Jonathan B. Baskin, Jr. Paul J. Miranti. *A History of Corporate Finance.* New York: Cambridge University Press, 1997. X + 350 pp.p $29.95, cloth, ISBN 978-0-521-55514-2.

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The Alleged Poverty of Positivism and the Modern Theory of Finance

`A History of Corporate Finance' is a solid contribution to scholarship that should gain the interest of historians, lawyers, economists, and business persons. Its unusual combination of scope, clarity, and brevity, combined with its reasonable price, may induce professors to make it required reading for advanced undergraduate and graduate courses in economic or business history, or in management education courses. Highly interpretive, the book is more a work of synthesis than of original research in primary sources. At 350 pages, the book is hardly comprehensive, but it nevertheless manages to tie much temporally disparate material into its thesis.

That thesis the authors lay out carefully in the introduction, "History and the Modern Theory of Finance." Citing Keynes and Schumpeter, Jonathan Baskin and Paul Miranti remind readers of the "complementary" nature of history and finance and announce their intention to employ "historical methods to amplify an important contemporary paradigm" (pp. 1-2). That paradigm, the "modern theory of finance," seeks to evaluate the "financing question" (optimal capital structure decisions), and the "dividend question" (distribution of income to shareholders). The early leaders of modern finance theory were Franco Modigliani and Merton H. Miller. Based on an abstract model, they argued that "firms cannot increase value by issuing either debt or equity" and that "managerial decisions are irrelevant" (p. 16). Questioning conclusions based on what they consider to be ungrounded, formalized models, Baskin and Miranti argue that the modern theory of finance needs to take greater recognition of "path dependence and historical evolution" (p. 3). To substantiate their view, they describe the intellectual history of economics (economiography?) since the diffusion of Karl Popper's "falsifiability" philosophy of science, and, at the end of each chapter, they test the assumptions and real-world applicability of theoretical models. Generally, they find the abstractions empirically deficient, and thus call into question "the profession's current infatuation with models that lend themselves to formal mathematical explication" (p. 23).

Divided into three parts, "The Preindustrial World," "The Rise of Modern Industry," and "The Transition to the Contemporary Era," the main body of the work opens with a discussion of medieval and renaissance finance. After a brief description of the medieval commercial revival, Florentine and Venetian finance is treated at some length with emphasis on enterprise organization. The authors conclude, not surprisingly, that "other factors than those considered in the modern theory as laid down by Modigliani, Miller and others had been foremost in defining early financial institutions" (p. 51).

Corporate finance in the age of global exploration, especially the rise of joint-stock trading companies like the East India Company, forms the basis of chapter 2. Baskin and Miranti conclude that the "pecking order" hypothesis of Gordon Donaldson, "the traditional explanation of funding decisions prior to Miller and Modigliani," best explains the East India Company's financial decisions (pp. 22, 84). Donaldson's hypothesis predicts organizations will finance operations first from retained earnings, then from debt, and lastly from the sale of additional equity. With debt interest rates lower than equity returns, business cycles violent, and the probability of losing control of the company in an equity expansion high, East India Company managers borrowed capital with short-term debentures.

Chapter 3 takes up the emergence of public markets for investment securities from the Glorious Revolution to the final defeat of Napoleon. Predictably, the Bank of England, John Law, and the South Sea Bubble are the major subjects covered, but an interesting twist, the notion that the "watershed of 1720" caused British and French financial development to diverge markedly, enlivens the discussion. If true that France turned "antitrade and antimarket" after the "Law fiasco," the authors have hit upon a major explanation for the Anglo-American victory in the struggle to control North America (French and Indian War [1755-1764] or Seven Years' War [1756-1763]) and an important cause of the French Revolution (p. 114). In any event, Baskin and Miranti's main goal in the chapter is again to attack the modern theory of finance by pointing to the "high risk in economic affairs and poor information" facing eighteenth-century investors. In that environment, low-risk government debt was a more attractive investment option than equities (p. 122).

The problems involved in accurately valuing equities persisted into the nineteenth century, the age of massive infrastructure improvements. With particular emphasis on canal and railroad corporations, the authors describe the evolution of preferred stock, a hybrid between debt and equity financing. Preferred stock paid a guaranteed dividend, but conferred no voting privileges, thereby allowing managers to maintain control over the corporation. Also, unlike bond payments, dividend payments could be suspended without forcing the corporation into receivership. The creation of preferred stock, the authors believe, supports the "pecking order hypothesis" more than the modern finance theory. By incorporating the fixed-income and non-voting characteristics of debt instruments into a hybrid equity form, managers transcended some of the limitations of the pure debt market and staved off the flotation of true equities.

After 1900, the authors admit in the next chapter, a broad, impersonal market in common stock arose in both Britain and the United States. Managers, however, continued to prefer retained earnings, fixed debt, and preferred stock over the flotation of common stocks. The main body of the book concludes with two long chapters of in-depth analysis of the financing of center firms, conglomerates, and leveraged-buyout partnerships. Not surprisingly, the pecking order hypothesis again emerges as the key means of understanding successful corporate financing strategies. By downplaying the successful initial phase of the post-1960s merger movements, the authors por-

tray conglomerates and LBOs as failures inspired by the over-simplistic models of academics. For instance, they label Henry G. Manne's contract theory "underspecified" because it fails to account for the effects of government regulation and the importance of manager tenure (p. 287). However, Baskin and Miranti admit that although the pecking order hypothesis generally "predicts the progression of corporate financial preferences, it does not provide guidance with respect to either the relative weight placed on these alternative sources or the rates at which this process progressed" (p. 297).

The basis of `A History of Corporate Finance' is Baskin's dissertation and 1988 `Business History Review' article, "The Development of Corporate Financial Markets in Britain and the United States, 1600-1914: Overcoming Asymmetric Information." Baskin died before completing revisions, but Paul Fink, Baskin's father, arranged for Miranti to bring his son's contribution "to fruition" (p. ix). Probably because of the difficulties of editing a half-posthumous piece, the book suffers, in places, from an over-rigid style, poor balance, and uneven organization. Over one-half of the book, for instance, covers the twentieth century.

Also, the epilogue and two appendices seem out of place. The former reads like a conclusion except for the formulation of an original algorithm that purports to explain the relationship between short-term, firm-specific factors and long-term environmental elements in financial development. If truly significant, the algorithm should be explained in the introduction and applied throughout the narrative. Appendix A, a short description of finance and informational asymmetries in the ancient world, rightfully belongs in chapter 1. Appendix B, "International Patterns of Corporate Governance," contrasts Anglo-American financial markets with their equivalents in Japan and Germany. The main contention is that, because of ist transmission of "reliable information" to investors, the Anglo-American financial system is more efficient and conducive of economic growth than the "opaque regimes of Japan and Germany" (p. 322).

Although probably correct and extremely interesting, the presentation is `ad hoc' and, at 8 pages, too truncated to be entirely convincing. I hope that Miranti will take up a broad, comparative study of financial institutions since the late nineteenth century as his next major project. Although an outstanding study that will deservedly gain a wide audience, the book ultimately fails to reconcile the methods and outlook of history with those of economics. The belated algorithm is a step in the right direction, but still short of creating realistic (adequately specified) models that can be quantitatively tested. Though it is true that some past models have been unrealistic in some regards, nothing in this book will convince economists to abandon formal, mathematical theorizing. Baskin and Miranti, in other words, have rightly called the modern theory of finance into question, but have not set forth a completely viable alternative.

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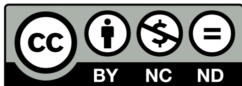
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