



# Jay Gould, the Union Pacific Railroad and Value Creation

By Maury Klein and Joseph Calandro, Jr.

DURING A RECENT financial history presentation, the name Jay Gould was mentioned. It was immediately followed by a discernable “gasp” from the audience. This apparently was the reaction the presenter was looking for as he proceeded to deride Gould’s memory (Gould passed away in 1892). This presenter’s criticisms were very broad and culminated with a reference to Gould as an “infamous speculator.” The criticisms and comments were generally inaccurate, but nevertheless in accord with many of the things that were written about Gould during his lifetime, which have been carried over into the present.

No one in United States financial and business history is as misunderstood, and under-appreciated, as Jay Gould. There are a number of reasons for this: First and foremost, Gould earned a reputation as the most hated man in America. Two early episodes, the Erie Railroad War and Black Friday, when he conceived an audacious scheme to corner the nation’s gold supply in 1869, did much to create the image of him as a ruthless, unprincipled Wall Street renegade who seemed always to skirt the letter of the law. Hardly anyone recognized the breadth of his talents or viewed him as anything more than a stock manipulator who played the game better than most.

Second, Gould was an intensely private man who did not speak with the press unless he wanted something specific out of such interactions. Predictably, his desired ends were not always what members of the press supposed; in other words, Gould used the press to achieve his ends, not to advance theirs.

Third, Gould was uncommonly successful in investment, speculation/trading *and* business due to a variety of strategic moves frequently so audacious and complex that few, if any, of his contemporaries understood what he was doing, or why. Moreover, Gould did not socialize with the elite of his day, preferring instead to spend his non-working hours with his family and his books. Over time, factors such as these resulted in an information vacuum. As the press, like nature, abhors a vacuum, information was generated to fill it whether it was factually accurate or not.

More important than historical misunderstanding for our purposes here are the lessons that can be learned from the years that Gould controlled the Union Pacific Railroad (UP). By “control” we mean set the direction of the firm rather than own a majority interest in it. To explain, Gould exercised control by dominating the UP governance structure as a major, albeit not majority, shareholder. His activities at the UP helped give rise to modern *financial strategy*, which is an integrated and interactive discipline encompassing strategy, investment, finance and operational management.

We profile our reasoning in this article noting that it is an all too brief profile. Maury Klein’s biography demonstrates in detail how Gould’s entry into the management of the floundering UP marked the beginning of his emergence as a businessman and economic developer of the first rank, who went on to create his own railroad system around the modest Missouri Pacific Railroad.

Few men embody that most cherished of American myths, the rags-to-riches saga, better than Jay Gould. Born in 1836 on a farm near Roxbury, New York, he inherited his father’s passion for education. Small, frail and somewhat sickly, he hated farm work, but he worked to improve himself whenever an opportunity arose. Shortly before his 16th birthday he

left home to work for a surveyor. Already he had learned to push his stamina to the limit and to master any skill that came his way. He taught himself surveying, wrote an impressive history of Delaware County and learned how to cultivate the confidence of those older than himself. He won the trust of a prominent tanner and at age 20 was sent into the woods of Pennsylvania to build and run a tannery from scratch. Despite his youth, older workers respected him well enough that the settlement was named Gouldsboro.

Tanning occupied him until 1860, when an unfortunate partnership with the prominent firm of Charles M. Leupp unraveled as Leupp succumbed to mental illness and committed suicide. At the age of 24, Gould turned his attention to Wall Street. Despite being an unknown outsider in a world where being an insider counted for nearly everything, he not only survived but gradually mastered the intricacies of finance. His fertile intellect seemed capable of absorbing everything it touched, and his capacity for growth seemed unlimited. Unlike many Wall Street denizens, his approach was quiet, subtle and self-deprecating. He learned well the art of being underestimated.

For seven years Gould gradually improved his fortunes in the shark-infested waters of 19th century Wall Street. The business style that emerged was an astringent one, as lean and compact as Gould himself. It was both stealthy and secretive, the silent running of a loner forging his own way through dangerous territory. He formed the habit of telling no one about an operation except those directly involved, and then only as much as he wanted them to know.

To this passion for secrecy he added a view of ethical and legal niceties that, at times, bordered on amorality, which was common at the time. In struggling to survive in an arena where no mercy was

Financier Jay Gould’s control of the Union Pacific Railroad from 1874–1880 helped give rise to modern financial strategy.

wasted on those who failed, he learned its lessons well, showing himself willing to employ bribery and other shady tactics to gain his objective.

As an outsider who relied on trading as his only source of capital, Gould recognized the game of business for what it was at the time and played with few illusions or pretenses. He entered Wall Street on the eve of the Civil War, a time when the rules soon became unsettled and malleable amid the opportunities afforded by wartime. Since the Panic of 1857 a younger, brasher, more aggressive breed of brokers had come to dominate the Street, and Gould adapted quickly to their coarser form of financial combat. In time, he proved himself to be superior to them all.

Two episodes that became Wall Street legends catapulted Gould from obscurity to notoriety. During 1867 and 1868, he joined forces with Daniel Drew and Jim Fisk to outmaneuver Cornelius Vanderbilt in the “Erie War” that ended with Gould and Fisk in control of that railroad. In 1869, he conceived an audacious scheme to corner the nation’s gold supply that culminated in the “Black Friday” panic on the Street. Together these episodes both enhanced and blackened Gould’s reputation, elevating him to the status of one whose words and deeds were always to be watched and never to be trusted. From them also emerged the steady stream of abuse from the press that would do so much to shape his reputation in the coming years as the most hated man on Wall Street.

To a greater extent than anyone realized, that reputation was undeserved. Unlike many, if not most, Wall Street men (then and since), Gould lived a quiet, extremely private life unmarred by any form of personal excess. He shunned the trappings of high society, was devoted to his wife and six children, created an extensive personal library of books he actually read and loved flowers so much that he built the largest privately-owned greenhouse in the nation.

Contrary to the image of him as a lone wolf, he formed close associations with colleagues that lasted throughout his life and rarely worked any large operation alone. Collis Huntington, one of Gould’s bitterest rivals, was not alone in praising Gould’s reliability. I (Klein) quoted him as follows in my earlier biography of Gould:

“I know there are many people who do not like him... I will say that I always found that he would do just as he agreed to do.”

Having earned a formidable reputation as a speculator/trader on Wall Street, Gould longed above all else to excel as a businessman. From his first encounter with railroads he applied his uncanny grasp of finance to the problems posed by running a large enterprise. Even as the public dismissed the Erie War as a financial circus, Gould devised a competitive strategy so bold and original that it forced Commodore Vanderbilt to revise his handling of the New York Central Railroad. Confronted by Gould’s policy of making alliances with other roads to outflank the New York Central, Vanderbilt abandoned his conservative approach and expanded his rail empire westward to Chicago and elsewhere. Gould lacked the financial resources to compete with Vanderbilt on this widened battlefield, but his daring changed the course of railroad history.

After being ousted from the Erie in 1872, Gould pursued his career on Wall Street while awaiting a suitable opportunity to take hold of another railroad. It came at the end of 1873, when Gould bought heavily into the UP. Part of the first transcontinental road completed in May 1869, the Union Pacific-Central Pacific remained the only rail line from the Missouri River to the Pacific Coast. Like the Erie, it was a grandiose, oversold property with a tarnished past tainted by the Credit Mobilier scandal of 1873 and a history of inept management that culminated in 1871 when Oliver Ames left the presidency. Tom Scott of the Pennsylvania Railroad gained control but left after a year. In 1872, Horace Clark, Vanderbilt’s son-in-law, became president and the road seemed firmly connected to the Vanderbilt system. But Clark died suddenly in June 1873, leaving the road once again in managerial and financial limbo.

In winning the trust of the suspicious major stockholders of the UP, Gould promised that he would restore the road’s financial credibility, improve its operations, formulate its strategy and boost its stock price. To their astonishment, he did all this and more. Within a year, having rescued its finances from the brink of disaster, he cleared up the floating debt and refunded its income bonds.

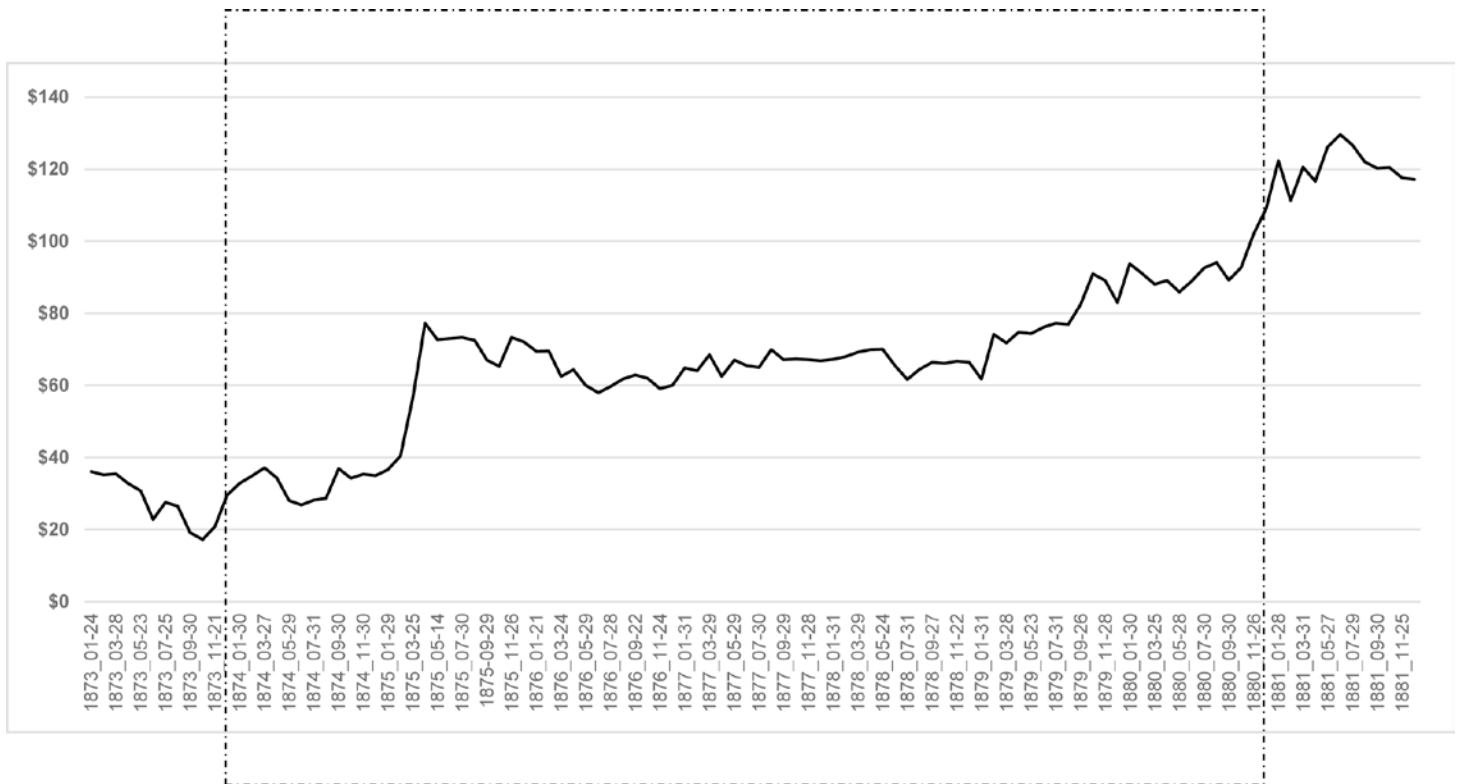
Observers had expected him to milk the UP for all it was worth and depart, leaving a financial wreck in his wake. Instead, he turned it into a stable, profitable enterprise through close attention to the details of every aspect of its operation. The former speculator/trader had become a successful businessman, and he remained one for the rest of his career.

Gould stayed with the UP for six years, leaving only when it became clear that he could not solve one financial albatross: the government debt. Contrary to popular belief, the government bonds issued to help construct the road were not a subsidy but a loan. To make matters worse, the UP was one of a very few railroads with a federal, rather than state, charter. This made it something of a plaything of Congress. The task of trying to reach a settlement on the debt with venal Congressmen taxed even Gould’s patience. Through a series of brilliant maneuvers, he sold his UP shares. To illustrate the value creating impact of Gould’s activities while he controlled the UP, consider Exhibit 1.

The compound annual growth rate of the UP’s stock price from December 24, 1874 to December 24, 1880 (Jay Gould controlled the UP from 1874 to 1880) is 19%, which is impressive in-and-of-itself, but all the more so relative to the 7.5% compound annual growth rate (price-weighted) of the New York Stock Exchange over the same general time period. It is important to note that the US economy was both in a major depression and generally deflationary from October 1873 — following the infamous financial panic — to March 1879.

Gould used the proceeds from the sale of his UP stock to put together a new southwestern rail system built around the Missouri Pacific Railroad, which ran from St. Louis to Kansas City. This new system played a major role in the economic development of the Southwest. He stayed with that work, expanding the system and its territory through construction and acquisitions, until his death in 1892. During the 1880s he also gained control of two other major properties, Western Union and Manhattan Elevated. Domination of them put Gould astride the two most significant industries in late 19th century America: transportation and communications. That fact alone rendered him one of the most important business figures of his era.

## Exhibit 1: Select UP Stock Prices from 1873 to 1881



Note: The data source for this graph is the *The Commercial and Financial Chronicle*, <https://catalog.hathitrust.org/Record/000548353> for the years 1873–1881 (thanks to Bob Wright and Kristin Aguilera of the Museum of American Finance for referring us to this source). The dotted rectangle encloses the years that Jay Gould controlled the UP, i.e., 1874 to 1880. The chart illustrates one stock price for each month of the years profiled (every-other-month is labeled on the x-axis). No one consistent date is used, so the chart should only be considered representative of UP performance over the profiled timeframe.

To generate the kind of returns that Gould did at the UP—in a troubled economy no less—required a broad set of integrated skills. Modern financial strategy encompasses four disciplines: strategy, investment, finance and operational management. Gould excelled in each of them.

*Strategy:* Gould seemed hard-wired to be flexible when it came to strategy, switching gears quickly when a particular strategy did not prove itself and/or a better one presented itself. This approach was consistent with his speculating/trading background and, interestingly, it is also consistent with modern “complexity economics.”

According to a popular book on that subject, *no* strategy is sustainable. Such a position necessarily “changes our definition of an excellent company from one that has continuous high performance for very long periods of time (an achievement that is almost non-existent) to one that can string together a series of temporary advantages over time.” This quote summarizes well Gould’s strategic success at the UP:

he continually “strung together” strategic moves, each of which exhibited, more often than not, a positive net present value.

*Investment:* In addition to speculation/trading, Gould was an expert investor; in other words, he invested at price levels which, over time, increased in value. For example, his aforementioned gold speculation earned him a fair bit of notoriety, but his investment in the Erie Railroad was timed perfectly from both the buy- and sell-sides which, as one astute observer noted at the time, enabled him to invest in the UP at depressed price levels following the Panic of 1873. This powerfully enabled the generation of abnormal (or well in excess of market) returns.

*Finance:* Gould also exhibited a level of financial expertise that rivaled the top bankers of his day, especially the legendary J.P. Morgan. For example, and as noted above, the UP was debt-heavy when Gould assumed control of it, but he proposed to restore the credit and boost the earnings of a dishonored railroad in

the teeth of a depression. Gould delivered what he promised, and he accomplished much of it within one year. He accomplished this through a combination of hard-nosed negotiation, innovative financial structuring (which included Gould assuming some of the debt himself) and leveraging the relationships across his wide financial network.

*Operational Management:* Gould was incredibly detail oriented as an operating executive, which is a trait that continues to define top performing executives. Like Gould, such executives demonstrate shorter-term expertise by generating revenue and tightly managing expenses, and in the longer-term through investment expertise by positioning their firms strategically to grow profitably over time. Moreover, these executives tend to have another trait in common, one described by legendary investor Phil Fisher as, “the general term of integrity and encompasses both the honesty and general decency of those who are » *continued on page 39*

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running the company.” Indeed, as an operator, Gould was remarkably non-dictatorial and humble. According to Klein’s history of the UP:

In meetings he [Jay Gould] never dominated discussion but let it drone on before expressing succinctly and precisely the point others had been groping for. He did not command or dictate but suggested politely. Far from being an imperious figure, he was content to dwell in the shadows and let others take credit. For a man consumed by ambition, he was strikingly unaffected by considerations of ego or vanity.

Expertise in each of the above disciplines was profiled on a standalone basis for explanatory purposes. However, in practice all of the disciplines work together, many times simultaneously, which adds a level of complexity to financial strategy that helps to explain why it is difficult, and rarely done well.

Despite its historical context, the above framework can provide insight into “activist investing,” which is popular today. To explain, corporate executives who employ suboptimal strategies, allocate capital unwisely, manage their finances poorly (e.g., uneconomical stock buybacks) and/or run inefficient operations over time invite “activism,” especially when their under-performance is followed by behavior such as “insider selling.” Therefore, executives should generally not try to “outsmart” activist investors, as some business scholars have recommended, but rather manage their companies in accord with sound strategic, investment, financial and operational principles over time. For executives so inclined, the experiences of Jay Gould offer many valuable lessons. **\$**

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# TRIVIA QUIZ

By Bob Shabazian

1. On August 11, 2016, the three major stock market indices matched a record last reached in 1999. What was it?
2. What legislation, passed during the Depression era of the 1930s, separated commercial banking from investment banking?
3. Who was known as the “Financier of the American Revolution”?
4. What is a victory tax in the context of the Olympic Games?
5. Wells Fargo, the center of a recent banking scandal involving the opening of unauthorized accounts, acquired what major bank in 2009?
6. Ratification in 1913 of the 16th Amendment to the US Constitution gave Congress what power?
7. What companies have announced plans to merge that — if completed — would create the world’s largest hotel company?
8. Nationally, women earned 72% of what men earned in 2015. What state had the lowest women’s earning percentage?
9. What is the wage base cap on the Social Security employment tax?
10. What do Wells Fargo and American Express Co. historically have in common?

1. The Dow Jones Industrial Average, the S&P 500 Index and the Nasdaq Composite Index all closed at their all-time highs on the same day. **2**. The Glass-Steagall Act of 1933 (later repealed in 1999). **3**. Robert Morris. **4**. A tax on the value of a medal won during the competition. If applied, the tax for winning a gold medal could be as high as \$9,900. **5**. Wachovia Bank. **6**. The power to levy and collect a tax on income. **7**. Marriott International and Starwood Hotels & Resorts Worldwide. **8**. Wyoming, with 54.3%. **9**. \$118,000. **10**. Henry Wells and William Fargo were involved in the founding of both companies.