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Market Entrepreneurs: Building Empires of Service

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In addition, Dr. Folsom is the editor of the history journal *Continuity*, and he has written five books, including *The Myth of the Robber Barons: A New Look at the Rise of Big Business in America, 1840-1920* (3rd edition, Young America's Foundation), *The Spirit of Freedom: Essays in American History* (Foundation for Economic Education), and *Empire Builders: How Michigan Entrepreneurs Helped Make America Great* (Mackinac Center for Public Policy).

America's most successful businessmen have long been portrayed as "robber barons." But historian Burton W. Folsom, Jr., argues that we ought to distinguish between market entrepreneurs who succeed by creating better products at lower cost and political entrepreneurs who use government to gain an unfair advantage.

Dr. Folsom spoke at Hillsdale's Center for Constructive Alternatives seminar, "Inventions that Have Changed the World," in September. His remarks here are adapted from his new book, Empire Builders: How Michigan Entrepreneurs Helped Make America Great.

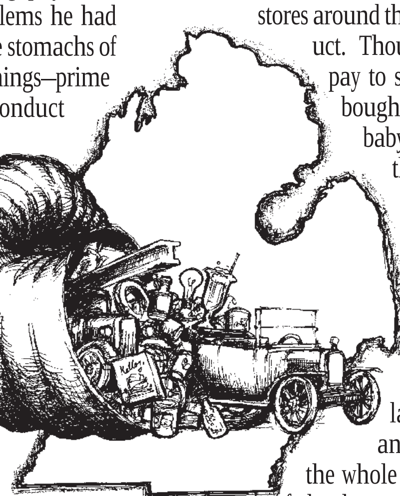
We can pinpoint a time—the late 1800s and early 1900s—when America rose to world dominance. And we can pinpoint a group of entrepreneurs who built economic empires that caused the balance of power in the world to shift from the Old World to the New World. Finally, we can pinpoint a strong Judaeo-Christian culture that values limited government and individual liberty. This convergence of a time period, a group of heroes, and a spirit of the age is a story worth telling.

Empire Builders in Michigan History

One of the most exciting ways to tell this story starts with Michigan—an underdog state long dismissed as a frozen wasteland. From the time Michigan entered the union in 1837, the governor and the legislators wanted to make the state an economic powerhouse. Their first effort was to enlist massive government aid in building railroads and canals throughout Michigan.

When this experiment with state control failed, they tried free enterprise and individual liberty. They sold the railroads to private owners and, when that succeeded, they wrote a new constitution that opened Michigan to entrepreneurs and barred the state from intruding on private enterprise. Michigan's future was to be left in the hands of its entrepreneurs.

How well did this experiment work? Let's look at some examples. In 1883, a young physician named William was troubled by problems he had with pills that would not dissolve in the stomachs of his patients. William set aside his mornings–prime earning hours for physicians–to conduct experiment after experiment in the small attic of his house in Hastings, Michigan. He rejected the standard method of making pills from paste; instead he created them from "starter particles." He added powdered drugs and moistening agents while he rotated the particles in a revolving pan. The result was a pill that held its contents, but was soft enough to dissolve easily when swallowed.



In 1885, William–Dr. William E. Upjohn–patented his "friable pill" and started the Upjohn Pill and Granule Company in a small brick building in nearby Kalamazoo. His first price list included 186 formulas for everything from quinine pills to iron pills. In the next six years, Upjohn sold millions of pills and generated the capital needed to enter the pharmaceutical market. In the next forty years, he marketed a superior product that sold widely throughout the United States and even the world. His business did not rely on any natural resources found in his state. He could have done his work anywhere. He stayed in Michigan because its economic system triggered his entrepreneurial energy and allowed him to keep the profits he made.

Let's look at another example that parallels the Upjohn story. One Sunday evening in 1927 in the town of Fremont, a young man named Dan waited impatiently for his wife Dorothy to feed their daughter, who was seven months old. They had a social engagement that evening, and Dan was ready to go. He paced back and forth, looking at his watch and waiting. Dorothy, meanwhile, was tediously straining vegetables into a bowl, piece by piece. Soon her fidgety husband stomped into the kitchen, pleading with his wife to hurry up. That's when Dorothy decided to teach him a lesson. "To press the point," Dorothy later recalled, "I dumped a whole container of peas into a strainer and bowl, placed them in Dan's lap, and asked him to see how he'd like to do that three times a day, seven days a week."

Dan got the message. The next day, when he went to work in his family-owned cannery, he had an idea for something new to put in the cans: strained baby food. During the next year, Dan Gerber would establish the baby food market and then dominate it for decades. He test-marketed strained carrots, peas, prunes, and spinach on babies in Fremont. Then he persuaded grocery stores around the country to carry his product. Thousands of mothers chose to pay to save time and energy; they bought 590,000 cans of Gerber's baby food at 15 cents per can in the first year.

Gerber, like Upjohn, did not need his state's resources to flourish. But he needed Michigan's entrepreneurial spirit and freedom from heavy taxation and stifling regulation. In the late 1800s and early 1900s, of course, the whole United States had a small federal government, no income tax, and strong constitutional support for free enterprise. But Michigan, through its liberating state constitution, went out of the way to limit government and stake the state's future on what its entrepreneurs could accomplish.

Business was booming. Even blacks, who were subject to much discrimination, had opportunities in Michigan. A good example is the great inventor Elijah McCoy. McCoy was born in 1843 in Canada, where his parents had fled from Kentucky to escape slavery. After the Civil War ended and blacks were legally free, McCoy settled in Ypsilanti, where he began work for the Michigan Central Railroad as a locomotive fireman.

He immediately applied his skills to a major problem: the dangerous overheating of locomotives. Trains had to stop regularly to oil engine parts to reduce friction. If they stopped infrequently, the overheating could damage parts or start fires. If they stopped too often, freight and passengers would be delayed. McCoy invented a lubricating cup that oiled engine parts as the train was moving. He secured a patent in 1872 and steadily improved the device.

Others tried to imitate his invention, but he kept ahead of them with superior engineering skills. The standard of quality was so high that to distinguish his product from cheaper imitations people began calling it "the real McCoy."

McCoy showed remarkable creative energy during the next half-century. He received 51 more patents for inventions ranging from a forerunner of the ironing board to a special cup for administering medicine. Not even old age dimmed his creative light. When he was 77, he patented an improved air brake lubricator; when he was 80, he patented a vehicle tire.

McCoy was not an isolated example of black entrepreneurship. In 1887, Fred Pelham was president of his class at the University of Michigan. From there he became assistant civil engineer with the Michigan Central Railroad. His innovations in structure and design included the "skew arch" bridge. Some of the twenty bridges he built still stand in Michigan today.

Why, then, did so much of the building of the American empire take place in Michigan? To find out, we need to see why Michigan chose free enterprise over government direction. Then we need to study what some of the state's early residents accomplished. In a recent book on this subject, I examined seven of them:

–John Jacob Astor, who began fur trading in the Michigan Territory in the early 1800s;

–Stevens T. Mason, a politician whose state-financed railroad scheme backfired, leading him to belatedly champion free enterprise;

–Henry Crapo, who helped Michigan become the top lumber-producing state in the union;

–Henry Ford and William Durant, who made the state the world center for automobile manufacturing, one of the greatest industries of the 20th century;

–Herbert Dow, who helped break forever European monopolies in chemicals; and

–Will Kellogg, who introduced flaked cereal, thus changing breakfast habits throughout the Western world.

Succeeding Through Serving Others

These men, with the exception of Mason, were indeed empire builders. The word "empire" comes from the Latin "imperium," or dominion, and "imperare," which means to command. The best entrepreneurs fulfill these terms. They dominate their industries and extend their command into new territories around the world. From a central location or capital, they expand their markets and control their industries–not by force but by service: selling products that customers want at competitive prices.

Several points are striking about Michigan's most successful entrepreneurs. First, they built their empires locally–in places like Flint, Midland, Battle Creek, and Dearborn–but expanded them to locations around the nation and then around the world. Many middle class families, whether in New York, Paris, or Buenos Aires, ate Cornflakes for breakfast, drove Chevys to work, used Dow's bleach on their clothes and his bromine for sedatives. Kellogg, Durant, Dow, and Ford, like Astor in an earlier generation, built empires that shaped the world long after their deaths.

Second, they were highly inventive and highly creative. They not only took risks and carved out markets but also introduced many of the key products needed to establish their empires of service. Dow heads the list with his 107 patents, but Kellogg and Ford were in some ways even more impressive. Kellogg, with help from his brother, practically invented the whole flaked-cereal industry. His example inspired others, and, from Rice Krispies to All-Bran, Kellogg cereals set the standard. Henry Ford, among other things, invented the V-8 engine and assembled the team that made plate glass from a continuous ribbon with no hand work. More than this, his whole company was for years an experiment in creativity–from the assembly line to raising wages to cutting work hours.

A third point to remember about Michigan's entrepreneurs is that they wanted to build empires more than they wanted to make money. Of course, the two usually go together. But making such a distinction is critical to understanding the mind of Michigan's early entrepreneurs. Money, or capital, is valued not as an end but as a means to create an economic empire. In the same way, weapons are valued by an army not as an end but as a means to conquer people and territory. Capital is a tool for the entrepreneur in the same way that weapons are tools for the soldier. The big difference here is that an army creates and expands its empire by force; entrepreneurs create and expand their empires by service to others. A soldier controls by using weapons to threaten violence; an entrepreneur persuades by using capital to offer better products at lower prices.

The challenge to entrepreneurs in an undeveloped area like Michigan was raising capital. John Jacob Astor made his money in New York and plowed it into Michigan. Henry Crapo forged a complex network for wheedling capital from his cautious friends in New Bedford and Boston. Herbert Dow lobbied established businessmen in Cleveland. Will Kellogg sought help from a large investor in St. Louis. By the early 1900s, some Michigan cities were rich enough to support their own entrepreneurs. Henry Ford, with mixed success, solicited a variety of investors in Detroit. William Durant tapped the bankers of Flint–first to build carriages and later, Chevrolets.

With capital in hand, the next step was mobilizing workers behind tough and compelling goals. For Ford, the task was building a reliable car so cheaply that middle class Americans could afford it. For Dow, the issue was survival–how to make bleach, bromine, and dyes cheap enough to compete with European cartels. Kellogg and Durant started with high quality products, so the challenge was in marketing: how to get every American to eat a bowl of Cornflakes and to ride in a blue ribbon carriage.

Workers, like soldiers, will usually follow if the leader knows how to lead. The prevailing theory of management said that employees must be controlled, directed, and closely supervised. Michigan's entrepreneurs, by contrast, tended to give their workers freedom to create, personal responsibility for hard tasks, and rewards and bonuses for jobs well done. Henry Ford wanted the best workers in Michigan, and he launched the "five dollar day" to get them. Will Kellogg liked to reward worthy employees with a handshake that contained a $20 bill. Herbert Dow might argue loudly with his chemists, but he trusted their abilities, paid them well, and turned them loose to invent and create.

Fourth, Michigan's empire builders all followed biblical principles, even though not all of them were practicing Christians. As George Gilder has observed, they truly believed in the commandments, "Do unto others as you would have them do unto you" and "Give and you will be given unto." He also notes that they suppressed their own desires to serve the desires of others, and they committed their work and wealth to bring to the world new goods that they knew might well be rejected.

The faith of these empire builders was continually tested. They all either went bankrupt or verged on it at some critical point in their lives. They did not experience the steady growth and predictable success that one might have expected from talented men with good and popular products to sell. They took leaps of faith, fell flat on their faces, then desperately changed their tactics and tried to raise new capital to stay afloat.

Herbert Dow, for example, failed in his first business venture; in his second, he was ousted from control. On his third try, he went into the bleach business, and he calculated his costs of production very carefully. Then came the unexpected. He was immediately challenged by a British cartel, which cut its price for bleach in half. Dow had to find ways to slash costs even more or he would fail a third time. When Will Kellogg finally broke loose from his old menial job, he calculated the cost of making Cornflakes. What he didn't count on was having his factory burn down and his main competitor buy up all the new equipment for making cereal. Henry Crapo floundered in the lumber business until he doubled his risks, bought some sawmills, and began to process and market his own timber. Only after years of cutting costs, improving products, and removing bottlenecks did these men make breakthroughs. Henry Ford refused to listen to the experts, who claimed that steam and electricity were the only practical options for automobiles; instead he developed the internal combustion engine. When Ford was losing sales to competitors, he was forced to adopt drastic measures, slashing the price of the Model T by 20 percent. Sales doubled, but who could have known his gamble would pay off? Only hindsight makes such accomplishments seem easy and inevitable.

The fifth trait of Michigan's empire builders was their fierce independence and their aversion to monopoly and to government solutions to problems. Even before statehood, John Jacob Astor displayed this independence with his American Fur Company when he challenged the government fur factories. The next two generations of Michigan entrepreneurs were among the most independent our nation has ever produced. When Henry Crapo served as governor, his defense of the Constitution of 1850 was intense. He sacrificed popularity, party loyalty, and even his health so that he could veto bill after bill that allowed Michigan cities to subsidize local railroads. Crapo was an expert in attracting outside capital, and he knew the dangers that subsidizing railroads posed to individual liberty and to the integrity and credit rating of his adopted state.

In 1919, fifty years after Crapo's death, his grandson, William Durant, was president of General Motors. In a speech that year, Durant sounded just like his grandfather:

> Competition is the life of trade. I stand for competition. I am opposed to monopoly or control on the principle that it destroys initiative, curtails freedom of action, and frequently leads to abuse of power.

Durant's chief competitor, Henry Ford, could not have agreed more. Ford, in fact, was one of the main reasons the auto industry was so free of monopoly and government control. The resulting pressure of competition improved the quality of cars dramatically–automatic starters, hydraulic brakes, and gas gauges became standard by 1930. With Ford and General Motors locked in combat, the American consumer was the winner. Vehicle sales soared from 181,000 in 1910 to over 5,000,000 in 1929. Trucks for moving freight were part of this rise because the railroad industry, with its price fixing and government controls, was too expensive and too cumbersome.

In the 1930s, Ford led the opposition to President Roosevelt's National Recovery Administration (NRA). Auto companies were pressured to join together to regulate wages, prices, and hours of work. Ford refused to join. Durant was out at General Motors, so he stood virtually alone. When the federal bureaucrats refused to accept his low bids on government contracts, Ford ignored them and survived on private sector business. The irony here is that Ford already led American industry in paying high wages. Why should a government agency set minimum wages, Ford wondered, when he set the standard long before the 1930s? Referring to the NRA auto code, he said, "If we tried to live up to it, we would have to live down to it." Before the government could coerce him into joining the NRA's auto cartel, however, the Supreme Court stepped in and declared the NRA unconstitutional.

If possible, Herbert Dow opposed government activism even more strongly than Ford (except for protective tariffs). Dow actually built his chemical empire by challenging government-supported monopolies. In the 1890s, when Dow entered the chemical business, the British and the Germans had long dominated the chemical industry–and their governments encouraged them to form cartels and to control prices and production. American chemical companies not only lagged far behind Europe, they often faced predatory price cutting whenever they sold abroad. Some American companies, like DuPont, carved niches in special markets, such as gunpowder. But Dow was the first American to openly challenge the Europeans where they were already established–in areas like bleach, bromides, and indigo.

In doing so, Dow gave the world a model demonstration in how to defeat predatory price cutting. Before Dow, many people could argue against monopolies and oligopolies this way: "If a corporation is big enough, it can cut prices below cost, drive out its small competitors, and then raise prices to whatever it wants to charge. Therefore, we need government regulation, antitrust laws perhaps, to control large greedy corporations." Dow showed how a small company could beat large firms. In the bromide industry, the Germans cut prices below cost with the specific intent of destroying Dow. In response, Dow secretly bought the cheap German bromides, repackaged them, and sold them at a profit in markets around the world! It was a brilliant strategy. During the early 1900s, Dow regularly expanded his chemical empire when the Germans tried to reap large profits from their cartels in indigo, magnesium, and other products.

New Empires

The 1920s was the last decade when an empire could be built without major interference from the federal government. With the Great Depression came the rapid expansion of federal powers. The Smoot-Hawley Tariff, passed in 1930, was the most restrictive tariff in U.S. history. The Reconstruction Finance Corporation had the government financing banks, railroads, and other industries. The Agricultural Adjustment Act regulated farm production; the National Industrial Recovery Act regulated most corporations–except for the Ford Motor Company. And later the Wagner Act shifted the balance of power from the entrepreneurs to the labor union bosses.

The tax revenues needed to pay for these and other new programs were astonishing. The top federal income tax rate in 1930 was 24 percent. In 1932, under President Hoover, the rate was hiked to 63 percent. Under President Roosevelt the rate was first raised to 79 percent and later jumped to over 90 percent. Large inheritance taxes scooped up what the income tax missed. During the 1930s, the empire builders were, in effect, asked to send their empires to Washington.

Herbert Dow died in 1930, before he could denounce such a request. William Durant lost his fortune on the stock market, before Washington could confiscate it. Ford and Kellogg chose to shelter their wealth from the swirling storms. With the Ford and Kellogg foundations quickly in place they preserved their empires, but they were no longer the commanders. The era of "laissez faire" was essentially over. A new breed of businessman began to emerge: the "political entrepreneur," who sought special concessions from government and empires built on political power instead of service. The old "market entrepreneur," who found success through creating better products at a lower cost, found it harder and harder to survive.

Today, however, there are more and more calls for deregulation and tax reduction. And more and more market entrepreneurs are bucking the system. Not surprisingly, Michigan is in the forefront of reform. Market entrepreneurs are flourishing here again. We can thus look forward to a new era of laissez faire–and building new empires of service.

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