money raised?** | Uses savings of owner<br>Borrows from creditors | Invests savings from limited partners<br>Borrows from creditors | Sells stock<br>Borrows from creditors |
| **Advantages** | Ease of setup<br>Nominal cost | Shared responsibility by each partner | Exists as a separate entity<br>Limited liability |
| **Disadvantages** | Owner is personally liable for all debts<br>Commingling of personal and business property and funds<br>Cannot raise capital by selling an interest in the business | Owners are personally liable for obligations and debts<br>Requires more legal and accounting services<br>Partners may disagree on the management of the company | Must adhere to the principles that govern a corporation |

1 ***Making Inferences*** Comparing proprietorships and corporations, why do you think both still exist today?

2 ***Making Generalizations*** Based on the chart, what generalizations can you make about why a corporation might have a competitive advantage over a sole proprietorship?

## CHARTS/GRAPHS — VERTICAL INTEGRATION AND HORIZONTAL INTEGRATION

Vertical integration and horizontal integration helped consolidate industry.

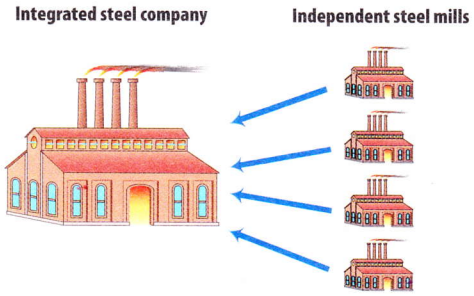
**1** ***Analyzing Information*** How does a large company benefit when it buys its competitors?

**2** ***Identifying Central Ideas*** Why did business owners want to vertically integrate their companies?

### Vertical Integration


Vertical integration occurs when a company owns all parts of the industrial process.

### Horizontal Integration




Horizontal integration occurs when a company grows by buying its competitors.

**PRIMARY SOURCE**

"Two pounds of ironstone . . . one pound and a half of coal, mined, manufactured into coke . . . one-half pound of lime, . . . [and] a small amount of manganese ore, . . . these four pounds of materials manufactured into one pound of steel, for which the consumer pays one cent."

—from *Triumphant Democracy,* 1893

Carnegie also began the vertical integration of the steel industry. Instead of paying companies for coal, lime, and iron, Carnegie's steel company bought coal mines, limestone quarries, and iron ore fields. Vertical integration saved money and enabled many companies to expand.

## Rockefeller and Standard Oil

Business leaders such as John D. Rockefeller also pushed for horizontal integration. Rockefeller's Standard Oil began buying out competitors. By 1880, it controlled about 90 percent of the U.S. oil refining industry, a near **monopoly**. Rockefeller was so successful that the *New York Times* declared that he "had accumulated close to $1,500,000,000 . . . probably the greatest amount of wealth that any private citizen had ever been able to accumulate by his own efforts."

**monopoly** total control of a type of industry by one person or one company

## New Business Organizations

Many Americans feared monopolies. They believed that a monopoly could charge whatever it wanted for its products. In the late 1800s, many states tried to stop horizontal integration and the rise of monopolies by making it illegal for one company to own stock in another company. Companies, however, soon discovered ways around the laws.

**Trusts** In 1882 Standard Oil formed the first **trust**. A trust is a legal arrangement that allows one person to manage another person's property. The person who manages that property is called a trustee. Instead of buying a company outright, Standard Oil had stockholders of that company give their stock to Standard Oil trustees in exchange for shares in the trust and its profits. The trustees could control a group of companies as if they were one large, merged company.

**trust** a combination of firms or corporations formed by a legal agreement, especially to reduce competition

PHOTOS: SuperStock/SuperStock

**Holding Companies** A new general incorporation law in 1889 allowed corporations to own stock in other businesses without special legislative permission. Many companies used the law to create **holding companies**. A holding company does not produce anything itself but owns the stock of companies that do produce goods. The holding company manages its companies, effectively merging them into one.

**holding company**
a company whose primary business is owning a controlling share of stock in other companies

**Investment Banking** Investment bankers began to help put new holding companies together. Perhaps the most successful investment banker was J. P. Morgan. He specialized in helping companies sell large blocks of stock to investment bankers at a discount. The bankers would then sell the stock for a profit. In the mid-1890s, investment bankers became interested in selling stock in holding companies. In 1901 J. P. Morgan bought out Andrew Carnegie and merged Carnegie Steel with other large steel companies into an enormous holding company. It was called the United States Steel Corporation, or U.S. Steel.

## Selling the Product

The creation of giant manufacturing companies in the United States pushed retailers to expand in size as well. The vast array of products that American industries produced led retailers to look for new ways to attract consumers. N. W. Ayer and Son, the first advertising company, began creating large illustrated ads instead of relying on the old small print line ads previously used in newspapers. By 1900, retailers were spending over $90 million a year on advertising in newspapers and magazines.

Advertising attracted readers to the newest retail business, the department store. In 1877 advertisements billed John Wanamaker's new Philadelphia department store, the Grand Depot, as the "largest space in the world devoted to retail selling on a single floor." When it opened, only a handful of department stores existed in the United States. Soon hundreds sprang up, providing a huge selection of products in one large building.

Chain stores, a group of retail outlets owned by the same company, first appeared in the mid-1800s. In contrast to department stores, chain stores such as Woolworth's focused on offering low prices.

To reach the millions of people who lived in rural areas, retailers began issuing mail-order catalogs. Two of the largest mail-order retailers were Montgomery Ward and Sears, Roebuck and Co. Their huge catalogs were widely distributed through the mail. They used attractive illustrations and appealing descriptions to advertise thousands of items for sale.

**✓ READING PROGRESS CHECK**

***Summarizing*** What makes monopolies disadvantageous for the consumer?

## LESSON 3 REVIEW CCSS

### Reviewing Vocabulary

1. ***Summarizing*** How did corporations use vertical and horizontal integration to grow?
2. ***Explaining*** How did trusts and holding companies create unofficial monopolies?

### Using Your Notes

3. ***Making Connections*** Review the notes you completed throughout the lesson to identify a way that a corporation today could use similar tactics to weaken its competition.

### Answering the Guiding Questions

4. ***Evaluating*** What advantages do large corporations have over small businesses?
5. ***Synthesizing*** What new business strategies allowed businesses to weaken or eliminate competition?

### Writing Activity

6. **INFORMATIVE/EXPLANATORY** Industrialization introduced many new ideas about how businesses could be formed and operated. Write a one-page essay explaining how these new ways of organizing businesses led to the establishment of corporate monopolies.