

“Energy and Persistence Conquer All Things”

Applying Benjamin Franklin’s Entrepreneurship in the 21st Century

Remarks by John C. Bogle, Founder and Former Chairman

The Vanguard Group

On Receiving

The Benjamin Franklin Founders Award

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Introduction

I am humbled by the honor you bestow on me today. But marking, as 2002 does, the 250th anniversary of the founding of The Philadelphia Contributionship in 1752, the timing seems delightfully appropriate. Just as the Contributionship was founded by Benjamin Franklin on the rock of true mutuality—the ownership of an enterprise by those whom it serves—so mutuality was the rock on which I founded The Vanguard Group in 1974. While our far more venerable cousin serves the community’s needs for the insurance of homes against the devastation of fire, this upstart younger cousin, serves the needs of our citizens for accumulating wealth by following sound investment principles. But the Contributionship and Vanguard are not only connected by mutuality. Both began their lives in our City of Brotherly Love and have continued in our region ever since. Were Dr. Franklin to return to earth this day, I believe that he would award both enterprises his seal of approval.

So much is known about Benjamin Franklin as founding father, framer, statesman, scientist, philosopher, author, master of the epigram, and fount of earthy wisdom that it is small wonder that we have little room left for recognition of his talents as entrepreneur and businessman. Yet remarkably, on almost the very day that I learned of my selection as the recipient of your award, a workshop on entrepreneurship was taking place just a few miles north of here, at Princeton University. The subject of the very first session on the conference agenda was “Ben Franklin, the First American Entrepreneur.” The recognition was long overdue.

Perhaps the delay in the recognition of Franklin's entrepreneurial talent has arisen from a misunderstanding of what entrepreneurship is all about. While in today's grand era of capitalism the word "entrepreneur" has come to be commonly associated with those who are motivated to create new enterprises largely by the desire for personal wealth or even greed, the fact is that *entrepreneur* (leaving aside its archaic meaning of "the manager of a public musical institution") simply means "one who undertakes an enterprise," a person who founds and directs an organization.

At its best, entrepreneurship entails something far more important than mere money. But do not take my word for it. Heed the words of the great Joseph Schumpeter, the first economist to recognize entrepreneurship as the vital force that drives economic growth. In his *The Theory of Economic Development*, written nearly a century ago, Schumpeter dismissed material and monetary gain as the prime mover of the entrepreneur, finding motivations like these to be far more powerful: (1) "The joy of creating, of getting things done, of simply exercising one's energy and ingenuity," and (2) "The will to conquer: the impulse to fight, . . . to succeed for the sake, not of the fruits of success, but of success itself."

Money—A Means to An End

There is a difference, then, between an entrepreneur and a capitalist. According to biographer H.W. Brands,¹ had Franklin possessed the soul of a true capitalist, "he would have devoted the time he saved from printing to making money somewhere else." But he did not. For Franklin, the getting of money was always a means to an end, not the end in itself. "During the years when his (printing business) had to be established and placed on a sound footing," Brands reports, "no one worked harder." But the other enterprises he created as well as his inventions were designed for the public weal, not for personal profit. When he reminded us that "energy and persistence conquer all things," Franklin was likely describing his own motivations to create and to succeed.

Today, as we move into the twenty-first century, I'd like to talk to you about three areas in which Dr. Franklin's idealistic eighteenth-century version of entrepreneurship should continue to inspire us. First, the application of his relentless energy and persistence to the service of the community's greater good. Second, his invention—largely through trial and error and common

¹ *Benjamin Franklin—The First American*, Doubleday, 2001.

sense—of devices that would improve the community’s quality of life. And third, his view that virtue is not only achievable by us mortals, but is the principal requirement of a life well lived. In each case, I shall deal both with Franklin’s accomplishments of yore and with the humble parallels reflected in the creation of Vanguard and the innovations we have brought to the investment community, which drive our growth to this day.

I. Mutuality

In the eighteenth century, fire was a major and ever-present threat to cities. In 1735, when barely 30 years of age, Franklin responded to that threat by founding the Union Fire Company, literally a bucket brigade that protected the homes of its subscribers. In a short time, numerous other fire companies sprang up. Fire protection became sort of “every company for itself”—but only until it occurred to Franklin that if Philadelphia’s fire companies joined in common cause it would be possible to insure the homes under their aegis against financial loss when a fire took place.

So Franklin joined with his colleagues in founding The Philadelphia Contributionship on April 13, 1752, following public notice in *The Pennsylvania Gazette*. The name of the new enterprise was inspired by the Amicable Contributionship of London, founded in 1696, and its name, in turn, was derived from the eighteenth-century definition of contribution—“that which is given by several hands for a common purpose,” an apt name for a mutual company owned by its policyholders. This combination of ownership and service—creating a true mutuality of interest between the owners of a firm and its managers—is not now, nor was it then, the common mode of business organization. But it was an inspired idea for its day and for its purpose.

And so began the distinguished history of the Contributionship, the oldest property insurance company in the United States. In a short time, each property it insured displayed a firemark carrying the now-familiar four-clasped-hands (“the scout carry”) mounted on a wood plaque. The company did more than insure; it worked diligently to increase the fire safety of its policyholders and of the city as well. The Contributionship quickly prospered, and the rest is history. It survives—indeed it thrives—to this day, with current assets approaching \$300 million.

A Much Younger Cousin, A Mixed Pedigree

Vanguard, of course, is a much younger enterprise, and its pedigree rather more mixed. We trace our lineage to 1928, when another remarkable Philadelphian, financial entrepreneur and fund pioneer Walter L. Morgan, founded Wellington Fund, one of America's oldest mutual funds. His company, Wellington Management Company, operated and managed the fund. Like its peers, however, while it was mutual in name, its management was engaged in carving out a profit from the advisory and distribution fees the fund generated.

It was the creation of Vanguard in 1974 that changed the operation of Wellington Fund from being a profit-making entity for its operators to one that operated on an at-cost basis, one in which the fund shareholders actually *owned* the operating company. Flying in the face of industry tradition and practice, Wellington Fund, under Vanguard's aegis, became a truly *mutual* mutual fund, now joined by 106 sister funds that compose the Vanguard family of mutual funds.

The change in the character of Wellington and its sister funds—from profit to not-for-profit—came when they were brought under the Vanguard umbrella. How that happened is a tortuous and compelling saga, filled with success and failure, joy and sadness, good choices and bad. I will not recount it today, except to say that we began operations as a tiny company with a crew of 28 members, providing only administrative services to Wellington and the other Vanguard funds. It took nearly three long years for us to develop into a full-fledged fund complex, providing not only administrative services to the funds, but distribution and investment services as well. And two more years were to pass before the new enterprise began to grow. But ever since 1981, our path has been one of unremitting growth—indeed the highest growth rate in the mutual fund industry.

Mutuality—The Rock Foundation

Suffice it to say that mutuality is Vanguard's most distinctive characteristic, the rock foundation upon which all that we have accomplished depends. But without Dr. Franklin's angels—energy and persistence—sitting on our shoulders, we never would have been able to form the new enterprise, nor to establish its character, nor to build it to its present substantial size. With assets of the Vanguard funds now exceeding \$575 billion, we have become the second largest fund complex in the world.

Why was mutuality so important? Consider this reality: Mutual funds are simply diversified investment portfolios that invest in securities traded on America's vibrant financial markets. Both common sense and the historical record tell us that equity mutual funds as a group earn *gross* returns on their portfolios that equal the returns generated in the stock market, but only before fund costs are deducted. The *net* returns funds *deliver* to their investors fall short of those *gross* returns by the amount of their costs—all of those management fees, operating expenses, portfolio transaction costs, and sales commissions that funds incur. Just as gambling becomes a loser's game after the croupier's rake descends, so beating the market becomes a loser's game after the costs of the financial intermediaries are deducted.

Fund costs are heavy, indeed onerous. The average common stock mutual fund incurs all-in costs of 2.8 percent per year. Think about it. If the annual returns of the stock market average 10 percent, fund costs would erase fully 28 percent of it. What is more, the impact of costs grows dramatically over time. Compounded over a quarter-century, fund costs at that level would consume, not 28 percent, but fully 47 percent(!) of the final value of the investment. In investing, *costs matter*. Over a long-term time horizon, costs may represent the difference between a comfortable retirement and a spartan one.

Marching to a Different Drummer

But while mutuality has been the key factor in Vanguard's growth and in the Philadelphia Contributionship's longevity alike, the concept is hardly winning any popularity contests. Part of the reason for my choice of the name *Vanguard* for our new firm was to suggest that our structure would establish a new trend, one that would lead the way in the mutual fund industry. Alas, after the passage of nearly 28 years, our mutualized structure has yet to attract its first follower. Indeed, in the insurance field, it is *de-mutualization* that is leading the way. Nearly all of the great mutual life insurance companies that once dominated their field have abandoned their heritage. And mutual thrift institutions—before its demise, even the venerable Philadelphia Saving Fund Society had converted to stock ownership—are today as hard to find as the cigar store indian.

The reason that mutuality has not come to rule the financial seas, I fear, is that the Schumpeterian *entrepreneurs* who originally created mutual enterprises—"for the joy of creating

. . . for success itself, *not* for the fruits of success”—are in the ordinary course of events succeeded by *businessmen* who are more susceptible to temptation by the fruits of success and the greater personal wealth that results from building their empires. They perceive, perhaps correctly, that having public stock available to acquire other enterprises will enhance—for better or worse—their ability to achieve those goals.

Yet one of the secrets of success is remembering whence you came, living up to the character you have established, placing the trusteeship of the assets entrusted to you by your owner-clients first, even if it entails substantial personal cost. I salute the Contributionship for staying the course that has served its policyholders so well, even as I assure you that I have neither personal nor professional regrets about creating a mutual structure for Vanguard. While mutuality is hardly in vogue today, it has been the linchpin of the strategy of two firms that have dared to march to a different drummer. They have succeeded in their highly competitive business simply by being *companies that stand for something*.

II. Invention

It is impossible to imagine a contemporary American who has demonstrated anything remotely resembling the breadth of interests of Benjamin Franklin. He was a central participant in the drafting of both the Declaration of Independence and the Constitution, and a signer of both. He not only established a fire company and an insurance company, but a library, an academy and college, a hospital, and a learned society, all the while running a successful printing business at which he made his living.

Like many entrepreneurs, Franklin was also an inventor, creating among other devices the lightning rod and the Franklin stove. He made no attempt to patent the lightning rod for his own profit, and declined the offer by the Governor of the Commonwealth for a patent on his Franklin stove. That “Pennsylvania fireplace” that he invented in 1744 to economize on fuel and improve the efficiency of home heating was designed to benefit the public at large. For Franklin believed that, “knowledge was not the personal property of its discoverer, but the common property of all. As we enjoy great advantages from the inventions of others,” he wrote, “we should be glad of an opportunity to serve others by any invention of ours, and this we should do freely and generously.”

Public Domain, Not Private Profit

Vanguard provides at least one parallel with Franklin's concept of placing his inventions in the public domain rather than seeking private profit. Vanguard's innovative structure was designed to reduce the claims against investment returns by institutional managers and distributors to the bare minimum, the better to enhance the residual returns remaining for investors. Shortly after we began operations in May 1975, it occurred to me that the best way to bring our common sense principles of investing to their logical conclusion: *Since an index of stock market prices provides a fine replication of the actual returns earned by the entire stock market, then investors could capture almost 100% of that annual return simply by owning the market at nominal cost.* This obvious insight quickly led to the simple invention that has been the most powerful manifestation of Vanguard's philosophy of mutuality—the world's first index mutual fund.

A Thesis in 1951, An Index Fund in 1975

But that was not the first time that the idea had occurred to me. Some 25 years earlier, in my Princeton University senior thesis on the mutual fund industry, I had written that mutual funds “could make no claim to superiority over the market averages,” and that mutual funds should, above all, *serve* their investors, and serve them “in the most honest, efficient, and economical way possible.” Those insights were based solely on anecdotal data. So I set about collecting and tabulating the results of each of the equity funds in the mutual fund industry, then a laborious effort. (Today it could be done almost instantaneously.) Over the previous thirty years, I found, the average mutual fund had lagged the results of the rather obscure index I had chosen—the Standard & Poor's 500 Composite Stock Price Index—by 1.5 percentage points per year—just the evidence I needed to convince the world that the index mutual fund was an idea whose time had come.

To add weight to my argument, I assumed an initial investment of \$1 million in the average fund and in the 500 Index, and compounded the average returns of each over the three-decade period. Final value: S&P 500 Index, \$25 million; average equity fund \$16 million. A nine million dollar increment! Although those mathematics were powerful, the investment world was not yet convinced. Neither were the Wall Street underwriters of the fund's initial public offering, nor the stock brokerage fraternity, nor, for that matter, the man on the street. The new

fund began operations with only \$11 million in assets. While what quickly became known as “Bogle’s folly” had an infinitely modest beginning, however, it was a *beginning*.

It took two decades of energy and persistence for us to bring that tiny original index fund to its present eminence. But today its assets of some \$90 billion mark it as the largest mutual fund in the world. We made no attempt to patent the investment, and indeed “freely and generously,” in Franklin’s words, encouraged others to follow suit. And while some of our rivals copied it, however, their high cost structures precluded success. Even without a patent, the index fund has become our trademark, the backbone of the Vanguard book of business. Together the assets of our stock index funds, our bond index funds (another of our inventions, if an obvious one), and our other funds that are managed with index-like strategies total \$410 billion, all because of that original invention of 1975.

Opportunity *and* Motive

Just as Franklin’s desire to enhance the public weal undergirded his invention of the Franklin stove and the lightning rod, so Vanguard’s investor-friendly mutual structure undergirded the invention of the index fund. While I was hardly the only person who understood the simple principles behind the index fund—there must have been hundreds of others—the traditional fund firm would have had little interest, regarding it with suspicion if not horror. How would such a firm make money on a fund that generated no advisory fees and no sales commissions, a fund in which virtually the entire investment return goes to its shareholders? While every firm in our industry had the *opportunity* to invent the index fund, like the prime suspect in a murder investigation, only Vanguard had both the *opportunity* and the *motive*.

I cannot tell you exactly how many modern-day investors have enjoyed the warm comfort provided by the remarkably efficient index mutual fund, but it may well be far less than the proportion of homeowners who were warmed by the efficient Franklin stove all those years ago. Nor can I assure you that the widely-diversified index fund has protected more investors from losses from the lightning bolts that have struck some widely ballyhooed individual stocks, causing them to become, well, toast, than the proportion of the Colonial citizenry protected by Dr. Franklin’s lightning rod. But I can tell you that in the 25 years since the Vanguard 500 Index Fund was invented, it has outpaced the annual return of the average stock fund by an estimated two percentage points. \$1 million invested at the outset would today be valued at \$23 million,

compared to \$14 million for the average managed mutual fund, as chance would have it, the very same nine million dollar increment reflected in my statistical study of a quarter-century earlier.

III. Virtue

It turns out that entrepreneurship, mutuality, and invention have something in common: *Virtue*. While virtue is a word that tends to embarrass us today, it surely didn't embarrass Dr. Franklin. In 1728 when he was but 22 years of age, he tells us that he, "conceived the bold and arduous project of arriving at moral perfection . . . I knew, or thought I knew, what was right and wrong, and I did not see why I might not *always* do the one or avoid the other." The task, he tells us, was more difficult than he imagined, but he ultimately listed thirteen virtues along with their precepts, even placing them in rank order of importance.

The first four were *Temperance*, *Silence* ("Speak not but what may benefit others or yourself"), *Order*, and *Resolution* ("Perform what you ought"). The next were *Frugality*, *Industry* ("Be always employ'd in something useful"), *Sincerity*, and *Justice*. Then *Moderation* ("Avoid extremes"), *Cleanliness*, and *Tranquility* ("Be not disturbed at trifles"). And finally *Chastity* (though here Franklin famously succumbed to temptation) and *Humility* ("Imitate Jesus and Socrates"). He regularly examined his failings in a notebook he designed for the purpose, and was "surprised to find myself so much fuller of Faults than I had imagined, but I had the Satisfaction of seeing them diminish." He began each day with "The Morning Question: What good shall I do this day," and ended with the "Evening Question: What Good have I done to-day?"

Even viewed through the lens of twenty-first century cynicism rather than eighteenth-century idealism, I confess a sense of wonder at the young Franklin's moral strength and disciplined self-improvement. While few of us in today's society would have the will to pursue a written agenda of virtue, Franklin had established, in his own words, the "character of Integrity" that would give him so much influence with his fellow citizens in the struggle for American independence. Wrapped in integrity and virtue, his character was also central to his dedication to the public interest. It is in that sense that his true entrepreneurship emerges. Franklin took joy from his creations and from exercising his ingenuity, his energy, and his persistence. Echoing the same ideals Schumpeter echoed a century and a half later, he succeeded solely for the sake of

success, exercising his talents with a view not toward personal gain and private profit, but toward serving the community. “America’s first entrepreneur” may well be our finest one.

The idea of a *contributor*—“one who bears a part in some common design,” according to a 1793 dictionary—seems archaic to our ear. But 250 years later, Franklin’s idea of *contributionship*—a shared mutuality of interest for a common purpose—is the defining characteristic of Vanguard. As Franklin’s stove and lightning rod and all of his other contributions to science and to mankind fostered the public good, so we have freely shared with others the fruition of our mutuality, the index fund. And both our structure and our invention arise almost entirely from our firm’s value system and the corporate character that we firmly established more than a quarter-century ago, which have undergirded all that we may be judged to have achieved thereafter.

I hope you will forgive my boldness in comparing the peerless accomplishments of our nation’s first entrepreneur with my own humble entrepreneurship and inventiveness, my own joy in what providence has led me to create, my own energy and persistence, and my own attempts to improve the lot of the American investing public. Of course I’m proud, but I console myself with these words of Benjamin Franklin, written when he was 78 years of age:

In reality, there is, perhaps, no one of our natural passions so hard to subdue as *pride*. Disguise it, struggle with it, beat it down, stifle it, mortify it as much as one pleases, it is still alive, and will every now and then peep out and show itself; you will see it perhaps often in this history; for even if I could conceive that I had completely overcome it, I should probably be proud of my humility.

If, in the history I have recounted today, I have allowed my own pride to peep out and show itself, I assure you that it is with great humility that I accept the award of the Benjamin Franklin Founder Bowl with which you honor me.