

**CORPORATE FINANCE  
IN CANADA**



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CORPORATE FINANCE IN CANADA

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## Chapter I.

### DEFINITION AND CLASSIFICATION OF CORPORATIONS.

In Blackstone's "Commentaries on the Laws of England" the following definition occurs:----

"We have hitherto considered persons in their natural capacities and have treated of their rights and duties, but, as all personal rights die with the person, and as the necessary forms of investing a series of individuals, one after another, with the same identical rights would be very inconvenient, if not impracticable, it has been found necessary, when it is for the advantage of the public to have any particular rights kept on foot and continued, to constitute artificial persons who may maintain a perpetual succession and enjoy a kind of legal immortality.

These artificial persons are called Bodies politic, Bodies corporate or corporations of which there is a great variety subsisting for the advancement of

religion, or learning and of commerce; in order to preserve entire and forever those rights and immunities which, if they were granted only to those individuals of which the body corporate is composed, would, upon their death, be utterly lost and extinct".

Today this practice has become so widespread that few persons are aware of the extent to which the corporate idea enters into their daily lives. As a practical illustration, the Church of England, the Royal Institution for the Advancement of Learning (McGill University), St. James' Club and the Canadian Pacific Railway are all bodies corporate, organized respectively for religious, educational, social and commercial purposes, and whose continued existence in no wise depends upon the life or death of any or all the individuals which they may at any time comprise. They may receive and disburse monies, they may purchase commodities and erect buildings, they may sue or be sued in the courts of law, in fact they can enjoy, as far as their charters permit, all the privileges of a British Subject and all liabilities, saving only imprisonment or death.

Bodies corporate may, as stated, assume a variety



of forms, presenting certain common features and differing in other respects according to the purposes which they are intended to serve. For our purpose it will be convenient to classify them into two great groups, Non-Gainful Corporations and Gainful Corporations, according to whether their activities are directed to the general good or the enriching of a group of individuals. In the first group we find three classes of Bodies Corporate, Governmental, Quasi-Corporations, and a third comprising religious, educational, philanthropic and recreational organizations. The third group we may dismiss at once as beyond the scope of this treatise. The first two, however, have frequently at various times assumed functions of commercial importance and even entered into competition with private enterprise, so that a brief glance at their functions may be profitable.

Three typical examples of Governmental Corporation are Municipalities, Metropolitan Commissions and the Local Government Boards.

The first of these is primarily engaged in the administrative arrangement of towns, cities or townships,

exercising certain inferior judicial powers, collecting revenues, passing local regulations or by-laws and performing such public services as road building, street cleaning, sewerage disposal, maintenance of public markets and police and fire protection. To these duties are commonly added a host of others, mainly of a regulative nature, like the inspection of buildings, the surveying of land for record and so forth. It is also usual to find municipalities engaged in the supply of commodities, such as water and sometimes gas, electricity and even tramway and telephone facilities. The last two are very similar to Quasi-Corporations in their origin and organization. The powers of Metropolitan Commissions in Canada are derived from legal enactment; their functions are to correlate the efforts of groups of municipalities, to co-ordinate and regulate borrowings and expenditure and generally to assist the administration of the municipalities concerned. They may themselves raise monies and enter into expenditures, but their powers are less extensive than those of the Local Government Boards from which they were copied, and which enter into a minute regulation of the activities of both rural and urban



municipalities which are their area of jurisdiction. For example, like Municipal Corporations, the Local Government Boards in England are very largely concerned with public works in these areas and with the police and other regulations therein, and similarly they may enter into commercial activities, as witness the London County Council Trams, which are in open competition with the omnibus and tubes systems of London.

There are many minor forms of Quasi-Corporations, such as the English Boards of Guardians, Commissioners in Lunacy and Bankruptcy and the like which perform purely legal or philanthropic functions. In Canada we have slightly different forms, and their activities are less generally familiar to the public. Interest in this country centres on the Quasi-Corporations engaged in direct competition with private enterprise, such as the Ontario Hydro Electric Commission, which sells electric power at or below cost to a large group of municipalities, or the Montreal Harbour Commission, which both regulates and executes improvements in the harbour of Montreal. There are, however, other important commissions in this class, notably, the Railway

Commission, which fixes rates and regulates transportation and communication between provinces, and the Joint International Waterways Commission which, together with members from the United States, controls the Great Lakes-St. Lawrence system along the international boundary and regulates the distribution of water and shipping facilities. It must be distinctly noted that these Quasi-Corporations, while in a sense they are appointed politically, are not mere committees or departments of government like the Civil Service. They have powers fixed by enactment and are perfectly free to act within those limits without let or hindrance.

It is obvious that the commercial activities of such Governmental and Public Quasi-Corporations are quite capable of execution by individual enterprises. To this extent the two classes of Non-Gainful and Gainful Corporations come into direct competition unfavourably to the latter, since Government plant is in these cases self-supporting or is being operated at an actual loss for the general good, the deficit being met through other sources such as taxation.



However, the Public Quasi-Corporation may still fall under the classification of Gainful. As an example, the Quebec Liquor Commission is perhaps the most striking. It is at the opposite pole from the idea of public service at low rates exemplified by the Ontario Hydro Electric Commission.

The class of Gainful Corporations also includes private Quasi-Corporations, which we shall ignore, and all private and public corporations organized for the profit of individuals. The same principles apply, in the main, common to private and public corporations and, as instances of private incorporation on a large scale are rare in Canada, the public corporation will be treated of most fully in what follows.

Before further elaboration it will be desirable to trace the corporate idea from its origin.

## Chapter II.

### THE HISTORY OF CORPORATION ORGANIZATION.

Curious as it may appear, when the great antiquity of commercial trading is taken into account, the idea of corporate organization is of comparatively recent origin. As Canadian Corporations share with similar bodies in England, as in the rest of the world, a common origin and have been created under analagous principles of jurisprudence, it will be desirable to trace the history of the corporation from its first appearance under the aegis of the Roman Empire.

Trading in primitive communities is mentioned in the earliest records and probably antedates these very considerably. Such trading consisted for the most part of barter, and was carried on in person by the proprietors of goods. Direct contact was thus an invariable rule, a necessary consequence of the absence of facilities for communication. This lack of the most



essential feature of our present civilization largely precluded the use of a medium of exchange of universal acceptability, while the division of the world into countless petty principalities and tribes prevented the establishment of any settled code of legal procedure or the growth of widespread customs.

Add to this the endless differences in speech, and the difficulty of enforcing or even arriving at a bargain is obvious; only by eternal and personal vigilance could a merchant hope to prosper. This view is confirmed by a study of the customs and history of the great trading nations of antiquity, Greece, Carthage, Tyre, Assyria and the barbarian Tartar tribes.

As these civilizations developed, settled practices in accordance with custom and often regulated by statute sprang into existence. Here, it is interesting to find a type of legislation which is today classed as socialistic or paternalistic existing in Nineveh and Thebes. The increased sense of security which grew from a better social order led to an important development, the idea of agency, which has in it the seed of all corporate or-

ganization.<sup>#</sup>

It is probable that agency is of military origin. On more than one occasion commerce has borrowed quite frankly from the camp. The professions of trader and marauder were at that early date inseparable. Merchants were forced to travel armed, banding together for security against hostile tribes and to secure equitable treatment by their customers. From the days of Joseph to Marco Polo the caravan has been a symbol of landwise trade, just as the long galleys of Scandinavia, manned by fair-haired, blue-eyed adventurers, at once shrewd, war-like and bound by the prospect of spoil to be divided, pillaging where they could and trading cannily where they dared not loot, became the model of ocean commerce for many a long year.

The conception of duty, enforced by rough and ready physical sanction, with the delegation of functions necessitated by even the crudest forms of military organization, suggested the further possibilities to the shrewd trader of using associates, or even

# This is an original theory advanced as an interesting piece of speculation. The obvious needs of a corporate form of organization, just as the need for money as a means of exchange, would suggest its own remedy. These needs and circumstances are brought out in the description.

slaves, who could be called to account for their actions, to carry out tasks beyond the power of one man to accomplish. The example of the more efficient of the predatory tribes in leaving behind them, after some successful foray, representatives to gather and forward tributes to the conquerors at stated times, must have had a great influence upon the mind of the individual trader. The practice of establishing garrisons to enforce these obligations by physical means envisaged the possibilities of a future system of policing, such as the satrapis appointed by the Medes and Persians to administer the conquered states or "protectorates" as they would now be called. To these same Medes we owe the conception of standard and inflexible methods of jurisprudence under which real advances in trading were possible.

It is an accepted maxim that "Trade follows the Flag". No better instance could be chosen than the growth of Rome. Here we have a wide-flung line of outposts from the Pillars of Hercules to Jerusalem and from Lake Lucerne to Alexandria, to enforce the

dues of Rome and the rights of her citizens. No mean privilege this; "civis Romanus sum" was no idle boast in the heyday of the Caesars, and the status of citizenship in the Empire was highly prized. "With a great sum obtained I this freedom", said the governor to Saint Paul, who rejoined, "But I was free-born".

As in contra-distinction to the drastic regulations of the Medes, the Romans appear to have contented themselves with the maintenance of local custom in their dependencies where such observance would not prejudice the rights of Romans. "If it be a matter of words and your laws", cried Gallio, "look ye to it; for I will be no judge of such matters".

Gradually, as the Roman jurisprudence crystallized into a definite code of statutory laws, the rights and duties of individuals became definite and easily ascertained, fixed by statute and enforceable by sanction. The Romans do not appear to have been great manufacturers, and also the more intimate details of business



were entrusted to Greek and Levantine accountants, sometimes slaves and sometimes freedmen, who acted as agents for their Roman masters. The practice of conducting all transactions in Roman currency became more and more common; its value was assured and it was legal tender throughout the Empire to the displacement of the local currencies. It became possible to transmit goods in safety over long distances under the protection of the Roman navy, which had swept the Carthaginians from the Mediterranean in a series of prolonged and bitter contests for the trade supremacy of the then civilized world. It became common for men to undertake commissions for others in distant parts, and the proceeds of such transactions could be remitted in specie or in bills of exchange to the owners of the ventures. The time was ripe for the next stage in the development of trade, the formation of the trading association and the corporation.

These associations found legal recognition in the Roman "collegium" or "universitas", and while in more recent times, the legal attributes of the corporation have been very fully expanded, especially under English

law, the conception has taken full growth from the laws of Rome.

The Roman "collegia"<sup>#</sup> could hold property in common, could sue and be sued as a body, but very clear distinction was drawn between the rights of the individuals as comprising the body, and the rights of the body as a whole. Internal government through means of the association's by-laws was allowed, provided that these laws did not conflict with the country's codes. These are still the essential principles underlying corporation jurisprudence.

Also, in the formation of the "collegia", association for different purposes was recognized as today. There were four distinct classes - (1) public governing bodies (civitates) such as our municipal corporations (2) religious societies (the vestal virgins) (3) official societies (scribae) like our public quasi-corporations, and, (4) trade societies (fabri, pictores, navicularii) representing the modern commercial company.

This was the birth of the Corporation; from this seed grew all the many organizations which we can trace

# For convenient summary see - "Corporation"  
Encyclopedia Britannica.

today. In the Roman "collegia" we note precisely those characteristics which distinguish our modern organizations, the legal existence of an abstract and deathless individual with statutory rights and obligations, with methods for dividing profits and even the conception of limited liability and insurance against loss. The Roman Empire, faulty as it may have been, marked a vast development which has served as a model in all the years to follow; commerce reached a high-water mark which was not regained until after centuries of strife and turmoil. But we know to our sorrow that this amazing system contained within it the seeds of its own destruction. Before the barbarian hordes the commerce of the Empire crumbled into dust and the commercial corporation vanished from the world as completely as though it had never existed. Indeed until the destruction of the Eastern Empire bathed Western Europe anew in the culture of Byzantium and the dark night of feudalism gave way to the dawn of the Renaissance, Europe reverted to a system little advanced from the methods of barter in primitive communities. There are a few

bright exceptions, notably, the rise of Venice, to which we owe the trading association and the tontine, later to yield us the joint stock association and the great structure of insurance as exemplified by Lloyds'.

In England under the Saxons and the Danes, commerce languished for centuries. The Roman system vanished and gave place to an agricultural age, with a small urban population which supplied the wants of the rural communities. The contributions of these times to the corporate development of England are very slender, but this era marks the origin of a crude form of guilds, the frith and cnithen guilds, to regulate the activities of tradesmen and the adoption of seafaring ventures, later so fruitful in the new world, was suggested by the raids which had wrested England from the weakened hands of Rome.

The Angevin invasion began a new development of English commerce. William the Conqueror commenced by an economic survey of England, and the subsequent policy of England's Rulers was to make the country self-



contained and self-protecting. Craftsmen were imported to teach and practice manufactures, and little by little a uniform legal procedure, partly based on the Saxon customs and partly on statutory principle, was evolved. Much of this legislation was concerned with the existing guilds, and a new class of guild, the craft guild sprang into being. These guilds owed their existence to statutory powers conferred upon them, and partook of the character of trade unions and co-operative societies. The governing bodies of these guilds were soon united by the establishing of guilds merchant, which partook of the nature of joint-stock associations, sharing losses and profits, conducting exchange operations and maintaining what would now be described as a forward and banking service, much analagous to the operations of express companies in the United States and Canada.

To a generation brought up on laissez-faire, the activities of the feudal times are remarkable. Much of the legislation and litigation of the period arose out of efforts to fix "fair" prices and to prevent

"usury". The modern conceptions of rent and interest, recognized by the Romans and practiced by the Jews, were regarded as positively unchristian by the mediaeval legislators, and the practice of extending credit was held in utter abhorrence. Even the functions of warehousing and dealing wholesale or "en gros" were stigmatised as immoral and severe penalties were enforced against wholesalers or "engrossers". It is not remarkable, therefore, that corporations should not have developed in such an unattractive environment. The objects of guilds are considered to have been to advance craftsmanship, to secure a measure of mutual protection against legal and physical assaults, to train apprentices and control journeymen labourers, to render military services under the feudal system, to enjoy specific legal rights and immunities, to fix prices and carry on trading both within and beyond England and to share in municipal government.

Out of the guilds merchant grew the Livery Companies, which developed rapidly and by the time of Elizabeth had so encroached upon one another that it became necessary to deprive them of those monopolistic privileges

which they enjoyed. These organizations exist today in England as purely social bodies, the Drysalter, Glovers, Weavers and a number of others, whose membership comprises the most successful London merchants. Interest other than historical the Livery Companies have none; it is to the great trading, manufacturing and colonization companies, inaugurated under Elizabeth that the commerce of today is due.

To appreciate adequately the rise of large scale commercial operations and the application of methods of combination to trading, a brief glance at the state of Tudor England will be necessary. Today so many strictures are levelled in a spirit of ill-formed criticism against corporate enterprise and the existence of so-called "vested interests" that it is easy to forget that these organizations arose in answer to an overpowering demand and in order to satisfy most pressing requirements.

Improvements in methods of communication, notably the invention of the compass, led to the rapid

extension of the limits of the known world. One by one the nations turned from land transport, tedious and expensive, to ocean travel. Africa, the Indies, Cathay, all were visited by the intrepid voyagers of the fifteenth century. Seeking for yet simpler avenues of approach, a new world unfolded its virgin lands to the explorer. Immediately a mad race ensued to claim new domains whose riches might profitably be exploited.

Under Henry VII, British commerce spread rapidly over the narrow seas, and by fostering the ambitions of the merchants Henry made himself master of England as no ruler before him had ever been. The power thus wrested from the nobles was shared somewhat niggardly with the merchants, who had made possible the change. Henry VIII, moved by resentment of foreign ecclesiastical limitations to his power, and perhaps even more strongly by a need of monies to cover lavish disbursements, renounced the Papal allegiance, and proceeded to transfer the wealth of the Church into the coffers of himself and his favourites. The succession of a minor to

the throne, in the shape of Edward VI, witnessed an attempt by the nobles to restore England to the state of a purely agricultural country in which the control and operation of land would be vested in the nobles themselves. It was an attempt at large-scale agriculture for the first time. Under Mary, however, the Tudor policies were re-affirmed, and continued by Elizabeth but with a singular reversal of aim. Mary had agreed to refrain from active competition with Spain in the new world. Elizabeth, at war with the Papacy, aided the Netherlands, who were at once a commercial thorn in the side of Spain and a most attractive bait for the grasping ambitions of Phillip. Elizabeth perceived that England and Spain must perforce be rivals, and determined to exploit for herself the rich lands of America, since by so doing not only might the military activities of Spain against England be hampered but the wealth which formed the sinews of war for those assaults might be denied to the Spaniards and diverted to the defence and development of England. She accordingly determined upon a steadfast policy of Imperialism,

with the fixed determination that her every action should be to render England in every respect capable of her own support and defence, and to develop England at every opportunity.

To this end she determined to encourage industries essential to English needs. Her method was very simple, and consisted in offering exceptional opportunities to individuals or groups capable of supplying the needs of the country. The Guilds Merchant and their offspring, the Livery Companies, had become so intricately involved in a mass of price-fixing and monopolistic litigation, and were overlapping to such an extent, that their essential characteristics were growing daily more and more obscured. Some fresh weapon was needed to refurnish the arsenals of commerce. It was found in the chartered company. These companies, as will presently be seen, were formed for various ends. Many of them were granted extensive monopolies, an early instance of a protective tariff unaccompanied by regulation of the price of commodities. The natural effect was to cause those favoured individuals to exploit their opportunities to the utmost in the pursuit of gain. The



indirect result was, as Elizabeth had designed, a more rapid and far more extensive development of commerce and industry than was possible under the restrictions of the guild system.

To instance the scope of the policy, monopolies were granted to furnish metals, gunpowder, materials of war and other essential commodities. Not only were successful manufacturers and merchants rewarded by the gains incident to monopoly, they were not infrequently elevated in rank in token of their services in developing industry. To the shame of all it must be recorded that Sir John Hawkins, a wealthy merchant adventurer from the Cinque Ports, received his accolade for introducing the traffic in negro slaves in England and was granted arms, having for supporters "two demi-moors sable".

But it is to the trading and colonization companies that we must look to observe the characteristic features of the modern corporation emerging after centuries of disuse. <sup>#</sup> The view has been advanced that the introduction of large quantities of gold and silver, by per-

# Throughout this period, the idea had been kept alive in the organization of the church and in the form of municipalities prevailing. The use of such examples in suggesting the renewed trading organization has not been established, but it is known that, when English lawyers were confronted with the new requirements of trading corporations, they copied the principles, and incidentally the old Roman principles, quite fully.

mitting hoarding, greatly increased facilities for accumulating a store of capital and thus financing new ventures.<sup>#</sup> The strictures against usury declined, and Elizabeth, deliberately avoiding the great continental money mart of Antwerp, borrowed from her own subjects or wealthy resident aliens. Towards the close of the century we find the goldsmiths of London carrying on extensive banking functions on a deposit basis. In spite of strong Puritan opposition to usury on moral grounds, the trend was irresistible. Clearly the possessors of wealth, especially the large amounts of specie flowing from the New World, desired to apply this wealth to the creation of more wealth, and through the primitive bankers of the time large quantities of capital were seeking employment.

Much of this capital was attracted to the overseas markets which offered the prospect of relatively large returns. Many colonization and trading companies were formed, the members sharing losses and gains on the basis of a joint-stock association. Some of these were incorporated by Crown charter, but a few of the

# W. Cunningham - "Growth of English Industry and Commerce" Modern Times Part I. Section 163.

older associations, such as the Merchant Adventurers, declined to incorporate in view of their great strength, although we have the case of the Merchant Adventurers of Exeter being granted a separate charter in 1560. Out of the older guilds merchant sprang the Muscovy Company, originally the Muscovy Merchants, trading in the Baltic.

The greater part of the colonization companies were ill conceived and failed to justify the anticipations of their founders. The names of some, however, are still well known. In 1581 the Levant Company was formed to trade in the Near East, and the successful Virginia Company in 1584. In 1600 the East India Company was formed to compete with the Dutch East India Company in the race for trade in the Indies. By 1661 This Company was granted political powers of wide extent and exercised wide judicial and military power in India. The Hudson's Bay Company was organized in 1670 and was re-organized in 1708. It exercised wide powers of a political and military character until the acquisition of the Canadas in 1763, after which its extra-judicial powers were gradually abrogated. The

# So called. The real incorporation name was The Gentlemen Adventurers of England Trading into Hudson's Bay.

African Company was re-constituted in 1772, but never prospered in spite of much legislative aid and was dissolved finally in the reign of George IV. The Darien Company and the South Sea Company, arranged on a joint stock basis, were designed on so grandiose a scale that they were doomed to failure from the start.

One interesting feature of these great Companies is the co-existence of two principles of trading, one of which is familiar to the commerce of today, and the other is frequently advanced as a remedy for defects in existing institutions. The first is the existence of the regulated monopoly company, such as the Merchant Adventurers, through which all trade must be transacted in a given region and to which all merchants having business in those parts must belong. "Interlopers" were kept out as far as possible by legal sanctions, but a compensating regulation of prices and conditions of trading was imposed by the Government to protect the general public from the less desirable features of a monopoly. It is a direct offspring of the guild merchant, and although now extinct, analagous methods have been

recommended by the soi-disant exponents of Guild Socialism, Industrial Democracy and other syndicalist methods for regulating the exchange and distribution of commodities.

Nearly all the great trading companies commenced on the same basis, but, with the exception of the Merchant Adventurers and the Muscovy Merchants, their powers were derived not from the precedents of guilds merchant but from statutes. From these companies spring our modern corporations. The chartered companies were one and all re-organized during the Stuart regime as joint-stock enterprises, with shares subscribed by individuals, thus permitting the ready adjustment of capital employed to meet the occasion, and the prompt transfer of his interest by a shareholder to anyone else. Speculation became common and led to the creation of an Exchange to handle these transactions, peopled by a class of agents or brokers who trafficked in shares. Contemporary records show the wild frenzy of speculation caused by the illfated Darien and South Seas Companies, culminating in results not unlike the market panics of our own times.

The principle involved is of enormous import; it marks the transition from an association of merchants actually engaged in trade for their own account under certain legal immunities and obligations, to an organization more resembling the Roman Collegium. One step alone was necessary to complete the transformation; the risk to the inexperienced purveyor of capital had to be reduced. The merchant, familiar with the conditions, could shift for himself; the shareholder, devoid of real power and first-hand information, could not be expected to incur jointly and severally with persons whose means and solvency were unknown quantities, obligations of unlimited extent, except for enormous returns. The free flow of capital was restricted by the risk involved, according to the well known principle that the return on an investment is made up of the economic rent or interest on the capital invested, plus a premium based on the degree of certainty of the yield being maintained.

The remedy was soon forthcoming. By Charles II Cap. 24 the principle was established that shareholders



in the East India and Guinea Companies were not liable severally for all the debts of the Company, or even for a pro-rata share thereof, but only for the amount of capital actually invested. Gradually this principle was extended to one after another of the chartered companies.

The natural consequence of this principle was that capital was more readily available for joint-stock companies of limited liability, and the regulated companies of merchants gradually went to the wall. The advantages of relative security of investment, of a fixed loss in case of insolvency and of the gain in efficiency due to co-operation and standardization triumphed over the principle of paternalistic regulation. The victory was in many cases aided by the continuance of monopoly privileges, but even considering the dangers incident to commerce it is hard to conceive of any other issue to the struggle. The way was thus paved for the startling developments of the early years of the nineteenth century, for the industrial revolution, the growth of laissez-faire economics and the rise of the corporation.

### Chapter III.

#### THE HISTORY OF CORPORATION ORGANIZATION (CONCLUDED).

Before leaving the transition periods of the Tudors and the Stuarts, it will be well to consider a few of the developments in minor fields. England has two legal systems existing side by side; on the one hand the statutory law of recent origin and of limited application, and on the other the older common law framework. The Common law soon began to break down under the strain; a system which was based exclusively on penalties such as imprisonment and other personal punishments or else monetary damages for wrongs could not cope with the intricate problems of an industrial century. The practice of referring complicated disputes to the Lord Chancellor, who decided them on their merits, and cases of specific performance and title to real property and inheritance, obviously of the utmost concern to corporate bodies, grew widespread until finally the courts

of the Lord Chancellor, better known as the Court of Chancery, became hopelessly choked and were replaced by the Court of Equity.

In 1571 an act was passed providing for winding up the affairs of a bankrupt person. An act regulating usury was passed in 1545, repealed in 1552 but re-established in 1571, thus legalizing interest provided it was "fair". In 1574 the practice of individuals insuring others against loss at sea, known as "bottomry", was sanctioned by a patent granted to a certain Chandler to register insurance. Fire insurance was introduced in 1670 after the Great Fire of London, and Life Insurance, an off-shoot of the Tontine, in 1674.

The foundations of the modern English banking system were laid in 1694, when Montague established the Bank of England. This marks the definite introduction of a recognized banking function, and is intimately connected with the foundation of the Royal Exchange and the consolidation of the National Debt, later known as Consols. Under the early Stuarts much difficulty

was experienced in raising revenues for carrying on the government, and the haphazard methods of extortion then practised bore fruit in the Civil war. To stabilize the manner of securing funds it was decided to borrow monies permanently upon payment of a fixed interest rate, thus funding the then public debt.

The Royal Exchange, the beginning of the Stock Exchange, was first formed to deal in Consols, so that subjects who had lent monies to the Crown might exchange their claim for interest for a capital sum which some other person was desirous of investing in government securities. This was a great advance; the mediaeval conception of debt as something uniformly undesirable was replaced by the idea of credit as we know it today.

Out of this new power grew the permanent policy of the Bank of England. Merchants who owed money to others in distant parts were hitherto under the necessity of remitting in cash or by the purchase of bills of exchange drawn on those parts. The Bank offered to

transact these affairs and to discount these obligations at their present value, trusting to the probable existence of the opposite kind of indebtedness to cancel the obligation. It was only necessary to remit specie to cover an adverse balance of trade. This function, of course, depended upon the ability of the merchants to pay the rate charged by the Bank for the use of its funds, and it is easy to see that the Bank could check borrowings and thus regulate the volume of trade by raising or lowering the rates for interest or discount. Thus, when through a great activity in trade, the funds of the Bank were lowered through borrowings, the rate would be raised, and vice versa. The Bank was also allowed to replace the sole use of gold and silver as currency by issuing notes against its wealth, subject to the maintenance of a certain proportion of specie in the vaults of the bank as a reserve.

This introduction of paper money was not effected without opposition, and its success was only ensured by a careful scrutiny and an insistence upon the paper currency being redeemable at all times. During the

Napoleonic wars it was found necessary on several occasions to practice inflation, and at one time gold payments were suspended, but it was found necessary to re-introduce them as the effect upon commerce was disastrous. This is of interest when it is considered that the issue of irredeemable treasury notes formed a not inconsiderable portion of the method of finance employed during the Great War of 1914-1918.

The effect of the commercial system upon the supply of labour was recognized under Elizabeth by provision of measures for the relief of the poor, acts which continued with minor changes until the close of the industrial revolution when they came in conflict with the laissez-faire doctrines of the time and emerged after many years of experiment in widely altered forms. This marks the transfer of the responsibility for the continued existence of the labourer from the feudal lord to the state, and compares interestingly with the present tendency to make such provision a first charge against the masters and labourers directly concerned.

The last feature of interest is the curious custom

of "privateering", practised from the days of the Tudors down to the close of the Napoleonic wars. During this era the nations of civilized Europe were continually at war amongst themselves or with their semi-barbarian neighbours. Hence the interception of enemy commerce was of strategic and economic importance. Elizabeth recognized this by encouraging the formation of trading ventures whose methods closely resembled those of their viking ancestors. These adventurers combined the functions of pirates and merchants, trading to profit with the merchants of eastern civilization or with the ignorant savages of America and Africa, and, when the occasion offered, capturing and selling into slavery those same savages or robbing the convoys of other European nations as opportunity arose. We have noted the activities of Englishmen against the Spaniards; the dandies of Elizabeth's court did not disdain to purchase a gold mine for a chaplet of beads or a hunting knife, to loot the great galleons bearing silver and spices to Madrid, or even to hawk the bodies of wretched negroes in the open market.

Daring seamen were knighted and ennobled for the like exploits. It is noteworthy that the Tudor character leaned to commerce and many of the nobles were of no long-reckoned feudal descent, but were the favourites of Henry who had dealt out fat abbey lands in no niggard fashion.

An empire was rising in the East under the aegis of the East India Company, and during the long struggle with France the exploits of licensed pirates against her sea borne commerce terminated only with the despatch of Bonaparte to St. Helena.

But to resume: the growth of the modern corporation is bound up with the changes in the industrial system which have been designated as the industrial revolution. The older industries were largely groups of craftsmen who supplied merchants with goods. Factories were small and in many cases consisted of journeymen working under their own roofs. In no case was their organization arranged to include the direction of large bodies of labour to the production of commodities, except in the case of mines. The absence of readily available stores of energy



other than human effort precluded the effective employment of machines. The primary cause of the industrial revolution was the discovery of the use of steam as a prime mover. As might have been expected, this development took place in the mining industry by the application of steam to pumping water from the mines, which under large scale operation were transformed from mere scratchings of the soil to extensive underground systems. The development of the steam engine led to the invention of machines which greatly reduced the amount of manual labour required to produce a given commodity. This tended to cause centralization of effort, and the plant of the small handicraftsman was displaced slowly but surely by the large factory or mill employing many workers.

The transition was not effected without bitter struggles; the worker, divorced from the ownership of the tools of production, became dependent on the goodwill of the employer and felt his position precarious. Scenes of violence ensued, and too often the greed of the employer resulted in the singular anomaly that while the average ability to produce was multiplied many-

fold, the share of the workman in the product of his labour became disproportionately small. The laissez-faire school of economists, strengthened by the failure of regulated trade to compete with the unfettered joint-stock limited liability company, and imbued with a superstitious reverence for the current principles of political economy, washed their hands of the plight of the labourer like so many modern Pilates. It was considered almost impious to doubt the sanctity of an economic principle, but the writers of the time failed to discern that not all the phenomena of the mercantile system were the result of immutable natural laws, but rather the products of the system per se.

Hence, while agriculture, still adequate to supply the wants of England, was regulated in truly mediaeval style, industry was allowed free scope to develop. Naturally the advantages of the incorporated company, with its limited liability and diffused responsibility for any unpleasant consequences of its actions, were apparent to the capitalists of the time,

who could thus by appeal to a majority vote reconcile their aspirations to be truly "economic men" with their religious scruples and philanthropic inclinations. There grew up a monstrous doctrine of "divine right", not of trumpery sovereignty but of actual prerogative to profit not only by their own good fortune, but by the misfortunes of their less favourably placed fellows.

This led to very definite abuses, wretched conditions of work, long hours of labour and the almost unrestrained employment of infants, as well as to the use of the Companies Acts as a cloak for the defrauding of creditors and shareholders. Remedies suggested themselves as the faults of the system were given consideration and were worked out in a long list of parliamentary enactments.

It also soon proved apparent that the cumbrous system of special incorporations was an impediment to unrestricted growth, and in several companies acts, notably, those of 1855 and 1862, the method of incorporation by registration was established, with definite procedures, rights, and disabilities for limited liability companies.

It is not intended to follow the growth of British corporations in the United Kingdom beyond this stage, as the development of corporations in Canada was already possible under the same acts. It is further undesirable to dwell on British Precedent, since in 1867<sup>7</sup> Confederation was to transfer to the Canadian Parliament the right to grant charters and to regulate the internal affairs of Canadian Corporations.

The subject of Canadian Corporations and their legal status has been reserved for a special chapter, but it is not intended to trace the history of the Companies Acts in Canada at all closely, nor to delve deeply into the finer legal restrictions and privileges. These will be dealt with when, in the author's opinion, they affect the course of a particular industry, but for the rest it will be sufficient to give some account of the status of the Canadian Corporation at the present day, so that subsequent references may be clearly understood. It is only considered desirable to furnish an abridged summary of the Companies Acts, to which the reader is referred for the exact extent and terminology of special clauses.

## Chapter IV.

### THE LEGAL ASPECT OF THE CANADIAN CORPORATION.

Before proceeding to a detailed study of Canadian corporations and their finance, it will be well to glance briefly at the legal principles underlying these bodies. For this purpose we shall only consider the commercial companies, for we are but little concerned with other incorporations, save for a few special cases which can be dealt with as they arise. It is not intended to furnish a digest of corporation law; it is not even desirable to do more than touch lightly upon some of the ruling features of corporate legislation in Canada which affects the financing of corporations.

As the organizations dealt with in this treatise are operating under so called Dominion charter, it will be superfluous to treat of provincial companies at any length, since, broadly speaking, these bodies

are subject to similar limitations and differ principally from companies organized under Dominion charters in that the former are limited in their scope to the powers which a province is entitled to grant.

For instance, a local sawmill could be organized readily under a provincial charter, while a company having its organization and plant distributed over an area embracing several provinces would naturally seek the wider powers conferred by a Dominion charter. For details of provincial regulations the reader is referred to the statutes enacted by the respective provinces concerned.

According to Canadian practice every company is a joint stock company except certain private companies incorporated without joint stock or shares. These need not be discussed here. The joint stock company is constituted in one of three ways -

1. By Royal Charter.
2. By Special Act of Parliament.
3. By Letters Patent under the  
Dominion Companies Acts.

There also exists in some of the provinces and in Newfoundland a system whereby companies are formed by re-

gistration instead of by letters patent, but these again, as the exceptional cases, need not be considered here.

The right of the Crown to incorporate forms part of its prerogative under the Common Law. The class of company so incorporated is now comparatively rare. The so called Hudson's Bay Company is one of the best known examples.

Certain companies such as those desiring to conduct a bank or a great public utility are required to be incorporated by special act. Banks, insurance companies and railway companies are further subject to the provisions of special statutes. Any other class of company may be, but most frequently is not, incorporated by special act. Practically all commercial companies are now incorporated by Letters Patent, the majority under the Dominion Companies Act. This method is preferred by reason of the fact that an incorporation can be attained with a minimum of delay, and because subsequent changes in the name, powers or capital stock of the company are more easily effected.

The powers conferrable, under these systems of Dominion incorporation are very generous; the Companies Act defines them as "any of the powers or objects to which the Legislative authority of the Parliament of Canada extends", that is to say, within the limits of the powers delegated to the Dominion Government by the Parliament at Westminster, and limited internally by the respective position and powers of their individual provinces within the Dominion as declared by the British North America Act.

There are few cases where the first named limit imposes any considerable restriction on business; the carrying on of business in other parts of the Empire may be restricted by special legislation in the localities affected, or business in a foreign state may be governed by the provisions of a trade agreement between that state and the central parliament at Westminster. Generally speaking, the self-governing Dominions are jealous of legislation interfering with their domestic affairs, and the settled Imperial policy has been to keep such interference down to the irreducible minimum.



The lower, that is, the internal limits, on the other hand, are the cause of frequent litigation as to the jurisdiction of the provinces, which adhere to their privileges as valiantly as any gentleman from the Southern United States adheres to the doctrine of "States Rights". The broad principle is that a province is ipso facto competent to deal with affairs relating solely to itself, and that interference by the Dominion Government in such "*res augustae domi*" is unwarrantable. However, when the relations of one province to another province, to the Dominion as a whole, or, sometimes, to other parts of the Empire or to separate states, are involved, it is necessary for the Dominion Government to determine the status of the parties to the dispute.

Thus, in the case of interprovincial traffic on a Railway, the rates and other matters pertaining to the operation on that Railway are subject to the control of the Railway Commission, while a local street railway would be dealt with by the provincial authorities.

To convey a clear impression of incorporation it will be well to trace the steps involved in the formation of a company. Let us take the most common form of incorporation by letters patent under the provisions of the Dominion Companies Act.

The first step consists in forwarding to the Secretary of State at Ottawa an application and petition for letters patent. This should conform in all its essential features to the statutory form provided for in the Act. The applicants must be not less than five in number and must all be of full legal age. These applicants must set forth their full names, addresses, occupations and the number of shares subscribed for by each, and at least three of them must be named as the provisional directors of the company. The application also sets forth the purposes for which it is desired to incorporate, and in some cases, certain by-laws which it is desired to include in the charter.

If the petition is approved and if everything is in order, notice will be given in the Canada Gazette of the issue of Letters Patent incorporating the company,

and the parties named and their successors become a body corporate and politic by the name therein mentioned. Subject then to the statutory requirements with respect to the amount of capital which must be subscribed for and paid up, the company is ready to commence business.

On receipt of such authority the provisional directors should call a general meeting of all the shareholders for the proper organization of the company. Usually the first meeting of the provisional directors will be their last. At the first meeting of the shareholders the procedure will consist in the approval and adoption of the letters patent as the charter of the company, the re-election of directors and the adoption of by-laws for the regulation of the company. Following the meeting of shareholders the new directors will meet and elect the officers for the ensuing year.

The Dominion Companies Act provides that a copy of every prospectus issued by or on behalf of a company, at the time of its incorporation shall be signed by every person named therein as a director, and filed with the

Secretary of State on or before the date of its publication. A company which does not issue a prospectus with reference to its formation is obliged, before proceeding to the allotment of any of its stock or other securities to fyle a statement in lieu of a prospectus. In practice, the prospectus or statement is fyled with the application for letters patent, Private companies, as defined in the Act, are not required to comply with this regulation, which is particularly aimed at preventing illegal or fraudulent offering of stock to the public.

All companies are required to keep records of the ownership and transfer ( and liability to call in the case of not fully paid up stock) of their shares. They must also furnish a report of the ownership of shares at stated intervals to the government, and, in some cases, this must be accompanied by a statement of the company's affairs. To ensure good accounting, auditors must be appointed annually, and a certain percentage of the shareholders or the Government at discretion may demand a further inspection of the books. General meetings of the shareholders must be held annually, and a

statement of the affairs of the company presented.

The shareholders cannot act for the company. They elect directors, as required by law, who have power for and on behalf of the company within the limits fixed by statute or by-law. The directors cannot alter any by-law without the approval of the shareholders and, in the case of certain special by-laws, such as those increasing or reducing the amount of capital stock, or by-laws which have been included in the company's charter, ratification by a two-thirds majority is necessary. A by-law passed by the directors alone has force only until the next general meeting.

The liability of shareholders is limited, except in certain cases, such as loan companies, to any unpaid balance on their shares. In the case of banks, shareholders are further liable for an amount equal to the paid up value of their shares in addition to any unpaid amounts due on their subscriptions.

As regards the liability of directors, the general principle is that the directors are not personally liable for any acts of or on behalf of the company.

There are certain exceptions to this rule, however, If, for instance, the directors declare and pay dividends when the company is insolvent, or pay a dividend that makes the company insolvent or impairs its capital, they become personally liable for all the debts of the company. They are also responsible for losses incurred through transfer of stock subject to call or not fully paid up to an insolvent, for loans to shareholders (illegal in most forms of company) and for commencing business before the legally required amount of capital has been paid up. They are also held liable for all the salaries and wages of employees for six months prior to insolvency. Directors are, of course, liable for willful acts of a criminal or fraudulent character, and a number of such offences are determined in the acts for specific sanctions.

Dealing with the incorporation of railways, these bodies to a large extent receive their revenues in return for the performance of public services. It is not altogether desirable that these services be subject merely to the laws of supply and demand, nor that they take place under free competition in all cases. Incorporation

of interprovincial railways is, therefore, controlled and it is the custom to regulate rates and expropriations (under the common law doctrine of eminent domain) and even to regulate methods of operation and construction. This is effected by means of an impartial body, having the necessary jurisdiction and termed the Railway Commission. This body is analagous to the Interstate Commerce Commission of the United States, and has wide summary powers. It is to be noted that Railway<sup>A</sup> with provincial charter do not come under the Dominion Railway Act, and that local railways and tramways lines are specifically excepted.

Railways and telephones, telegraph and express companies must render returns of capital, traffic expenditures at stated periods to the Minister of Railways, and must produce complete details of their business when requested by the Minister.

The next class of regulated companies is governed by the Bank Act. This act is different from the other acts in the provisions that call for very detailed

statements at monthly periods, and which greatly restrict the manner in which the business of banks is carried on.

Application for the incorporation of a bank may be made in much the same way as described above for a joint stock company but the number of provisional directors must be not less than five, nor can the amount of capital stock, actually subscribed, be less than \$500,000.00, nor the shares of a par value other than \$100.00. When \$250,000.00 shall have been paid up, the Minister of Finance upon the recommendation of the Parliamentary Committee on Banking, may issue a certificate which will allow operations to commence. As we have seen, before the commencement of trading, \$250,000.00 must be in the treasury in cash, and before notes may be issued, \$5,000.00 must be deposited with the Minister of Finance as a circulation fund, and maintained at 5% of the notes outstanding. Dividends in excess of 8% cannot be declared until a rest account equal to 30% of the capital stock subscribed and paid up, after all bad debts and losses have been allowed for, shall have been set up.



The outstanding particular of a bank's financial organization is that the shares have the double liability already described. Finally, the directors of a bank must possess certain qualifications in the amount of their holdings, and no person may describe himself as a banker or private banker without committing an offence against the Bank Act.

Loan companies are authorized under special rules, and these institutions may in part fulfil the functions of a bank. There is no limitation of the liability of shareholders. These companies, unlike any other company, may make loans to shareholders.

The ordinary company is forbidden to traffic in its own shares or to pledge them as security for loans as a precaution against fraudulent activities. It should be pointed out, however, that the objects of such actions may frequently be attained by the organization under the act of subsidiary, holding and loan companies, under the same control. Also, it is comparatively a simple matter at the time of original incorporation to secure very extensive powers, <sup>and</sup> provided

that such powers do not appear to be designed to be mere blanket legislation in restraint of trade, or of a character apparently fraudulent or injurious to the Dominion, the practice is to grant these powers as asked for.

Of recent years a tendency is recognized to incorporate with shares of no nominal par value, shares having no capital value but representing a certain fraction of the total assets of the concern. This is permissible under recent amendments to the Companies Act.

The final class of organization with which this chapter will conclude is of recent origin. They comprise the Quasi-Corporations administered by the Governor General in Council or by the Lieutenant Governor of a Province in Council, and are generally termed commissions. They relieve parliamentary committees of much routine work and are distinctly more effective since their membership is more permanent and usually drawn rather from expert than political fields. Some of these bodies are non-gainful, such as the Railway

Commission, whose functions are purely regulatory. A new class is springing into existence to deal with publicly owned enterprises, prominent examples being the Ontario Hydro Electric and the Quebec Liquor Commissions. These bodies resemble other companies of the class usually furnishing analagous services, in so far as their powers of operation and borrowing are concerned, and are administered by a chairman and a board of directors in much the same way as a limited liability company is. Their origin is by special enactment under which their powers are defined, the one exception being that there is no capital stock, the board being responsible, not to shareholders, but to the Governor in Council or the Lieutenant Governor as the case may be. All ownership is vested in the public, capital being obtained by public borrowings secured by bonds, and all losses or gains accruing to the public purse. Such corporations usually operate under exceptional conditions as regards exemption from taxation and monopoly, and hence furnish serious competition in the field of industry.

An interesting case is that of the Canadian National Railways. This system comprises many distinct

parts. First, a publicly owned railway, the Canadian Government Railways, under special act and formally administered directly by the Minister of Railways, under agreements dating back to Confederation. Secondly, a series of lines which had been heavily subsidized by the Dominion Government and finally taken over as insolvent instead of letting them go into the hands of a receiver as would be customary. These are consolidated into one large company with the Crown as the sole shareholder. This is a case of a publicly owned private corporation. The system is administered by an appointed board of directors and, as nearly as possible from the legal point of view and other standpoints, as if it were a private enterprise.

This brings to a close our study of the legal status of the corporation and the Quasi-Corporation as they exist in Canada today. No apology is offered for the sketchy nature of this chapter, since the intricacies of corporation law, if treated in detail, would fill many volumes. In summary: Corporations derive their powers chiefly under letters patent of the Dominion Government. The personal liability of shareholders is fixed by statute,

except as previously outlined in the case of loan companies, and the company can act only through its duly elected directors. Shares of corporations may be disposed of as personal property and the corporation is possessed of legal immortality, except in the cases of forfeiture of charter at the instance of Government intervention or by liquidation of a voluntary character, or involuntarily, under winding up proceedings under the Bankruptcy Act.

## Chapter V.

### THE FORM AND FUNCTIONS OF CORPORATE FINANCE IN CANADA.

This chapter will be devoted to the forms which Canadian corporations assume in practice, the conditions which determine or tend to determine these characteristics, and the categories into which these bodies fall as a result of the foregoing conditions. This chapter will serve to introduce a discussion of the methods by which the financing of these projects is effected, including the fundamental principles governing the market for capital, to follow in the next chapter. The eighth chapter will deal with the supply of this capital and, finally, we shall examine some typical or unique examples of the more important categories of corporation in order to demonstrate the principles laid down.

As the study of corporation finance involves a

familiarity with large quantities of statistics and facts, it has been deemed advisable to curtail as far as possible all discussion which could better be illustrated by tabulations or graphics. The latter will be used extensively as it is a relatively simple matter to prepare charts which show long periods of operation at a glance, and it is a matter of common knowledge that the eye grasps a physical image such as the slope of a line or the form of an area far more readily than the mind can correlate even well arranged tabulations. Frequent reference will, therefore, be made, especially in later stages, to the charts and tables which contain much summarized information.

In proceeding to the study of corporate finance in Canada, it will be necessary to consider the system of supply and exchange of commodities and services in that country together with the factors which affect them. A summary of the main points dealt with will be found in Appendix "A".

The most obvious factors affecting trade in Canada are geographical. Canada consists of a rather narrow

and thinly settled ribbon of land, bounded by practically uninhabitable northern wastes and uniting ports in the Atlantic and the Pacific by a triple railway system supplemented by great waterways. Certain internal physical divisions are of great importance. The western coast is separated from the rest of Canada by the Rocky Mountains, which greatly increase transportation difficulties. The prairie provinces lie on a succession of tablelands at a considerable elevation above sea-level, which causes their climate to be very severe, thus imposing limitations on their activities which are at the present largely agricultural. These provinces are separated from eastern Canada and their natural market by the barren lands which lie to the north of Lake Superior.

The waterways of Canada are numerous and large, consisting of the rivers which drain into Hudson's Bay and the Great Lakes, which form, with the St. Lawrence waterway and canals, an easy avenue to the sea for western grains. The eastern provinces are plentifully supplied with rivers steep in gradient and having a high spring run-off, rendering them eminently suitable



for hydro electric power developments.

The provinces of Ontario and Quebec benefit particularly from these natural advantages and, due also to the fact that they are most favourably situated and are the oldest in point of European settlement of the natural divisions, these two provinces are the most advanced industrially of any in Canada.

The Maritime provinces are located in a neck of land formed by the northeasterly flow of the St. Lawrence to the sea and the international boundary with the State of Maine. These provinces are thus cut off to a great extent from the rest of Canada, and the isolation is only partially reduced by preferential rates over the old Intercolonial Railway system, a strategico-political line now forming part of the Canadian National Railways. These provinces, while largely self-sufficing to the extent of food products, and most of the basic minerals natural to Canada, are largely dependent upon the rest of the Dominion for manufactured products. The natural flow of the commerce

of these provinces would be east and west, in dealing with the United States, but the economic advantage of such a course is prevented by the international tariff barriers.

Canada has abundant mineral deposits, coal and iron being plentiful in Nova Scotia and lignite in the foothills of the Rockies. Northern Ontario is rich in silver and auriferous ores, and nine-tenths of the world's nickel is located in the same area. Valuable deposits of lead, zinc, gold and silver are being mined in British Columbia, and some of the world's greatest asbestos deposits are in the province of Quebec. Much of the desolate northern wilderness is rich in minerals, and it may safely be said that the surface of Canadian ore deposits has barely been scratched. Even oil has been found, although not in very convenient situation or in very paying quantities.

Perhaps the greatest wealth of Canada is to be found in the forests. British Columbia furnishes redwoods and fir, while Quebec, Ontario and New Brunswick have enormous forests suitable for both lumber and pulp

on the slopes of the St. Lawrence watersheds.

The stable industry of the Maritime Provinces is fishing, providing the excellent seafish of the celebrated banks. British Columbia supplies large quantities of salmon, which are packed on an important commercial scale for export. The interior lakes yield their supplies of fresh water fish for the consumption of the central provinces.

Farming is practised extensively throughout Canada, usually together with the raising of livestock. The general tendencies are broadly speaking as follows. The prairie provinces produce grain on a large scale: Quebec and Ontario go in for mixed farming, while the latter shares with British Columbia the fruit growing business of Canada. Farm lands are readily available to prospective settlers, either by purchase from private owners of which the railways are the largest, or by direct grant from the Government.<sup>#</sup>

The climate of Canada is in general severe, the summer being short and fierce, the winter long and extremely cold with heavy precipitation and both spring

# The following table compiled by the Dominion Bureau of Statistics, an estimate of the national income of the country, shows almost an even balance between manufacturing and agriculture as the two primary income sources. The other figures are also of interest.

(see next page)

and autumn of short duration and low temperature. The precipitation over Canada is high, and when storage is provided power is plentiful and irrigation easy. The weather varies from a condition nearly approaching the sub-tropical in parts of British Columbia to the severest of Arctic winter conditions in the West and North. The effect of the short summer is to restrict farming and commercial operations considerably in comparison with some of the neighbouring of the United States. The intense winter cold necessitates buildings being designed to resist cold and occasions the consumption of much coal (especially of the hard varieties) for domestic and other heating. Special care must also be taken of snow loads on roofs, which results in an increased cost of construction, while transportation, both local and national, demands special construction to cope with weather conditions and large sums for clearing snow and maintenance of equipment. The waterways are only available during six to seven months in the year, being either blocked by ice or dangerous to navigation (even if kept open) during

	Estimate (000 Omitted)	Percent of Total
Trade, Transportation and Professional Services	\$1,800,000	30.8
Manufacturing	1,558,544	26.7
Agriculture	1,519,843	26.1
Forestry	408,832	7.0

the winter months. Of the two great outlets, only the St. Lawrence route is feasible, as the Hudson's Bay route is only open for a few months and the exit is imperilled by the summer southernly drift of ice. During the winter, therefore, only Vancouver is unaffected, Montreal and Quebec cease to be ports and goods must proceed by rail to Halifax or St. John or through American ports.

The most striking feature which remains is the international boundary between Canada and the United States of America. This imaginary line of demarkation is about three thousand miles in length, and is singular in that it is not fortified, a striking instance of international goodwill.

Canada is divided politically into provinces, each having minor legislative rights secured under the confederation agreement of 1867. These provinces have control of their local revenues and of all matters, except the levying of excise, which affects the province and not the Dominion as a whole. All have a common legal system except Quebec which has code law, and the

Mining	\$ 213,041	3.7
Building	135,874	2.3
Electric Power	65,705	1.1
Custom & Repair	63,963	1.1
Fisheries	49,241	0.8
Trapping	20,999	0.4
	<hr/>	<hr/>
	\$5,836,042	100.0

system allows of ready adaptibility for commercial<sup>^</sup> throughout the Dominion as a whole.

The population of Canada is mixed, and in some sections original national language and customs are maintained. Add to this the disadvantages of natural barriers already mentioned, and diverse nature of the products of the Dominion, and it is easy to find explanation for such diversity of interests as exists.

The linking together of the discordant elements imposes a great strain on the means of communication; in order to encourage national commerce in an east and west direction and to nullify to some extent the effect of natural obstacles, discriminative freight rates are common, and a protective tariff has been consistently applied to shield the manufacturing element from competition from more favourably situated industries south of the international border. Racial and national sympathies and religious prejudices are safeguarded by a mass of special legislation of considerable complexity.

Having explained the conditions under which trade

takes place, it will be well to glance briefly at the method of supply and exchange of commodities in the Dominion.

There are three main categories into which all commercial activities fall: manufacturers of saleable commodities (including agriculture), purveyors of services to manufacturers and the community and dealers in exchange services. An interesting parallel may be traced between this system and the human frame. The manufacturer of commodities resembles the digestive system, which converts food into brawn and bone and vital energy. The purveyor of services represents the muscular and nervous systems, which enable the body to carry on its functions as a whole, while the blood circulation and vascular system nourishes all parts of the body and removes waste products, and is represented in our analogy by the mechanism of credit, whereby the exchange of commodities is effected. All these are essential to the continued existence of the organism as a whole and of one another individually, the prosperity or adversity of one reacting favourably or the reverse upon the other two.

Taking production to include distribution, as is actually done in most modern businesses, the manufacture of saleable commodities may be divided into four classes, although any given manufacturer may fulfil more than one of these roles at once. The first division we shall call the exploitation company, which converts the products of natural resources into a more valuable form. This class includes mines, fisheries, agricultural and water power developments and the like. The second is the manufacturer of intermediate products intended for further manufacture before ultimate consumption takes place. This is a wide group, and is often a functional division rather than a definite physical grouping. For example, a steel works which buys ore or pig iron and turns out wire nails or steel shapes falls into this category. Another excellent example is the concern manufacturing coal-tar bases for dye purposes, which also produces the so-called "heavy chemicals", such as soda, sulphuric acid or muriatic acid. The manufacturer of final products is so familiar that no further definition is needed. The manufacture of telephone equipment, of clothing, or



the infinite variety of food products is a good instance. Last comes the system of distribution, which includes the wholesaler and the retail merchant who guide the commodity into the hands of the ultimate consumer.#

Public services are those functions performed in a disinterested manner for the benefit of the community at large and which are, therefore, an essential factor in daily life. These services are performed either by government direct, through departments such as that of public works, trade and commerce and the like, or by lesser legislative bodies. A municipally owned tramways falls into this class, as does likewise a provincial telephone system. Or the service may be performed by a quasi-corporation designated by the government body concerned, such as the railway commission, the Ontario Hydro Electric Commission or the Quebec Liquor Commission. Again, the service may be performed by a joint-stock corporation in which the government is the sole or majority shareholder and dictates the policy of the enterprise, such as the Canadian National Railways. The place of such bodies in the scheme

# It is interesting to note here the figures of the Dominion Bureau of Statistics of the national income from manufacturing. They are given in the following table:

	Estimate	Percent of Total
Iron & Steel	\$265,473,097	23.43

is slightly anomalous; if carried on at or below cost the enterprise is a public service properly so called, and the deficits are met, or the possible profits foregone, by the taxpayer. When the project is frankly a source of revenue, such as the Quebec Liquor Commission, it becomes a public utility in so far as it affects the public as a whole, although this particular body is really in the importing and distributing division, according to our scheme of division. A municipal tramways, if a source of municipal revenue, would be a first class instance of a true public utility.

Public utilities as distinct from public services under our classification are enterprises which carry on the purveyal of services which are of importance to the community as a whole over any set area, on a frankly gainful basis, the essential character of such organizations lying in the nature of their wares, which are in general incapable of storage and resale as such, but are consumed in the act of supplying them. Thus, a coal mine is not a public utility,

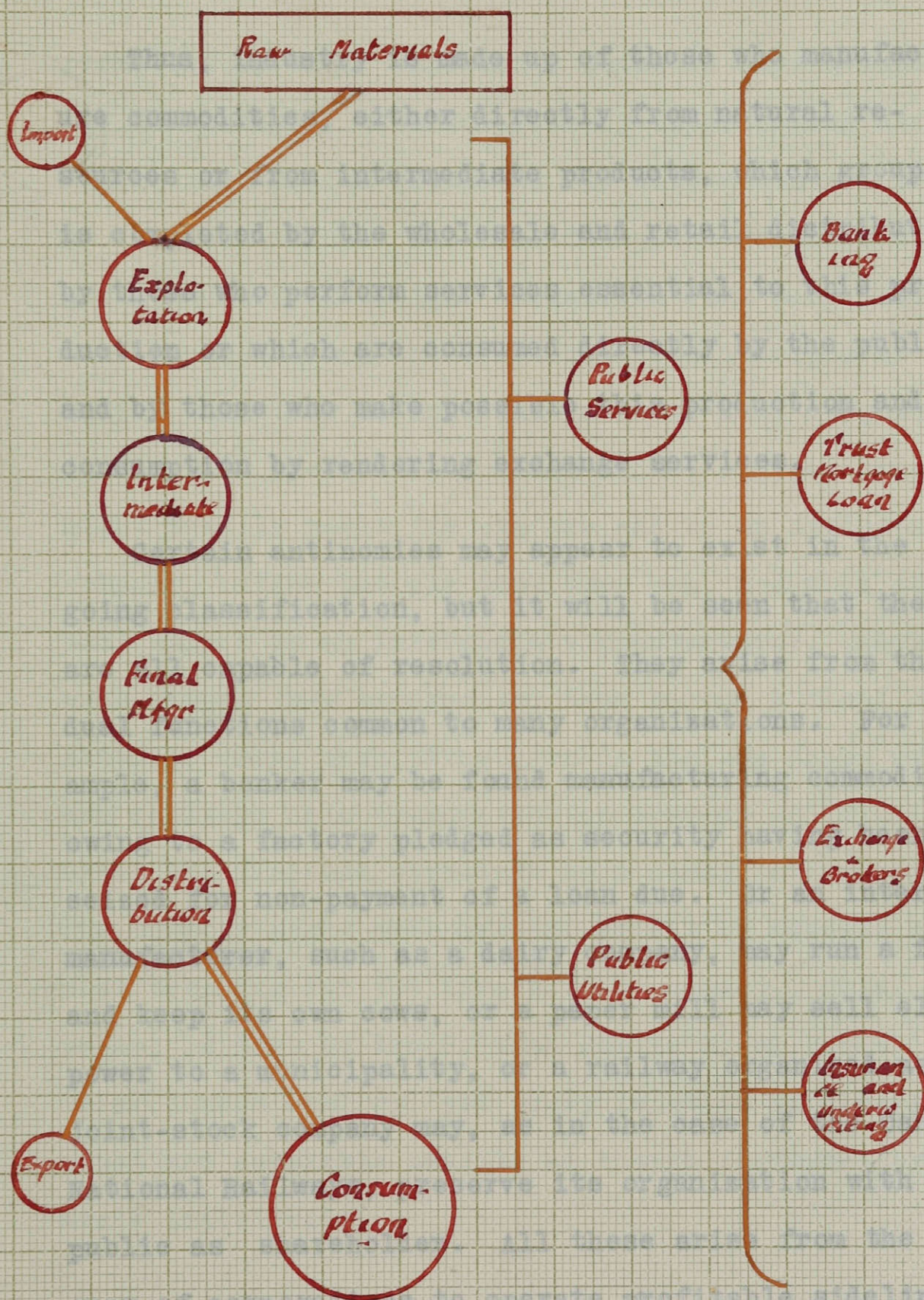
Wood & Paper	\$299,582,226	19.26
Vegetable Products	235,709,433	15.15
Textiles	192,984,741	12.39
Animal Products	152,995,130	9.82
Non-metallic Minerals	91,371,578	5.84
Non-ferrous Metals	88,447,178	5.64
Chemicals	65,183,212	4.17

but a tramway company or a power plant is one variety of it, since power cannot be purchased without consumption, neither is it possible to purchase transportation without consuming it to complete the transaction. Again, accommodation, either by renting a house or staying at a hotel, can only be completed by consumption, and, in the same way, a theatrical performance is consumed on the spot and automatically by the spectators. Broadly speaking, then, public utilities comprise services of communication, transportation, supply of energy, accommodation and amusement, and bureaus of statistics and information. Without straining the point we might also admit publicity organizations, such as newspapers and advertising bureaus, as another example.

The dealers in exchange services are capable of more exact definition. They comprise bankers, who deal in monies and credit, trust, mortgage and loan companies, various kinds of exchanges and brokers and underwriters. Real estate dealers in so far as they act as agents may also be included.

Miscellaneous	<u>\$ 66,787,599</u>	<u>4.30</u>
	\$1,558,544,194	100.00





THE ORGANIZATION  
OF INDUSTRY.



permitted by their charters. There is also a tendency for the grouping of industries by interlocking directorates into allied groups or the self-contained industry or vertical trust. The Bell Telephone-Northern Electric group and the Shawinigan industries form such instances, but by considering the functional subdivisions of such bodies when they do not fall into the same corporate strata will prevent confusion. Thus, a steel company might readily smelt its own ore and be an exploitation company, refine the pig iron thus won, and roll structural shapes as an intermediate manufacturer, fabricate such shapes into bridges and thus become a final manufacturer, carry such structures in its own ships or on its own railways as a transportation company and finally erect the finished structure as a construction company. The company might even arrange credit on secured notes, thus becoming for the time a loan company. This, in a sense, is true of the British Empire Steel group, and is no forced analogy, yet every function is clearly defined and separable exactly as though performed by separate individuals.

In treating of industry in detail, it will be recalled that Canada present certain very definite and immutable characteristics, some of which tend to restrict and others to promote development on different lines.<sup>#</sup> Certain industries will be recognized to possess singular natural advantages, such as the pulp and paper and the nickel industries in respect of foreign develop-

# It is estimated by the Forestry Branch of the Department of the Interior that approximately one-quarter (600,000,000 acres) of the total area of the Dominion is covered by forest growth. Of this, about 150,000,000 acres bears timber of merchantable size. The total pulp wood resources are estimated to be about 1,300,000,000 cords.

Capital invested in pulp and paper mills in 1922 exceeded \$381,000,000: over 25,000 people were employed and the value of the output was \$85,000,000 for pulp and \$106,000,000 for paper.

Quebec is the largest producer of pulp wood of the provinces. Ontario comes next, then New Brunswick and British Columbia.

The production of nickel in 1922, as estimated by the Mines Branch of the Department of Mines, was 17,496,490 pounds, having a value of \$6,123,771. This production greatly exceeds the production of any other country.

ments on similar lines. Others are on approximately the same footing, always with due regard to the fact that Canada as a whole is less favourably situated climatically and geographically than the United States or even other countries. The causes of this handicap have been clearly set forth above, and operate to produce higher operating and commercial costs which are reflected in the cost of living in Canada in so far as this is not due to inequalities of exchange, inflations, borrowings and protective tariffs and represent the net natural disadvantage under which Canadian industry must operate under the most favourable conditions possible.

Certain other industries labour under natural disadvantages in that the climatic or geographical conditions or other causes operate singularly to the disadvantages of this class. Many of these activities are deemed essential to the safety or wellbeing of Canada as a nation and an integral part of the British Empire capable of self-support. On this account, as has been mentioned, protective tariffs exist in Canada to permit the continued existence of such industries. In some

cases the tariffs exist or were originally created to enable the industry to become at some future date self-supporting. In other cases, the tariff is designed to secure the possession of so called industries which, taken with other groups, yield a profit on the whole or form part of the national defences in case of war. This class can never hope to be self-supporting and represents a permanent charge against the community by which the taxpayer as a whole shoulders part of the burden of a limited section of the community.

It would be interesting to discover the extent to which Canadian industry as a whole is depending upon protective tariffs. The study involves too many details and too great an examination of facts and history to be taken up in this treatise. W.J.A. Donald made a notable contribution to this part of our subject in the examination of the Canadian iron and steel industry. Further contributions of this character are much required.

Industrial executives, financiers and investors are



directly concerned with a knowledge of actual benefits. Investments protected by theories, tariffs and a faith in political policies are not accustomed to stand the trials of industrial depressions. More than one promising Canadian security has failed to continue its healthy condition when subjected to the actual trials of industry and the unhealthy atmosphere of protective tariffs.

## Chapter VI.

### THE FINANCING OF CORPORATIONS.

We have studied in the historical chapters the rise of modern business from a state of barter in primitive communities to its present complex system. We have seen that at each stage in the advance the inspirational force has been supplied by ideas that have in each case altered the whole concept of business organization. The ideas of agency, money, credit, foreshadowing as they did the idea of the corporation itself and still holding force along with this last are the most notable. Also, they are not disconnected, for credit would seem to be the natural combination of all three.

It is customary to say that modern business rests on a foundation of credit and when the metaphor is carried further that the soundness of any business

undertaking is measured by its credit.

But credit is a concept which is definable by the use and purpose to which it is put. For our purpose we shall say that it is employed in two senses, and that, firstly, it may be defined as that mechanism whereby the use of economic capital is secured in consideration of future return to the source of that capital. Secondly, the term is a figure of speech signifying the quality of that credit, that is to say, the prospect of return in any given case. Thus, an undertaking which is generally conceived to be sound and well administered, and further has justified this opinion by earning power, is said to have good credit, while a business whose ability to meet its obligations as they arise is admittedly precarious, is said to have poor credit. In this latter case, should an actual failure to meet, not its total obligations, but merely its current liabilities, arise, the concern is said to be insolvent.

To carry on an enterprise on a commercial scale a relatively large amount of capital is necessary.

There is, first of all, the ordinary capital required in the administration of the business from day to day, which is called working capital, and the capital needed for expansion. In the case of large and successful businesses the additional capital required for expansion is sometimes provided for out of the operations of the concern itself, representing expansion out of savings or undivided profits. To meet a large expansion, however, imposes a severe drain on any accumulation of capital in a business, and, indeed, the accumulated surplus is often inadequate for the increasing demands of working capital account.

Thus, it arises that a concern is under the necessity of borrowing capital not, as is popularly supposed, because of financial difficulties, but in order to anticipate favourable opportunities for increased business. Such borrowings take two forms, increase of stock in trade and increases in plant.

In borrowing to provide capital for increases of stock in trade it is customary to employ short term

credit, represented by such instruments as promissory notes and drafts. The following is an interesting example of the employment of such instruments.

A manufacturer of hardware fills an order for a wholesale merchant and receives in payment for his goods a promissory note to run for 90 days. The merchant through his salesmen distributes the goods to retailers, upon whom he draws at 60 days, thus having 30 days from the receipt of his goods and the date from which his obligations begin to run, in which to dispose of his wares to his customers. In the same way, the retail dealer sells to his customers, allowing them 30 days in which to meet their bills. The retailer thus has 30 days also in which to effect his sales and the final purchaser has 30 days during which he may employ his purchases to work for him. Provided all the parties to these transactions are solvent, it is evident that the retailer can collect from his customers in time to meet the wholesalers draft which he has accepted, and which may have been discounted at the wholesaler's bank. In any event, the payment will

be made to the wholesaler in time to allow him to meet the note he has given to his bank or to the manufacturer. The net result is to increase temporarily the working capital of all the parties to the transaction, except that of the manufacturer, who it is presumed on account of the scale of his operations is in a position to extend credit. Naturally, this man will demand compensation for his virtual loan and this he receives either as interest on the face of the note or in the discounting of that amount and the wholesaler and retailer will so adjust their transactions as to pass this amount on to the ultimate consumer.

While this system is excellent for goods intended for immediate sale and speedy consumption, the capital and monies being paid for its use being restored to the lender within a few months, it is obvious that such a method cannot be applied to the provision of fixtures or plant intended to be consumed gradually over a long period of years, during which the returns from this plant will arrive piecemeal and relatively slowly. In point of fact these returns may come so slowly that

the machines producing them will be partially worn out and greatly decreased in value before they are fully paid for. Accordingly, a collateral lien on this plant, such as banks demand for current loans on merchandise, possesses a constantly diminishing value and the system becomes impracticable.

Under these circumstances more circuitous means of securing capital must be adopted. The general practice is to appeal to individuals or to the public at large, not for the articles themselves, but for sufficient monies to effect their purchase. The use of these monies is solicited by offering either a share in the prospective profits anticipated from the employment of these items of plant, or by offering a stated rate of interest secured by a lien upon some part or the whole of the physical assets of the borrower with adequate provision for the maintenance of these assets and the guarantee of the return of the capital borrowed within a stated period.

This process is termed financing. Limiting our enquiry to corporations, this financing may thus take

two forms. The first consists in the sale of shares in the capital stock of the company, whereby the lender exchanges the right to the return of his capital for the possibility of future profits. These profits he may share with existing stockholders to an equal extent, as in the case of a further issue of common shares, or the lender may be granted a priority of return to a fixed extent over existing shares, further profits, however, going to the original shareholders. Such an issue is called a preferred stock issue.

In case of an interruption in the dividends to preferred shareholders it is often specified that the arrears of such dividends shall accumulate and constitute a prior charge ranking before dividends on the common stock. In this case the issue is termed a cumulative preferred stock.<sup>#</sup>

To render the offer more attractive it may be specified that the preferred shall participate to an equal or less extent after the returns on the common shares shall have reached a stated level, in which

<sup>#</sup> A familiar example of such a stock is Canada Steamship Lines 7% Preferred. The initial dividend on this stock was paid March 1, 1914, but after the second payment on June 1, 1914, it went into arrears. In 1916 5 $\frac{1}{4}$ % was paid and in 1917 19 $\frac{1}{4}$ %, thus clearing up all accumulations to the end of that year. Regular payments were resumed in 1918 but passed again January 1922. The stock is now 15 $\frac{3}{4}$ % in arrears.



case the stock is said to participate as to dividends or as to principal and dividends according to arrangements in case of alteration in capitalization or in winding up.<sup>#</sup>

The second method of financing is to incur an indebtedness fixed as to principal and interest and secured by lien on the whole or part of the physical assets of the company. This is termed funding the indebtedness of the company. At a later date this indebtedness may be paid off out of earnings and is then said to be retired. Alternatively, it may prove possible to obtain money at a reduced rate of interest and the original funded debt may be replaced by fresh obligations bearing a lower rate of interest. Whatever the relative interest rates may be, this process is termed refunding.

The position of the lender under this scheme is vastly different from that of the shareholder, who, as we have seen, has really entered into partnership with the original owners of the company. The lender here takes no further part in the administration of the company. All those lending monies in this fashion are or-

<sup>#</sup> An example of an ordinary non-cumulative but participating preferred stock is found in Asbestos Corporation of Canada Limited 6% preference. This stock participates with the common stock after 5% has been paid on the latter. An initial dividend of 1% was paid February of 1917; total paid in 1917, 4%; 1918, 4 $\frac{3}{4}$ %; 1919, 6%; 1920, 8 $\frac{1}{2}$ %; 1921 and 1922, 7%. In 1923 when the 6% dividend on the common was passed the dividend on the preferred fell back to 6%.

ganized under the creation of a trust deed and are legally termed "cestuis que trustent". Their relation to the borrower is determined by this trust deed which creates a lien against the assets specified therein and appoints trustees to ensure the administration of the clauses of the trust deed which is signed by both the company and the trustees. The clauses vary in different cases but, broadly speaking, all such instruments provide for the operation of the company by the trustees in the interests of the lenders in event of failure to meet interest charges, or the capital obligation; to provide also for sinking fund provisions and the retirement of obligations as they mature, for the redemption of interest bearing coupons, for the transfer and registration of the scrip issued and, finally, for the maintenance of the physical assets covered by the trust deed, and for the creation of a reserve equal to the interest on obligations outstanding for a stated period before dividends may be paid.<sup>#</sup>

The nomenclature of these obligations varies, being usually indicative of the character and seniority

<sup>#</sup> An interesting trust deed is that securing the 8 $\frac{1}{2}$ % General Mortgage Bonds of the Brompton Pulp & Paper Company Limited. These bonds were sold at a time when interest rates were at their highest and when the investment markets were at a low ebb. The underwriters insisted on the provision that the Company could not pay dividends on preferred or common if the working capital of the Company, i.e.,

of the security. Short term obligations are usually termed notes, and those with long terms to maturity bonds. In the case of railways, equipment is usually covered by notes secured by that equipment, termed equipment notes. This form is sometimes also used by other corporations, but to a very limited degree in Canada. Except in the case of railways where they rank as, but junior to, debenture stock, debentures in Canada are bonds in point of law, the name being used to render the securities more familiar to certain non-Canadian markets.

In order that an enterprise may attract the capital it needs it must be sound, that is to say, it must offer a reasonable prospect of adequate returns. There are four essential requisites to the soundness of an enterprise; a sound undertaking, sound financing, sound organization and an adequate market. Every business deals in four markets, but only in one of these may returns be sought. The first market yields materials and supplies; the second, money; the third, labour and in the fourth or selling market the wares of the excess of current assets over current liabilities should fall below \$2,000,000. In 1922 this did happen and preferred dividends were discontinued. The arrears were paid off in 1923 and the 1923 statement of the Company showed a working capital position of approximately \$2,800,000.

company must yield their return. It is essential to efficient operation and to the earning of the maximum return on capital that all the four factors of a sound undertaking be fulfilled and it is the function of sound organization, not only to conduct operations in the most up to date and efficient fashion, but also to deal with foresight and to the best possible advantage in the four markets just named.

In proportion as these requirements are fulfilled capital will enter more readily and under more favourable terms. Thus, a well established manufacturing process, carried on with well designed plant, acquired through carefully executed financing, will in a good market, with competent management, yield immediate returns.

In a short time the securities of such a concern will be classed as a seasoned investment. On the other hand, untried methods of manufacture, risky finance, inexperienced management and unexplored or fluctuating markets, introduce a speculative element. Broadly

speaking, all entirely new enterprises are highly speculative, while new promotions of familiar industries should generally be ranked as more or less speculative investments. Finally, large flotations representing little more than goodwill and the pious hope of future profits should be classed by their true value, as nothing but gambles.

This element of risk has a direct bearing on the conditions under which capital will enter any enterprise. In a new promotion the owner of capital is asked to exchange tangible assets for possibilities whose true value only time can determine. Under such circumstances a security with a share in future profits, such as, say, a participating preferred stock, is almost certain to be required. Frequently an actual interest in the concern is demanded and may be met by a bonus of common stock<sup>#</sup>. On the other hand, a well established enterprise is not forced to pay so highly for fresh additions to its capital, and, also, the original interests are adverse to forfeiting an anticipated increase in returns for which they have themselves

# Some of our best known securities were originally stock bonuses of this kind and in many cases this feature of underwriting has proved immensely profitable. For instance, Abitibi and Spanish River common, among the well known paper stocks, were in part given as bonuses with original underwriting, as was also Canada Cement. Abitibi has sold at the equivalent of \$435 and has paid dividends at the rate of \$30 a share on the original capitalization. Spanish River,

laid the foundations. As the risk is now much less, the premium may be correspondingly reduced, and in return for the security guaranteed by actual accumulated savings, it is generally possible to secure capital for a fixed rate, the remainder of the increased earnings going to the holders of the junior securities, or to the further building up of the company's surplus. Should, however, the flotations be made necessary by the urgent requirements of the business, or should the demand for the particular class of investment, a bargain may have to be struck under less advantageous terms, representing the balance of conflicting interests.

While cases are not rare where corporations are put to the necessity of borrowing because of financial difficulties, that is to say, when their working capital is below the requirements of the business, the bulk of security issues is made because business is good, and the corporations are in a healthy enough condition to allow expansion. The well recognized principle of borrowing for such means is known as "trading on the equity".

after selling at very low levels, has sold as high as 125 $\frac{1}{4}$  and has been on a regular 7% dividend basis since 1920. Canada Cement has been on a 6% basis since 1917 and is now quoted around 87. Alberta Pacific Grain common is another good example. This stock was given as a 25% bonus with the offering of preferred in 1912, paid in one year (1921) the following dividends - 33% in cash, 50% in Victory

## Chapter VII.

## PROMOTION UNDERWRITING AND MARKETING.

The process whereby the possessors of a business opportunity are introduced to those having access to supplies of capital is termed promotion, and the person or persons exercising this function are known as promoters. It is to be noticed that the function of promotion begins with the discovery of the opportunity for development, and ends with the introduction described. The promoter then becomes superfluous and his services may be dispensed with. On this account the promoter usually takes steps to prevent direct access by those persons who are expected to furnish the capital required to the owners of the project by an elaborate system of options, which he is only prepared to surrender in return for definite and valuable considerations. In this connection, it is well to disabuse oneself of the popular conception of a promoter as a species of financial pirate which is inaccurately based on the activities of fraudulent stock salesmen.

The person who actually furnishes capital may be a private individual, but, more generally, the capital required is obtained through the efforts of a special-bonds and 7 1/7% in additional common stock. Recently power financing has frequently offered this attraction. Southern Canada Power, originally a bonus, now on a dividend basis, is often quoted as an illustration.

ist called an underwriter, who is in a position to tap sources, not otherwise available. The underwriter may combine the functions of a promoter with his own, or may be approached directly by the owners of a project. Although, in this case, there are but two parties to the contract, the functions of a promoter have nevertheless been performed by one or other of these parties.

The general procedure is for the promoter to secure at least temporary control of the project. For this purpose he will secure options, if unable or unwilling to purchase outright, on properties, plants, machinery, raw materials and patent or proprietary rights in inventions from the owners. He may secure franchises, concessions or guarantees from municipalities, and may, if desirable or necessary, form a preliminary incorporation, sometimes securing subscriptions from prominent men whose presence has a certain advertising value. He then has a prospectus, usually accompanied by reports from engineers and lawyers, prepared at some length, and thus armed the pro-



moter approaches the underwriter. The underwriter, in his turn, checks up the facts as set out in the prospectus by the testimony of his own experts and submits the scheme to his own lawyers for examination. If the project still seems attractive and the underwriter finds himself in a position to interest capital, the promotion is consummated in the following manner.

A fresh incorporation is sought, usually employing parties not financially in the transaction, termed "dummies". When the charter is obtained the legal capital of ten percent of the authorized capitalization is provided by the underwriter and paid into the treasury. A meeting of the provisional shareholders is then held, the charter is adopted and a provisional board of directors is appointed. A joint meeting is then arranged with the promoters, the owners of the project and the underwriters. The meeting then adjourns. A meeting of the provisional directors is held to arrange the details and also adjourns. At the joint meeting sufficient capital is paid in to meet the immediate

needs. The promoters then surrender their options in return for such cash and securities as has been agreed upon, and the properties and the like involved change hands. Ostensibly to conform to legal requirements, when securities are included in payment, all these transactions are on a cash basis, but the actual effect is that these properties, patents, goodwill and other assets, tangible and intangible, are virtually exchanged for securities of the new company, either with or without the cash consideration, the various parties to the transaction receiving an agreed proportion of these securities in return for the cash which they are presumed to have paid in. The provisional directors then resign and disappear from the transaction as such. A new board of directors is appointed and the meeting adjourns after the first meeting of the permanent board of directors has been called. The company is now ready to commence operations and the underwriter may proceed to dispose of his blocks of securities.

To take a concrete example, suppose a favourable

opportunity exists to build a paper mill with an initial production of two hundred tons of newsprint daily. With newsprint at \$75 a ton let us say that, on the basis of capacity operation, the profit is \$7.50 per ton, after all operating expenses and depreciation have been met. Let us assume that the capital required to finance and construct the plant and provide for working expenses during the first year to be \$5,000,000. The initial financing is effected by an issue of \$10,000,000 of common stock of a par value of \$100 per share, which yields, with the necessary expenses of underwriting provided for, and taking goodwill and other intangibles into consideration, \$50 per share. During the first year or two dividends will probably be passed. Let us assume that at the end of the fifth year earnings are normal, that is to say, two hundred tons at \$7.50 times 300 working days, \$450,000 in all. This represents earnings of  $4\frac{1}{2}\%$  on the common stock issued or 9% on the cash capital of the company. At this stage a dividend rate of 3% per annum is commenced.

Let us now assume that the market for newsprint, ten years after commencing operations, warrants a 50% increase in production. Let us assume that due to savings and efficient management, the production has been increased till the net earnings are now \$600,000 or 6% on the shares issued and that the dividend rate has been increased to 4%. A further 50% increase in production will demand \$2,500,000 of new capital. This could, of course, be secured by a fresh issue of common stock and, as the company's earnings are good, such an issue could possibly be made at \$70 a share, requiring the issue of \$3,571,400 in stock. Under this plan the total earnings would now be \$900,000 on \$13,571,400 and to maintain the dividend until the new plant is in operation will require over \$145,000 to be found from the resources of the company. Thereafter, old and new stock would share equally but the return to the old shareholders bears to the return of the new shareholders the ratio of 7 to 5 on the actual cash paid in and all future yields will be in this ratio. Furthermore, the new capital has a share in the control of the company of almost 30% and, by each fresh issue of common stock, the original shareholders will lose part of their control

and forfeit their claims to remuneration for their foresight and risks in the shape of a sole claim to increased earnings.

Now, let us suppose that the disadvantages of this course have been pointed out and that the company decides to finance with a limited return security. It is intended to issue a 7% non-participating preference stock at 90, thus securing \$2,500,000 for \$2,766,000 of preference stock. The guaranteed dividend on this stock is \$193,600 before a dividend on the common stock can be declared, and the draft on the reserves is less than \$200,000 during the new construction. When the earnings reach the \$900,000 mark there are \$706,400 available for common dividends to the original shareholders as against \$600,000 under the first scheme, a clear gain of \$106,400 or one percent.

The underwriter is not satisfied with the offer, however, and suggests a 20% bonus of common stock amounting to a par value of \$550,000, reducing the yield to the original holders to  $6\frac{1}{2}\%$  and reducing

future earnings to original shareholders by about 6%. The company makes a counter offer, whereby the preferred stock shall participate with the common after 10% has been paid on the latter, the directors considering that immediate increase of one-third on net earnings to be unlikely. This is accepted by the underwriter subject to the preferred stock becoming cumulative should the dividends thereon fall into arrears.

Five years later, earnings have been maintained and the company wishes to add another machine, thus raising the production from its present level of 400 tons a day to nearly 550 tons, representing anticipated earnings of \$1,200,000. On this occasion, the company, being on a sound basis, decides to keep further earnings in the company by raising the desired capital through a bond issue, thus securing capital at a fixed rate of interest without forfeiting future profits. The underwriter is now willing in view of the position of the company to float an issue of 6% First Mortgage bonds at 95, maturing in 40 years. This will require \$2,500,600 worth of bonds, yielding

\$2,375,000, the balance being available from reserve. The interest on these bonds is \$150,000 per annum plus \$62,500 per annum to be set aside to retire bonds when they mature.<sup>#</sup> Note that this charge is about \$19,000 greater than in the case of the preferred stock issue, but, as a fresh issue of preference stock would represent, being a cumulative permanent claim against earnings, while the bond interest and sinking fund requirements will commence to diminish immediately and the sinking fund reserve is not withdrawn from the business but is available for productive purposes, the saving is nearly 25% of the fixed charges by a cumulative preference stock issue, not to mention the fact that these bonds will not participate in any subsequent increase in earnings. The advantage of bond financing is apparent.

This may lead to the dangerous practice of financing with bonds before the position of the company is firmly established. For this reason the proportion of bonded indebtedness should be kept at a low figure. Otherwise, a high fixed charge with mortgage rights may cramp the

<sup>#</sup> A complete chapter might be profitably devoted to sinking funds in a fuller description. There are a variety of forms, suitable in different cases, the subject of considerable controversy. The main methods are - (1) To set aside in reserve a certain proportion of the amount of the issue, i.e., a bond sinking fund reserve. (2) To purchase or call a certain number of bonds and to hold them, applying the interest to further purchases. (3) To purchase or call bonds and cancel them. Nowadays, the method of making serial issues, that is.

operations of the company and prevent the maintenance rate. A further drawback lies in the so called closed mortgage by which underwriters seek to prevent further bond issues, insisting that the mortgage securing the bonds cover not only the equipment which they are destined to provide, but all the assets of the company then existing or thereafter to be acquired.

Such a clause in a trust deed has the effect of transferring the total equity to the "cestuis que trustent" during the life of the bonds. In the case of a sound concern, this proviso tends to operate unfairly by compelling the company in spite of the fact that its position amply warrants further expansion, either to float an issue of second mortgage or less attractive obligations at a higher rate of interest, or, as a last resource, by a further issue of stock. The only other avenues of escape consist in buying in bonds at their callable rate or by the formation of a subsidiary company for the new development. The first scheme, being a forced refunding, a premium will ordinarily be exacted by those underwriting the new issue and, in addition, the callable value of the bonds outstanding invariably in-  
providing for the maturity of different parts of the issue at intervals, is not uncommon and has much to recommend it as a conservative course.



cludes a premium to their holders so that, unless the money market is very easy and the new issue obtainable under exceptionally attractive terms, it will be difficult to average the loss over the whole transaction. The formation of a subsidiary company,<sup>#</sup> while it involves additional expenses of incorporation and a certain duplication of organization, will tend to be more economical, but unless the development is of a character differing greatly from the original or parent company, or is situated in a distant location, the efficiency of the combined system is liable to suffer.

In the sale of new securities to the public the services of all the members of the financial community are necessary. The process of underwriting consists in the purchase from a company of an issue of securities, or the guarantee to that company that the securities in question will be sold at a price to net the treasury a certain amount. In Canada, the process is usually the more simple one of outright purchase.

In the foregoing we have seen how arrangements

<sup>#</sup> An example of this policy is given by the Canadian Salt Company Limited. The 7% General Mortgage bonds, issued 1921, were a blanket mortgage "on all the assets, now owned or hereafter acquired". When the company wanted to purchase additional equipment in 1923 they organized the Canadian Salt Equipment Company and issued 6% Equipment Notes, a first mortgage on the new equipment.

are entered into between the issuing company and the underwriter. The price paid for an issue represents a balance between conflicting interests, but the company will in most cases have to accept the underwriter's terms and the price that he is willing to pay for an issue will depend on a great many circumstances, particularly on the state of the investment market, the soundness of the issue being bargained for and the nature of the underwriting. He is taking a responsibility which it is his intention to shift immediately on to other shoulders, and he will try to secure terms which will suit those persons to whom he expects to shift this responsibility.

He must, first of all, secure banking accommodation, for it is not likely that from his own private surplus capital he will be able to pay the price which he stipulates. The bankers, however, are agreeable to financing the arrangement by carrying the security as collateral. The underwriter supplies the margin which they require as protection.

As the actual practice is in Canada, what we have called the underwriter is a group of investment or banking houses, which is more correctly known as an underwriting syndicate. When this syndicate has arranged for the purchase of the issue and has secured banking accommodation, its function is usually finished. It organizes, then, a group which is known as the buying syndicate, which usually includes the original members of the underwriting syndicate and other firms which are able to distribute the issue again to other dealers with rapidity. When the buying syndicate takes over the issue they pay the underwriting syndicate a higher price than this syndicate paid the company and the first profit is realized at this stage. The duties of an underwriting syndicate may appear light, but their responsibility is great and their function is a very necessary one.

The buying syndicate now owns the issue, and it is the purpose of this syndicate to distribute it in blocks to the members of another syndicate, which is known as the selling syndicate. It is sometimes

at this stage that an issue runs against rocks, for the buying syndicate must convince each member of the new selling syndicate that the issue is sound and that it will meet with demand from private investors. Otherwise, the selling syndicate members will not enter and it sometimes happens that a buying syndicate is left with an issue on its hands and must perforce fill the two functions and attempt to sell the issue itself. If their distributing power is not large enough, and if the issue drags or a balance remains unsold, from the point of view of investment banking it is not a success and the market price of the issue in secondary trading will reflect the fact.

The selling syndicate is made up of the buying syndicate members again with a much larger number of firms than were previously admitted. All the members agree to take certain shares in the selling. One firm may take \$1,000,000, another \$500,000 and there may be a host of small firms that only take \$25,000. They are all responsible in the ratio of

their allotment to the amount of the whole issue for the sale of the security and, at a certain date, when the syndicate agreement expires, they will be called upon to take up the balance of unsold bonds which is still in the syndicate's hands.

It is usual for a syndicate to engage itself in the sale of an issue to certain institutions or specially wealthy investors who receive a discount price. On sales made by the syndicate to such buyers all the members share pro-rata to their allotment.

It should be noted that throughout the process of these three stages of underwriting, banking accommodation has to be secured and each different syndicate makes its own arrangements with its bankers. It is the aim of the selling syndicate to take up the bonds from the bank as quickly as possible and, in the case of an issue being a success, this aim is usually accomplished within a few days time.

The different members of the selling syndicate may further distribute the issue to dealers who

commonly work in association with them and who may not have been invited, or who may not have cared, to enter the selling syndicate, but these members will be particularly concerned with the sale of the new security directly to customers of their own. It is only by this kind of sale that they realize their full profit, for it is customary to give dealers a definite discount which is provided for in the syndicate agreement.

There is really no difference, as the term is used in Canada, between an investment banker, a bond dealer and a broker, except that a broker is usually a member of one of the recognized stock exchanges and acts for his client as an agent, charging him a certain regulated commission rate. The general practice, however, is for brokers to supply their clients' investment needs in unlisted securities and new issues as well, and it is understood that in such cases they frequently act as principals, purchasing the security for their own account and re-selling it to the client at the retail market or issue price as the case may

be. Putting aside for the moment the description of the stock brokerage business in Canada, let us point out the economic functions fulfilled by the investment banker in a country like Canada.

While he may act as a banker, making loans against collateral and accepting deposits pending investment, his principal occupation is to attend to the investments of his client, who usually acts on his recommendations. The success of his business will very largely depend on the successful outcome of such investments made and the investment banker will, therefore, investigate thoroughly the soundness of his recommendations. This is a highly specialized function and one which would have to be fulfilled in a country where investment is general. From an economic point of view, however, his principal usefulness is that he acts as the intermediary between companies anxious to obtain capital and persons with surplus funds seeking employment. Also, he is the centre of the market for such investments. One of the greatest advantages of bond

and share securities over such investment forms as real estate mortgages is that, in the general rule, they are quickly marketable. So true is this fact that it is quite a feasible thing, and among large investors this is largely availed of, for an investment to be made for a period of weeks or months only through the intricate organization of the secondary security market. When one investor wishes to sell, it is possible to find another who wishes to buy that identical security, or who is willing to buy it on the recommendation of his investment banker. Notice how the banker's recommendation is again an important factor.

This secondary market is of the greatest importance in the scheme of security investment. For bonds, particularly, the market is maintained by what is known as Street or over the counter trading among investment houses. Each house will have securities in which it is particularly interested, securities which the house itself has sponsored or ones in which it has taken an interest, and the house will conduct



the wholesale market, that is to say, the dealers market in this security.

In some way the markets in particular bonds or stocks become known and other dealers will call on the interested house for quotations on the buying or selling side. As the interested house will want to maintain its predominance in the market, the buying and selling quotations must be as close as possible to meet competition. It is important to notice that this security market is typically a wholesale one and all investment houses participating in the purchase or sale of the security for their own account will confirm the sale to or the purchase from their clients of the security at a net price.

The stock exchange provides a retail market for the securities which are listed on its board and members of the exchange act only as agents, getting as good execution as possible on the floor of the exchange and charging their clients a set and regulated commission.

The securities traded in on any stock exchange have passed the examination of what is known as a listing committee. The requirements of listing differ slightly between exchanges. It should be borne in mind that the listing of a security is not a recommendation of its investment soundness. If it has any significance, it is that the security is not surrounded by any atmosphere of fraud and that it has reached a certain advanced state of distribution. The purpose of the examination into such details is in protection of the stock exchange more than the public who deal with it. It ensures against the exchange being used as a means of distributing securities, either good or bad, and impresses the purpose of a stock exchange to be the supplying of a market for the purchase and sale by the public of securities.<sup>#</sup>

<sup>#</sup> It should be noted that the same security may be traded in on more than one exchange. There are several instances of double listing between Montreal and Toronto and some instances of double listing between these exchanges and United States exchanges.

The illustration is common of the old pre-war arbitrage business in such international securities as C.P.R. between New York, London, Paris and Berlin with occasional reference to the Canadian market as well. When securities are listed on more than one exchange it will inevitably result in arbitraging operations and by these means prices are kept at a common level.

Companies whose securities are listed on an exchange must agree to publish annual statements and to supply the stock exchange with full details of changes in capital and dividend policy.

No securities may be "called" or traded in on a stock exchange without first going through the process of listing, but Canadian exchanges have, in addition to the regular "board", what is known as unlisted departments, where securities which do not pass the requirements for regular listing are traded in. Such securities, however, pass examination and are admitted by decision of the same listing committee. Other securities cannot be traded in on stock exchanges.

The membership of exchanges is limited and membership can only be gained by election in the ordinary way. However, before a member can appear on the "floor" to conduct transactions he must hold a seat which must be purchased from a retiring member. The price of such seats often runs to quite high figures. Membership on the Montreal Exchange is valued at the present at about

\$30,000.00. Stock brokerage firms which are associated with an exchange will describe themselves as members of such and such an exchange. This means that one or more partners of the firm are members of the exchange and that through this membership the firm can execute orders in the listed securities on the floor. As a matter of fact, member firms are not allowed to deal in these listed securities except on the floor with other members of the exchange. Even if a member should have orders to both buy and sell the same number of shares of the same stock he must give all other members of his exchange the opportunity to compete for the offering or to themselves offer shares at a lower figure. Quotations, as established from minute to minute are changed by offerings and bids publicly made on the floor, and no transactions can be made except at these official quotations. Every provision is made and strictly enforced to prevent unfair competition between member firms, and by the rules of the exchange a very high standard of business honesty and integrity is required.

Stock exchanges are governed, as a general rule, and Canadian exchanges are no exception, by a chairman at the head of a group of elected governors with committees for attention to the many routine details. The governors on their own initiative, or on the recommendation of the various committees, have wide powers, not the least of which is the right to discipline any member by fines or suspension.

The clearing house departments of organized exchanges efficiently attend to the delivery and payment for securities bought or sold on the floor. Canadian and American practice is to deliver against transaction the following day. Failure to deliver securities or to make payment for securities purchased within this time, unless satisfactory arrangements are privately made, constitutes the very gravest offense against stock exchange rules.

In Canada, there are three stock exchanges, of which the Montreal exchange is by far the most important. The other two are located in Toronto and

Winnipeg, the latter being really a department of the important Winnipeg Grain Exchange. In addition, there are mining stock exchanges at Montreal and Toronto, which, in the latter case, provide an international market for transactions in Canadian mining stock issues.<sup>#</sup>

We have given this description of stock exchanges with a little more than usual fulness, but it has been felt necessary to meet the natural widespread interest in these institutions. Also, a discussion of the means whereby the secondary market in securities is created is well worth while for the feature of marketability enjoyed by security investments over other classes such as real estate investment is most important and should be carefully brought out in any study of finance and it should not be forgotten that the secondary market for securities is not solely made on the stock exchanges. Let it be repeated that the volume of actual trading between independent security houses will not infrequently exceed the

<sup>#</sup> An idea of the importance of these exchanges is given by the record of transactions during 1922, the most recent available at the time of writing. The turnover on the Listed Department of the Montreal Exchange amounted to 2,997,527 shares and \$48,186,916 of bonds. On the Unlisted Department 1,043,490 shares changed hands and bonds to the total of \$381,113. Transactions on the Toronto Exchange for the year amounted to 1,214,543 shares and a turnover of \$28,418,050 for

volume of transactions on the local stock exchange. This is true, at least in respect to some issues such as Victory Bonds, of the situation in Montreal and Toronto.

Of late there has been an increased tendency for Canadian chartered banks to enter the investment field as distributing agents. It has always been the practice of English and American banks especially to add this function to dealings in credit, monies and exchange, and, while such English and American banks have played a very important and useful part in their investment markets, the entry of Canadian banks into the field has been met with a good deal of resentment. It has been felt that the banks cannot impartially fulfil their functions as bankers proper in the process of finance if they are personally interested in promotions and sales, and that, furthermore, the action represents a usurpation of another business, in which the banks, because of their position of Dominion wide monopoly, have, it would appear, an unfair advantage. A bank's recom-

bonds. On the Unlisted Department of the Exchange, where the turnover of low priced mining stocks is high, stock transactions amounted to 3,438,279 shares and bonds to the total of \$16,500. These figures are all respectable enough but they shrink into insignificance as compared with the transactions of such as the New York Stock Exchange, where 1,000,000 share days are not uncommon.

mendation of a security to its clients and depositors will, of course, carry more weight than the recommendation of a less well known, however reliable, investment house. But the banks will have to conservatively restrict themselves to the underwriting and distribution of the most conservative issues, such as government and municipal issues, to the disadvantage of public utility and industrial financing so necessary to a growing country such as Canada.

This situation may be the result more of present trade conditions than of deliberate policy of the banks, for the banks must of course find employment for their surplus funds in security investments if they cannot be profitably and safely employed in loans to industry, and no one can blame them for seizing a profit at the same time by retailing their holdings, and replenishing their supply at the same time by bidding against the bond dealers in the original underwriting markets. One fact is true, that the present policy of the banks, that of holding



large amounts of securities, has a healthy effect on the bond market. While New York and London, before the War, used to be large buyers of Canadian bonds in the secondary market, and thus a sustaining influence, the Canadian bond market is now to an extent never known before independent of this demand, and has shown in the past couple of years an ability, not only to absorb its own original issues, but to conduct an active and steady secondary market in them.

At this point we may conveniently pass on to a more detailed examination of the sources and supply of capital that have influenced these markets.

## Chapter VIII.

THE SUPPLY AND SOURCE OF CANADIAN  
CAPITAL.

Sir George Paish who has made a special statistical study of international borrowings has summarized the needs of a young country for foreign capital as follows.

The young country desires, he says, to do all those things which an old country does and desires to do them quickly. The rapidity with which things move in a young country is so astonishing to those accustomed to the slower progress of an older country that persons living in those older countries cannot believe that the growth in the younger countries is as rapid as it is said to be.

Because of the rapidity of its progress a young country needs all its savings for the construction of houses, for the breaking of virgin soil, the build-

ing of roads and the building of factories and has not the means of constructing the more expensive works required to develop its resources.

"Hence the opportunity", continues Sir George Paish, "given to the older countries to provide a portion - indeed often the larger portion - of the capital needed for the construction of expensive works, such as railways, drainage systems, waterworks, gas and electric installations, street railways and similar undertakings, which offer special attractions to foreign capital which is willing to invest at a lower rate of interest and dividend than can be earned by native capital employed in trade, industry and house construction".

"The importation of this foreign capital", he concludes, "sets free the growing savings of the young countries for the rapid extension of their industries. Further, the young countries attract large numbers of immigrants who possess no capital, and in order to render this additional labour productive, the new countries need a much larger quan-

tity than they themselves possess. In brief, the importation of capital by the young countries enables them to construct those great works of public utility, without which their natural resources could not be developed, to secure and to employ profitably a great amount of cheap labour from the older lands, to use their own capital in industries where the return is high, and to employ their own labour in the most profitable manner".

Under these terms Canada has always been a borrowing country, firstly, with the United Kingdom in the London market and, secondly, with the United States in the New York market. Before the war, the flow of borrowings was predominantly from the other side of the water and the London market was still at that time making substantial loans to the United States. The outbreak of hostilities transferred the money centre to New York and before many months Great Britain and the continental countries were seeking money where formerly they had supplied it, so great was the need of war finance. The United States, too, from the tremendous profits of neut-

ality had now a large surplus seeking investment. Canada largely financed her war needs at home but the issues of municipalities and corporations were more successfully offered in New York. Two causes made this flow of capital natural, the easier money rates of the United States markets and the exchange rate consistently favourable to American investors.

While the flow of capital into Canada from England had before the war been the greatest the world had ever known, it is estimated<sup>#</sup> that between 1905 and 1913 over £256,050,000 of Canadian issues were sold in London, the movement is believed to have been equalled in the flow of capital from the United States to Canada during the next ten years. Whereas in pre-war years Great Britain had in one year sent \$275,000,000 to Canada against \$50,000 from the United States, that latter country in 1915 invested \$750,000,000 and the total American investments in Canada is now conservatively placed at from \$2,500,000,000 to \$3,000,000,000 and in this total it is not believed that proper allowance has been made for the American investment in branch plants

# By Fred W. Field - "Capital Investments in Canada", an authoritative work. By years the offerings reach the following totals.

1905	-	£13,530,287
1906	-	6,427,500
1907	-	11,203,711
1908	-	29,354,721

in Canada which are now reported to number 1500 or 2000.

During these years, however, Canadians had begun to provide for their own needs as never before. Investing is largely a habit, and Canadians at large were given their first real introduction to security investment by the internal War and Victory Loans. Canadians, as we have said, contributed themselves the great part of their war costs and the war time prosperity allowed a substantial surplus for investment in industry as well. It is not unimportant that the investment business in Canada made rapid strides during this period, filling a growing need and rounding into form to meet this need just in time to forestall the entry of American houses on a very wide scale. While a good deal of financing is carried on in Canada now by the branch offices or branch firms of New York security houses, the organization of purely Canadian houses is far advanced enough to take care of the underwriting of all important issues. This, as well as the growing independence, is seen in the successful offering recently

1909	-	£ 37,411,723
1910	-	38,453,808
1911	-	39,855,517
1912	-	32,456,683
1913	-	47,363,425

in the Canadian market of \$200,000,000 of refunding Dominion Loan bonds and two issues of \$50,000,000 each for the Canadian National Railways.

The practical impossibility, however, of exactly measuring the flow of capital into any country is not always clearly enough set forth.

This is what one authority<sup>#</sup> means when he said. "There is nothing more elusive than capital. Economists speak of the flow of capital as though we were dealing with a river which, rising in the mountains, finally finds its way to the ocean, receiving rivulets as it progresses, turning water wheels, bearing on its bosom all kinds of craft, fertilizing rivers by its overflow or as a result of irrigation projects, and, finally, by joining the Gulf Stream, coursing round the globe. The simile is not a bad one, but we must not overlook the fact that the water is apt to be sucked up by whirlwinds or by trade winds, to be again scattered over the earth at some distant point, while at all times the sun is absorbing moisture from the stream to be poured forth again as rain. Just as it is impossible accurately

# Harry E. Fisk - Economist to the Bankers Trust Company.  
New York.

to measure the fluctuations in the volume of water in the stream or to tell how it is augmented or diminished and all of the different uses to which it may have been put, so it is practically impossible to measure the flow of capital. The best we can do in the present state of the statistical data on this subject is to indicate the general trend".

It will be recalled that a war measure of the British Government was to retain the Canadian and American security holdings of British subjects, and these were used as collateral for loans in the New York market to purchase war supplies or to stabilize exchange. Many such securities stayed on this side, and in the years immediately following the war when the efforts to peg the sterling exchange rate were abandoned, very large quantities of Canadian and American securities were sold by British holders. So great was the movement of such securities back to Canada at this time that this "invisible" import was considered to be danger-



ously depressing the Canadian exchanges, and the government took the surprising action of requesting the banks and bond dealers to refrain from assisting in the movement further.

That the balance of English holdings of Canadian securities was materially changed, however, is seen in the table on the following page. This illustrates too the difficulty of supplying reliable data as the interest of other countries in Canadian investments. The figures which follow, believed to be the most reliable, are those of Fred W. Field of the Monetary Times. It has been thought that in the case of European countries the pre-war figures had best be given unchanged. As previously mentioned, the total of United States investments in Canada are now supposed to approach \$3,000,000,000, equalling, or slightly exceeding, the original interest of the London market.

France.....	\$99,250,000
Germany.....	31,725,000
Holland.....	18,000,000
Belgium.....	11,675,000
Russia.....	2,000,000
Turkey.....	3,000,000
Miscellaneous....	<u>11,500,000</u>
	\$174,150,000

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	1913-1914			1920-1921		
	<u>Outstanding</u>	<u>Canadian</u>	<u>U.K.</u>	<u>Outstanding</u>	<u>Canadian</u>	<u>U.K.</u>
Canadian Pacific Railway	2,600,000	299,000	1,560,000	277,000	460,858	1,242,837
Shawinigan Water & Power	123,750	59,918	51,699	200,000	134,889	40,662
Steel Company of Canada Pfd.	64,963	53,900	11,063	64,693	62,810	2,153
Ogilvie Milling Common	45,000	31,611	13,389	45,000	37,453	7,547
Lake of the Woods Common	36,000	28,556	4,015	50,000	43,108	4,084
Spanish River Pulp & Paper Com.	136,991	70,249	66,742	176,141	170,033	6,108
Canadian General Electric xx	100,000	26,561	59,827	107,544	48,871	45,658
Dominion Glass	68,500	49,320	19,180	68,500	60,554	6,439
Canada Car & Foundry	109,750	27,767	77,174	124,750	47,674	23,199
Tucketts Tobacco	45,000	42,173	1,324	45,000	43,044	782

xx - Since purchased as to almost the total outstanding stock by the General Electric Company of New York.

## Chapter IX.

### SOME PRACTICAL EXAMPLES AND A SYSTEM OF COMPANY ANALYSIS.

The foregoing has necessarily been a rapid description; no other treatment is possible of a subject as comprehensive as the subject of this thesis. Some of the broader features have necessarily been neglected, but without intending now to appear apologetic for the system followed, it is proposed to give before closing a few practical illustrations of Canadian financial practice.

The writer proposes to introduce a system of company analysis by graphical method and, before proceeding further, let this system be explained.

In analysing a company's position, you go about it from two angles. You consider it from the point of view of the company's responsibilities to the public and also from the point of view of the company's responsibilities to its bondholders and its

shareholders. The financier and investor, of course, are more concerned with the latter treatment, but, in order for securities to be sound as investments or promising as speculations, it is necessary that the company should be able at all times to meet its debts to the public. In other words, it must be in a liquid position.

The subject of accountancy is an involved one and balance sheet analyses often present certain technical problems. However, for explanation we can say that the balance sheet is made up on the assets side of fixed assets which represent the properties and tools of the company, current assets, which consist of cash on hand, quickly realizeable investments, accounts and bills receivable and inventories, which consist of the company's stock on hand.

On the liabilities side we have the funded debt of the company and its liquid debt or current liabilities, its common stock capitalization and its reserves for depreciation, maintenance and renewals,

insurance or contingencies together with its surplus or undivided profits. A balance sheet must, of course, balance: total assets will equal total liabilities, and in some instances a company will have to enter non-tangible items on the assets side in order to make this balance - such items as goodwill or discount on securities sold, which represents the difference between the capital value as carried on the liabilities side and the actual cash received as shown among assets or cash on hand, are common instances of balancing entries.

The current liabilities, which may include bond interest accrued and dividends declared, are considered to be the liabilities of a company to the public. These current liabilities should be less by a good margin than the current assets, from which, in the event of sudden demand or foreclosure, they would be met. If they do exceed these current liabilities by a good margin the company is said to be in a good liquid position and the term working capital is given the difference between these two items. The company's

liability to its shareholders is shown in the capital stock entries and the undivided profits. The reserves will be balanced by items on the other side of the sheet as in the following cases, the depreciation by the value at which the assets are carried, insurance or contingencies reserves in cash or investments or, as a matter of fact, in fixed assets or inventories account, if the money is placed back into the business.

It is evident that a balance sheet may be illustrated graphically and the changing positions of the various items through the years will plot as a system of curves, which will demonstrate the changing position of the company both as regards its liabilities to the public and as regards the liabilities to its shareholders and bondholders.

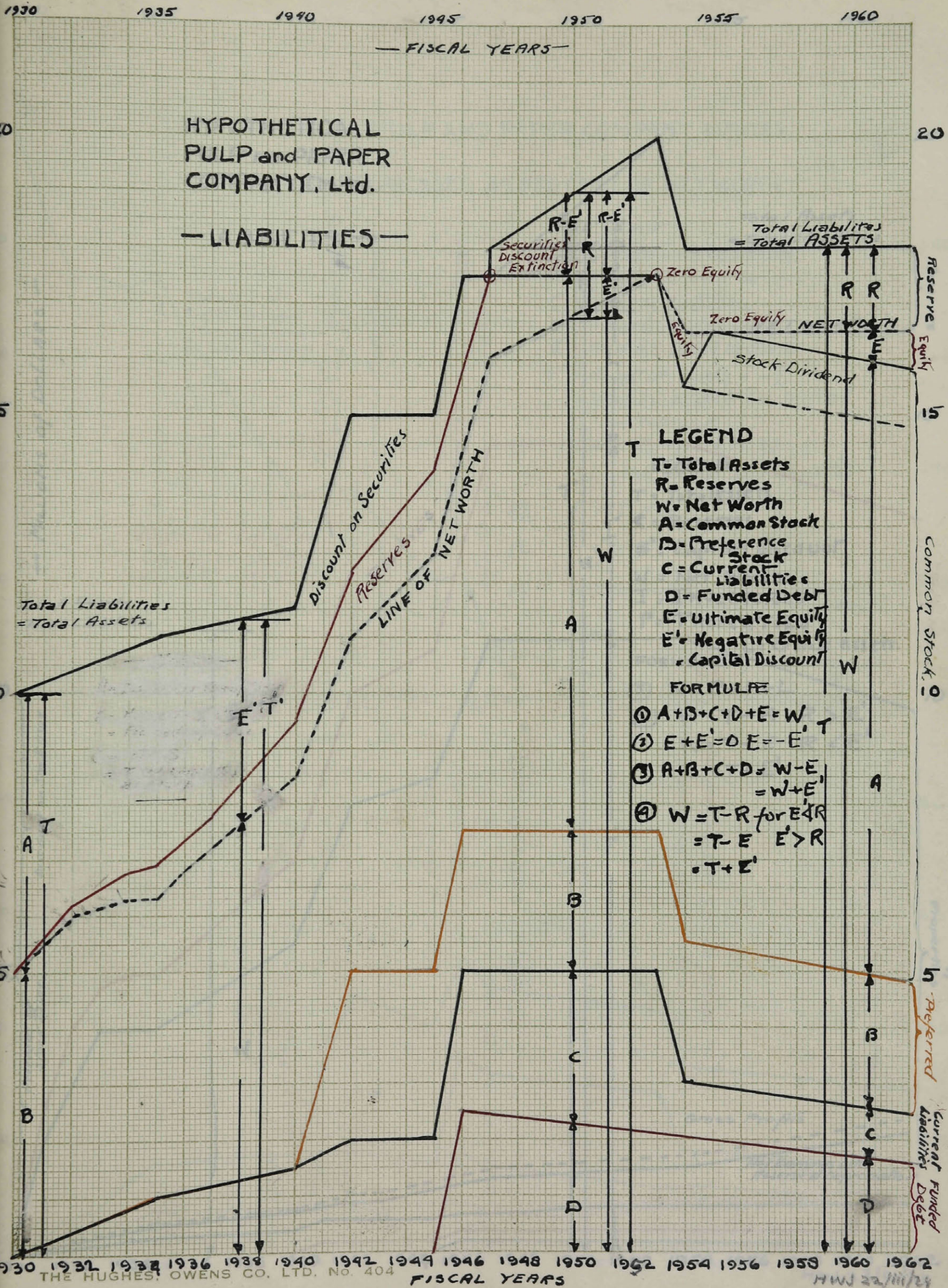
The method which will be illustrated in the accompanying charts is as follows. On the assets side the total asset line is first plotted. From this line downwards is deducted depreciation and so called negative reserves of the company in order to arrive at a line of

net worth.<sup>#</sup> From the bottom upwards the properties of the company are charted and, then, from the property line upwards the inventories. The difference between the inventory line and the net worth line will represent such items as cash, investments and other current assets as well as such items which we shall not bring into our discussion in order to avoid complication.

The liabilities side illustrates more. The total liabilities line is plotted again and will be the same as the total assets line. The same net worth line is shown again. From the bottom upwards we now chart the funded indebtedness of the company and from this line upwards the current liabilities. From the current, liabilities line upwards is the preferred stock and from the preferred stock upwards the common stock. It is obvious that the distance between the common stock line and the net worth line will be the equity behind the common shares. The distance between the net worth line

# This term has been used in the charts which follow, and it will do well enough. The same term is used, however, with a different meaning in some accountancy. Attention is drawn to this just to avoid confusion in case the reader should already have a familiar usage for the term.







and the preferred stock line will be the equity behind the preferred stock and so on. By this method the relative positions of the securities from year to year are easily ascertained, but, in order to give a further expression to these positions, a third chart shows the percentage of the bonds, current liabilities, preferred and common stocks to the net worth of the company in any given year. The net worth line, always standing at 100%, will be a straight line. The other curves will show the changing ratios from year to year and the building up or reduction of the equity behind the securities or the current liabilities. In addition, we shall show for purposes of comparison with the other figures, but simply imposed upon the chart, the earnings of the company before and after depreciation and reserves and the requirements of interest and dividends.

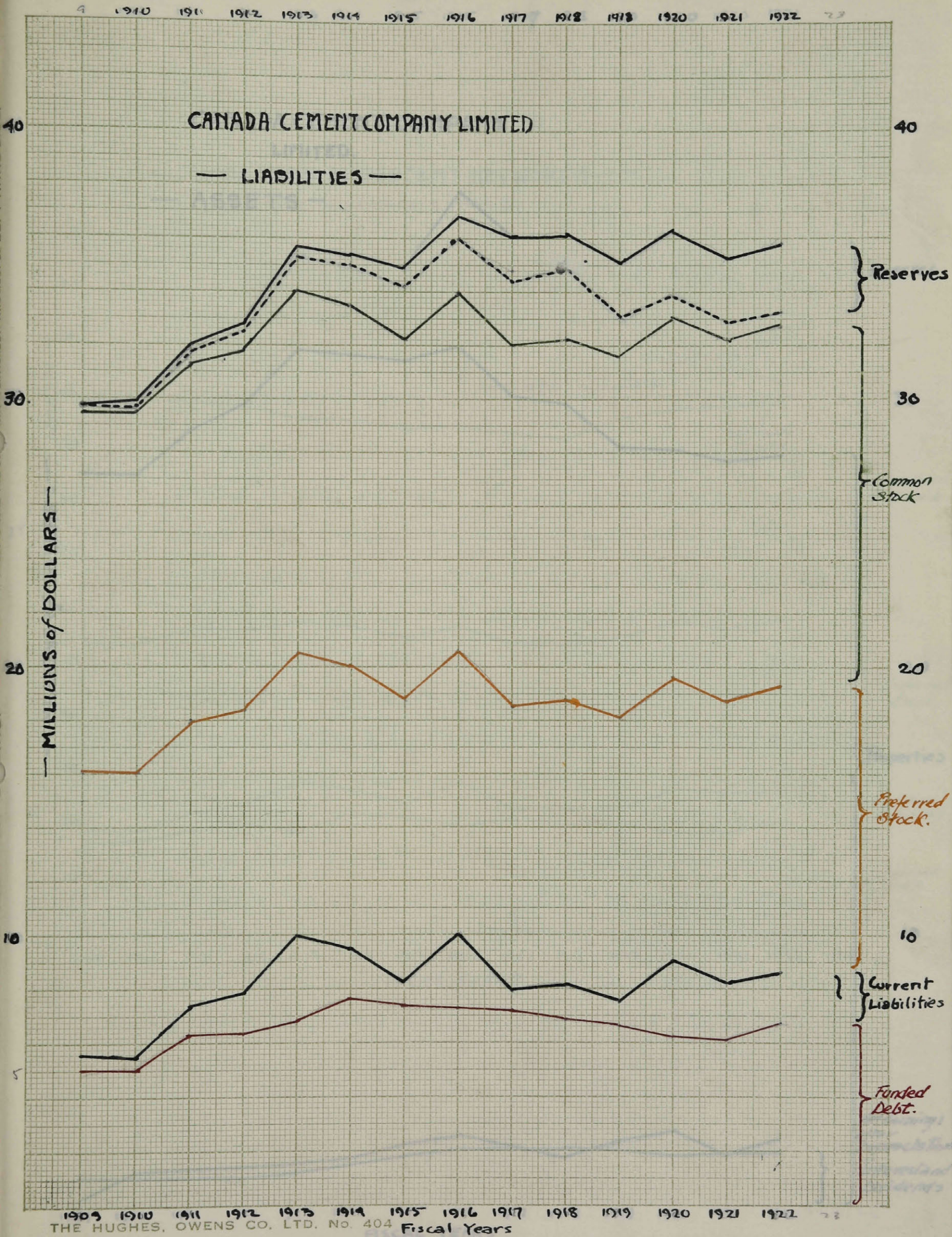
To illustrate, let us examine again the affairs of our hypothetical pulp and paper company. The first, simplest balance sheet of this company would have shown on the liabilities side - capital \$10,000,000: on the

assets side - cash \$5,000,000, discount on sale of securities, \$5,000,000. This discount on securities sold is plotted upwards from the total assets and the total liabilities line and the reserves made each year, also plotted upwards, gives us our line of net worth. Examine Chart No. 1, with which a legend is provided to make this explanation easier to follow. Notice how the current liabilities line is plotted upwards from the bonds when the issue is made in 1945 and how the preferred stock line and the common stock line also move upwards by the amount of this bond issue and how these lines reflect the changing current liabilities.

This chart shows the progress of this hypothetical company and it might be well to refer again to the description of the company's activities on pages 94-99.

In 1963 the company reaches a stage where the common stock is represented by actual values of 100% on the assets side. In the years which follow the equity is built up. Then, between 1954 and 1955 a common stock dividend is given, which again reduces the equity to zero.







In the years which follow again the equity is replaced.

Chart number 2 gives the assets side during these years and Chart number 3 shows the proportions of the different liabilities items to the net worth as previously explained.

Passing now to the examination of some actual companies, charts numbers 4, 5 and 6 describe the fourteen years of activity of the Canada Cement Company Limited. This common stock was given in part as a bonus with original underwriting. The company was a combination brought about to offset an unprofitable state of competition. Large parts of the new company's assets were valueless under the combination and, undoubtedly, large parts of these assets were carried on the balance sheet in excess of their value. The balance sheet figures showed, however, a very slight equity for the common shares. Our charts are interesting in that they show the steady building up of an equity behind these shares, and a slight reduction in the properties account of the company regardless of the fact that since the early years

of its organization very substantial additions and betterments have been made to plant, the useless units of the combination having been entirely written off. The earning figures given in chart number 5 show that at two periods the dividend requirements on the common stock had to be met out of surplus.

The reduction in the equity behind the common stock in late years is shown in charts numbers 4 and 6 and is accounted for by the asset write-offs seen in the properties line in chart number 5.

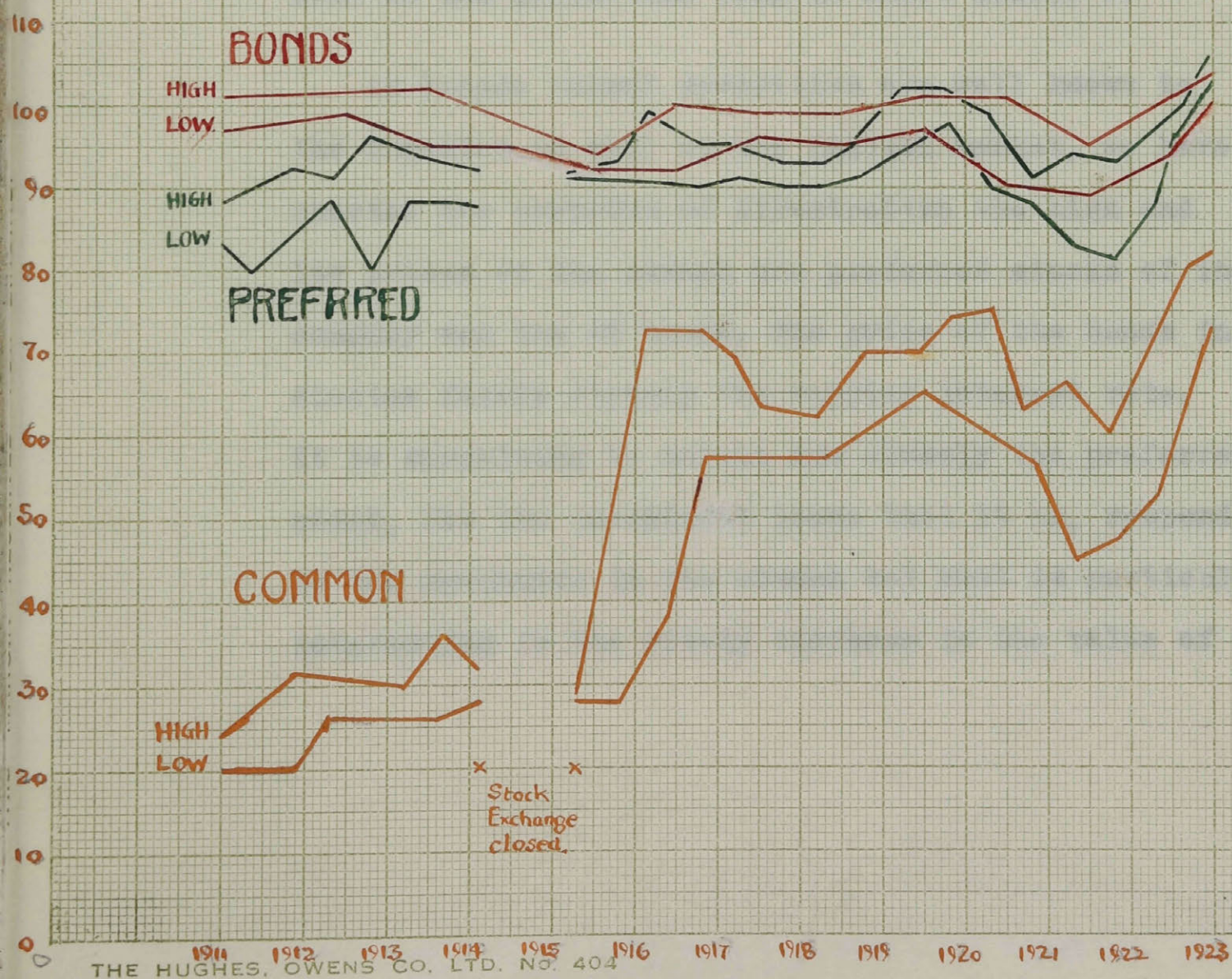
As Canada Cement securities are well known to the Canadian as well as the English market, we have charted for purposes of illustration the high and low prices of the common and preferred stocks of the company and the 6% bonds. The price of the bonds indicates fairly closely the varying interest rate. It is surprising to notice how closely the preferred stock, for the investment issue that it is, responds to the movements in the common but what is particularly interesting is the steady increase in the value of the



# CANADIAN CEMENT COMPANY LIMITED.

MONTREAL STOCK EXCHANGE  
HIGH and LOW PRICES.

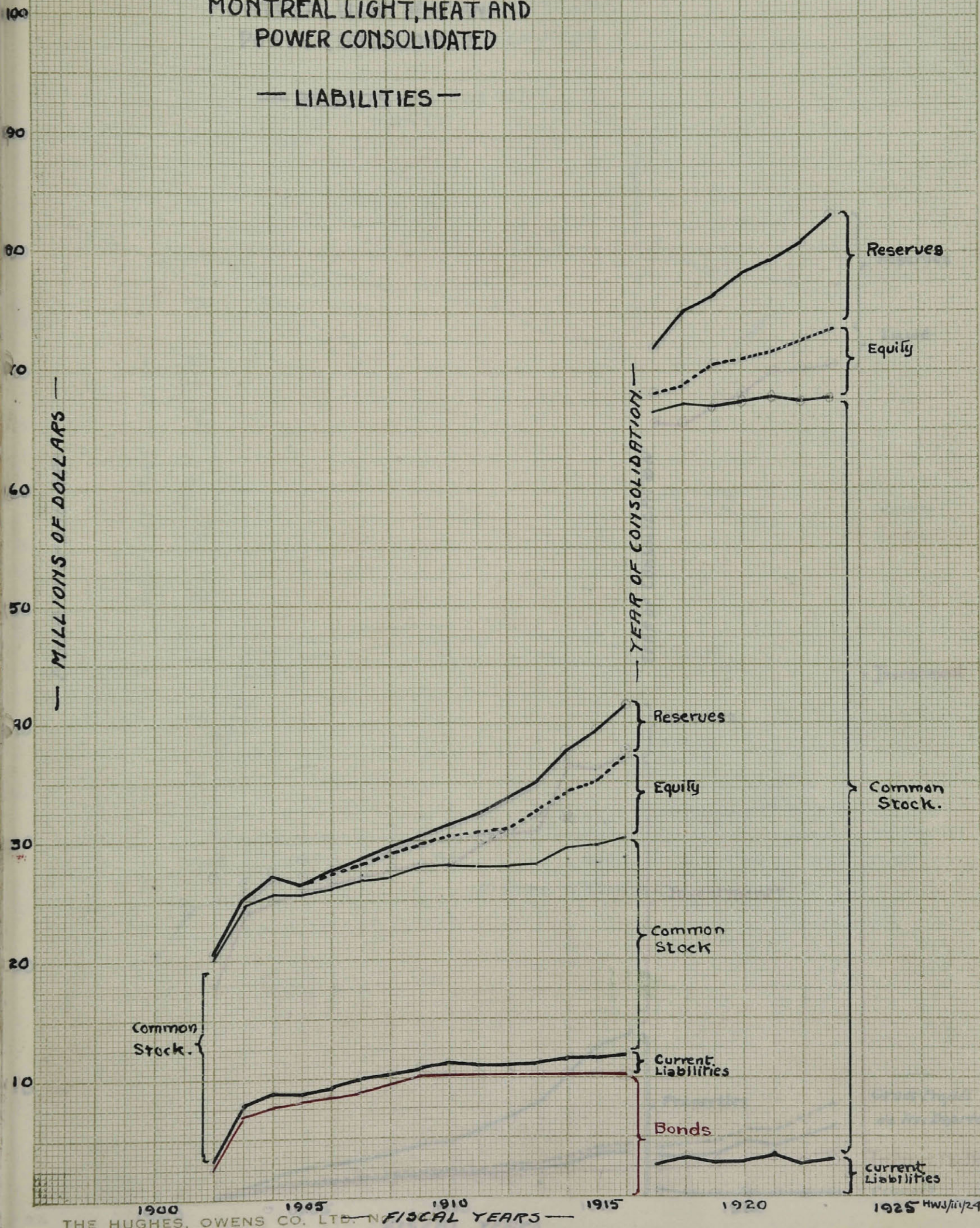
STOCK - HALF YEAR  
BONDS - YEAR.





# MONTREAL LIGHT, HEAT AND POWER CONSOLIDATED

— LIABILITIES —





# MONTREAL LIGHT HEAT AND POWER CONSOLIDATED

— ASSETS —

MILLIONS OF DOLLARS

YEAR OF CONSOLIDATION

Reserves

Liquid

Investment

Reserves

Investment

Properties

Gross Profits  
do less Depreciation

Interest & Dividends

Property  
1925 11/1/29

THE HUGHES, OWENS CO. LTD. FISCAL YEARS

1900

1905

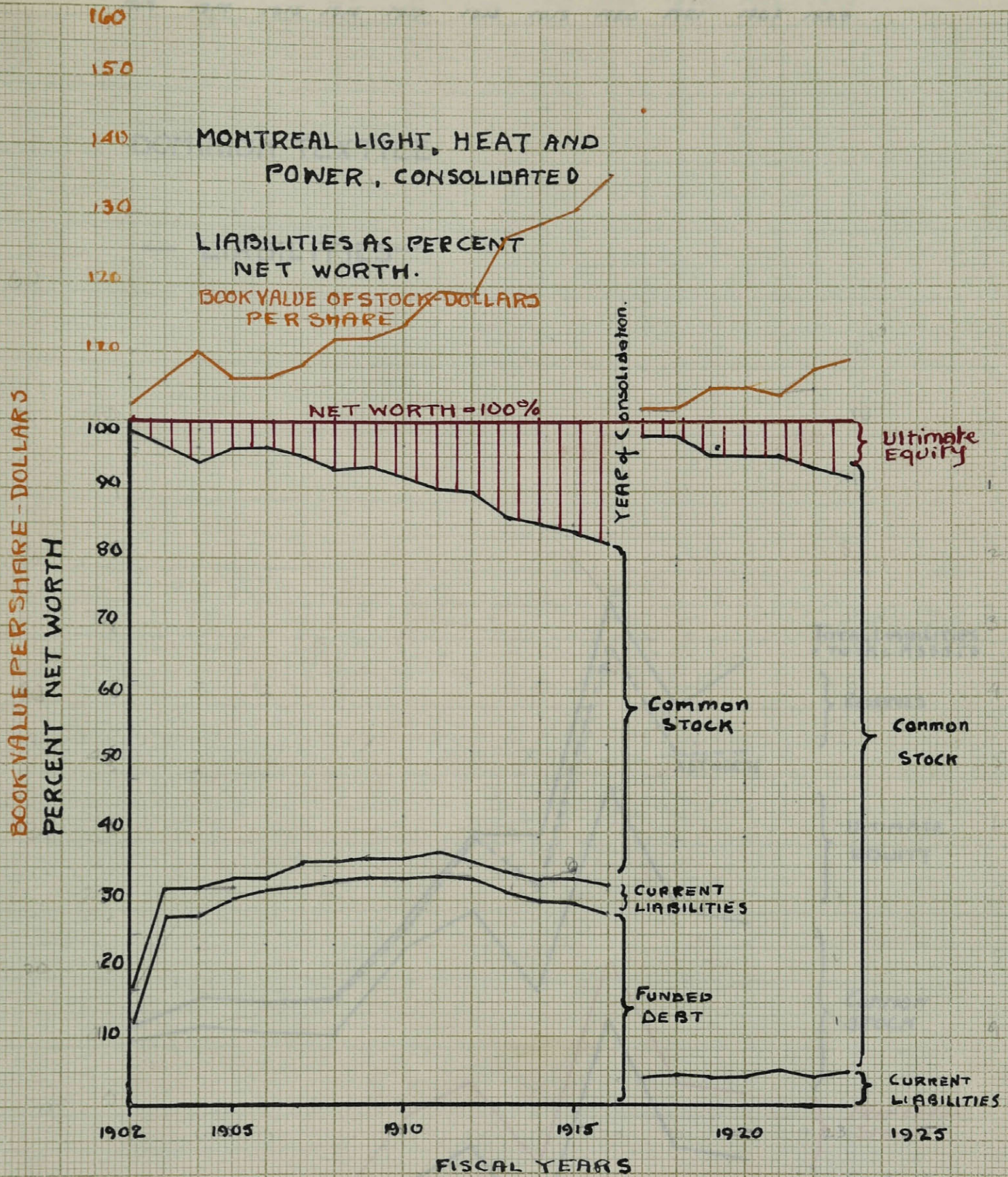
1910

1915

1920

1925 11/1/29





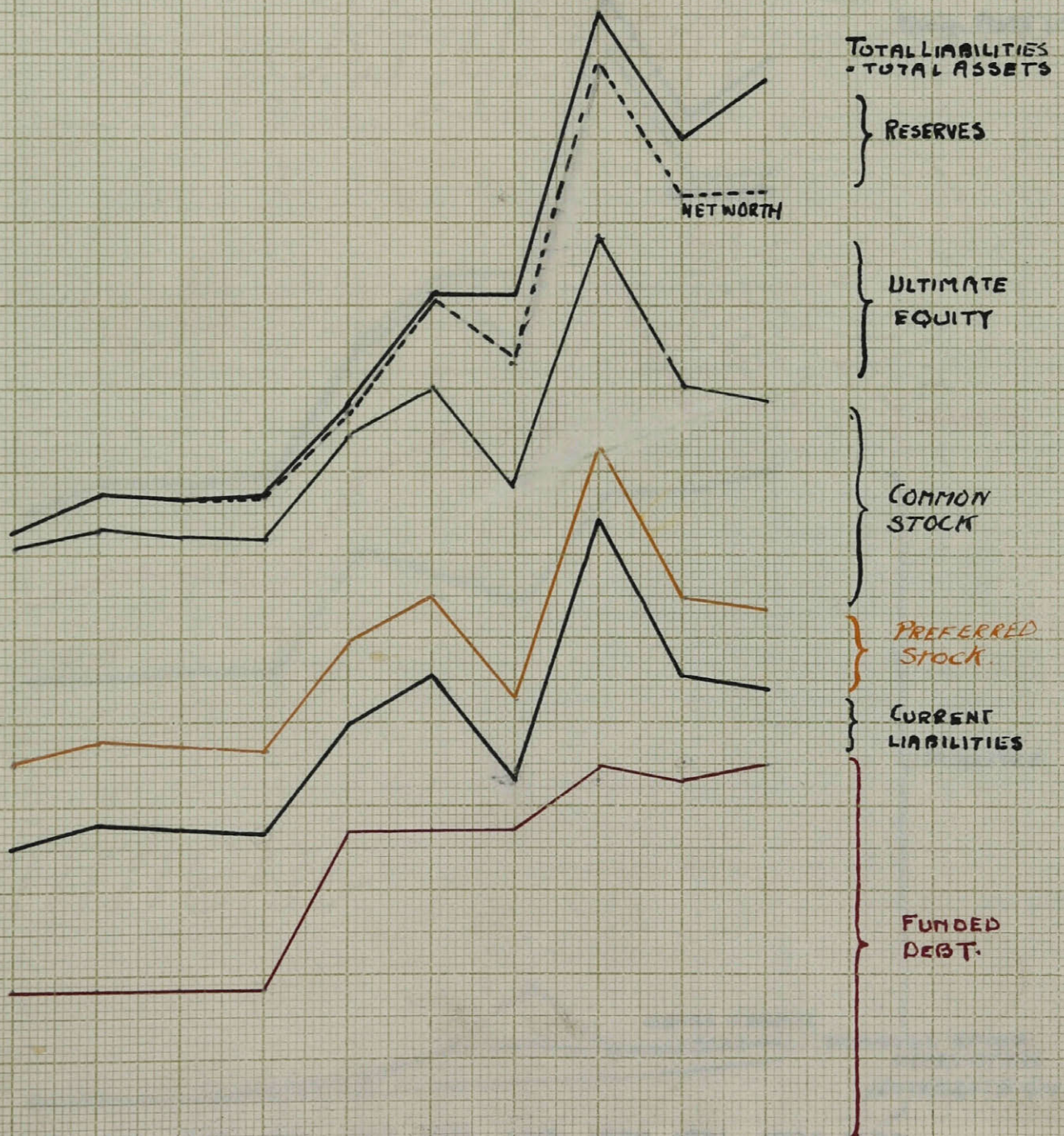


1913 1914 1915 1916 1917 1918 1919 1920 1921 1922 1923

# DOMINION TEXTILE

— LIABILITIES —

— MILLIONS OF DOLLARS —





1913 1914 1915 1916 1917 1918 1919 1920 1921 1922 1923

# DOMINION TEXTILE

— ASSETS —

— MILLIONS OF DOLLARS —

TOTAL ASSETS

NETWORTH

Inventory

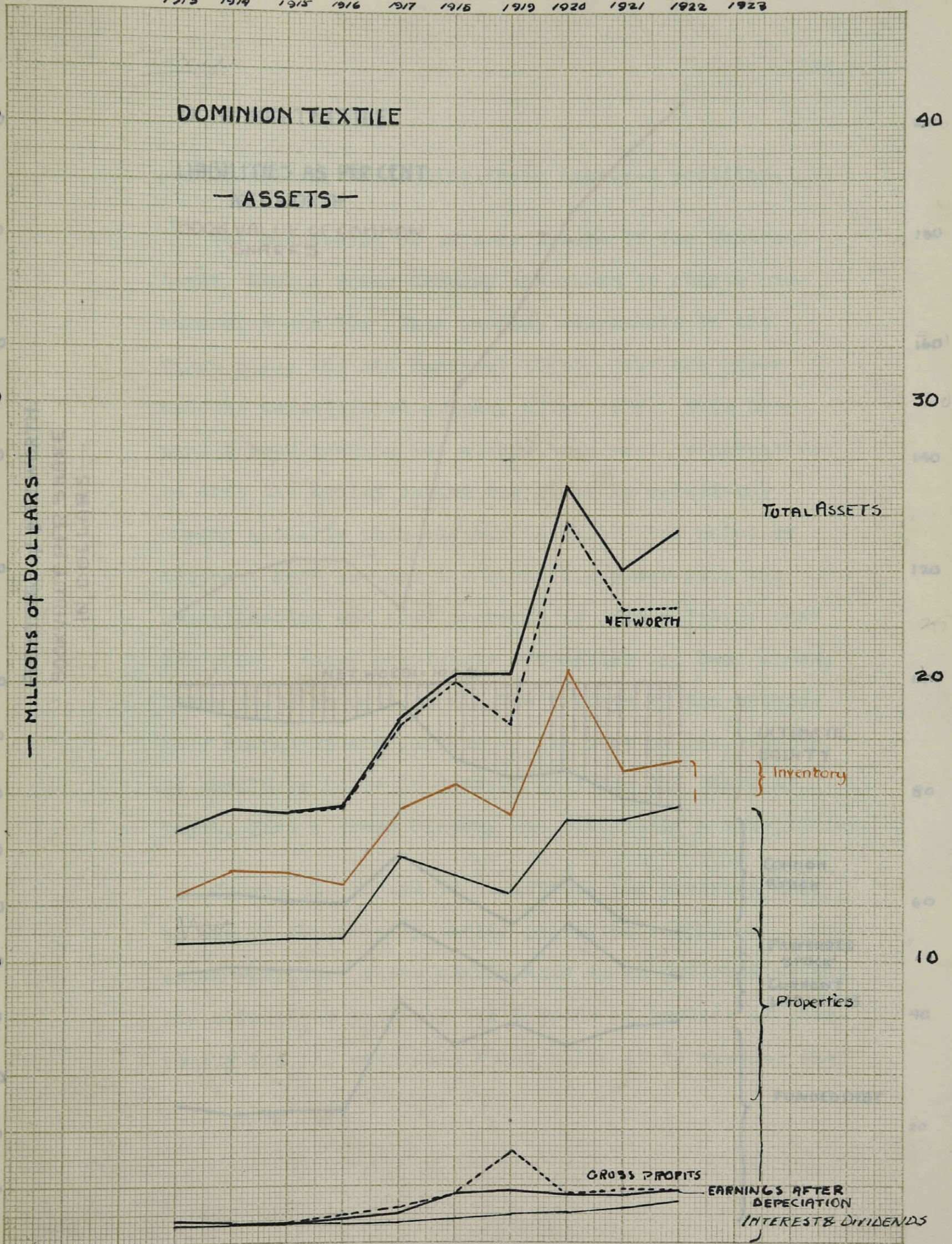
Properties

GROSS PROFITS

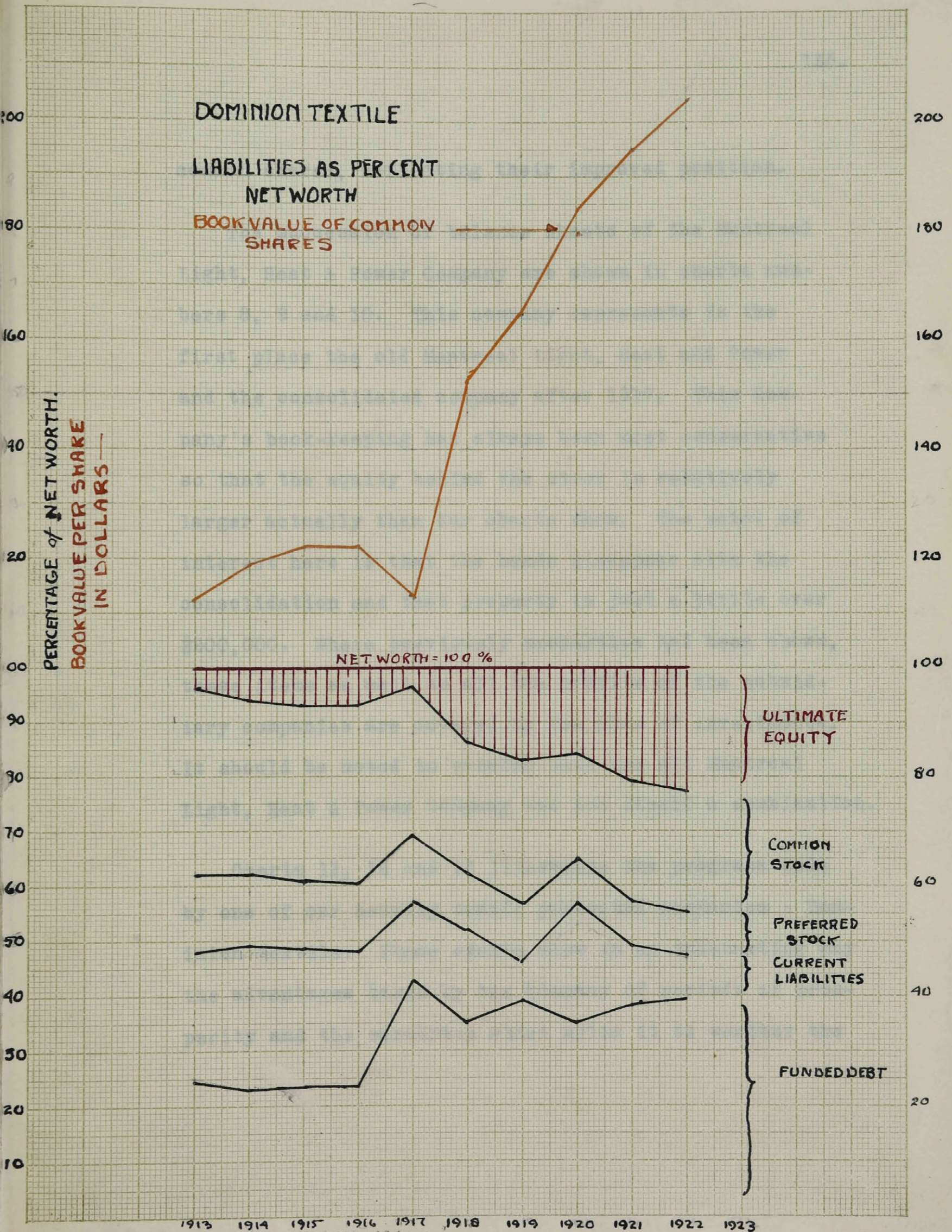
EARNINGS AFTER DEPECIATION

INTEREST & DIVIDENDS

1913 1914 1915 1916 1917 1918 1919 1920 1921 1922 1923







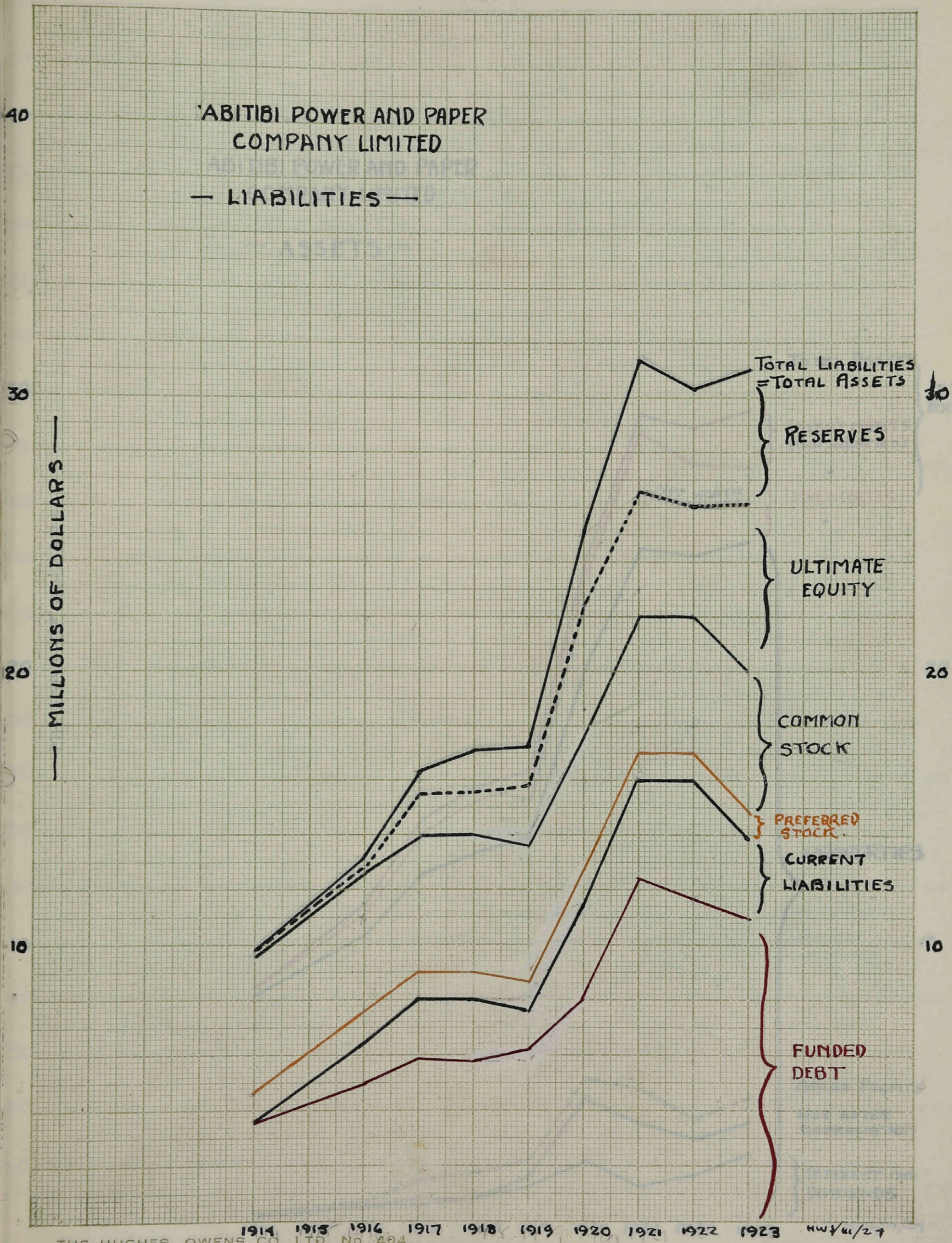


common shares, reflecting their improved position.

The succession of balance sheets of the Montreal Light, Heat & Power Company are shown in charts numbers 8, 9 and 10. This company represents in the first place the old Montreal Light, Heat and Power and the consolidated company after 1917. This Company's book-keeping has always been most conservative so that the equity behind the stock is relatively larger actually than our charts show. The point of interest here is that the bonds disappear with the consolidation and that property is just a little over \$200,000. Where previously properties had been shown, these items as well as all the profits of the subsidiary companies are covered by the item of investments. It should be noted in passing that the old Montreal Light, Heat & Power Company was not itself a combination.

Charts 11, 12 and 13 illustrate the progress made by one of our heavily tariff protected companies - Dominion Textile. These charts show in an interesting way the advantages taken by the Company of periods of prosperity and the resources which allow it to weather the



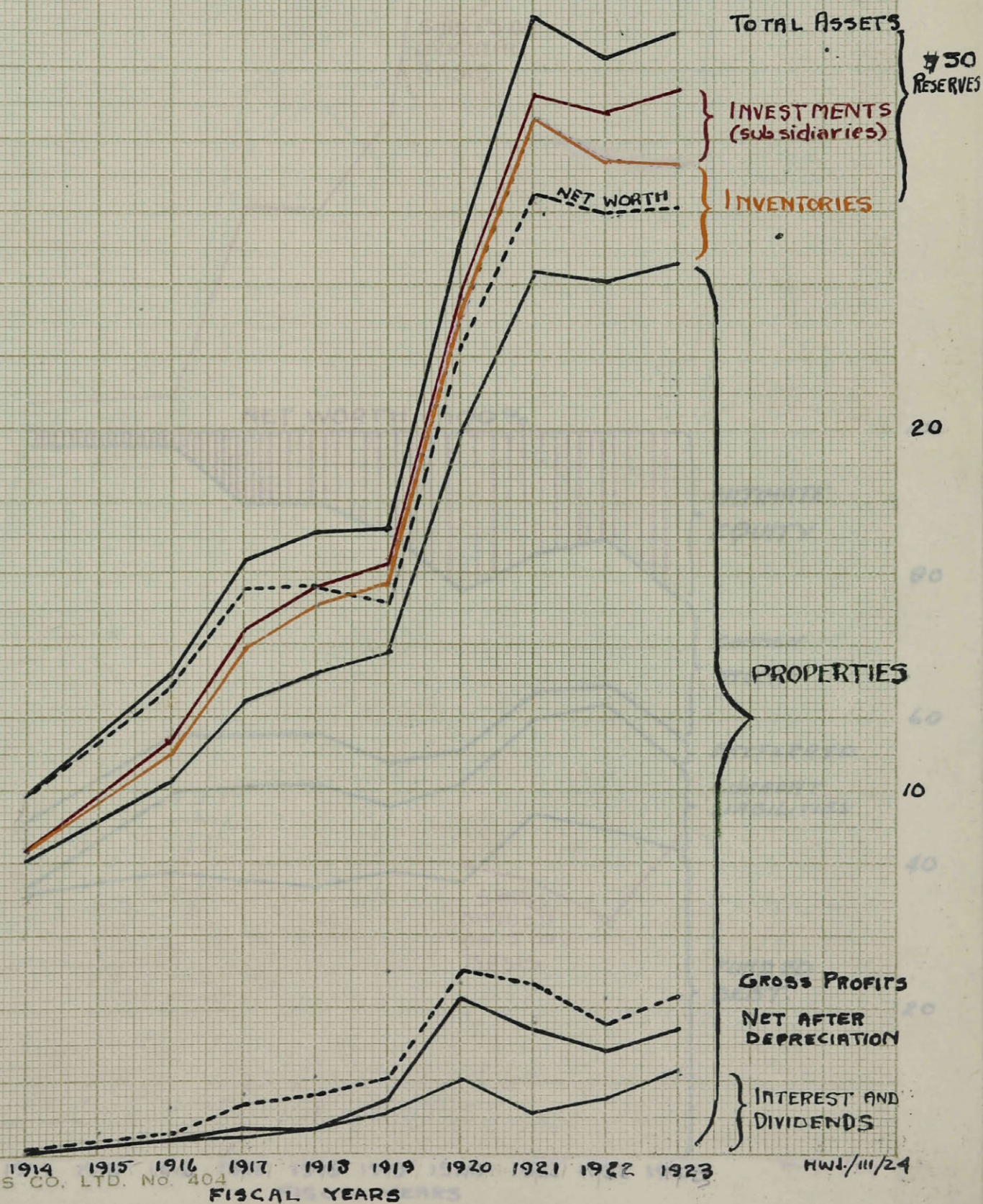




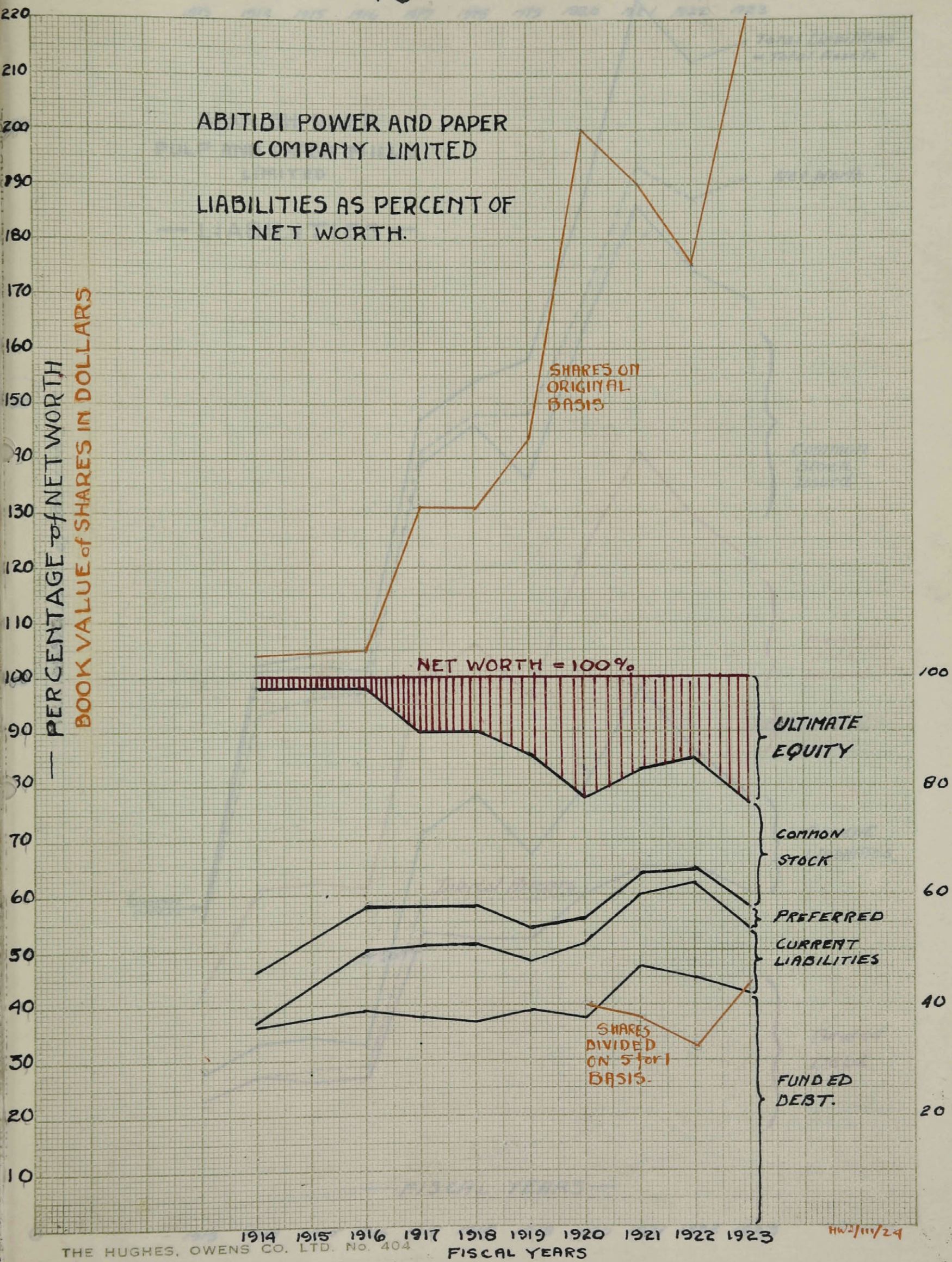
# ABITIBI POWER AND PAPER COMPANY LIMITED

— ASSETS —

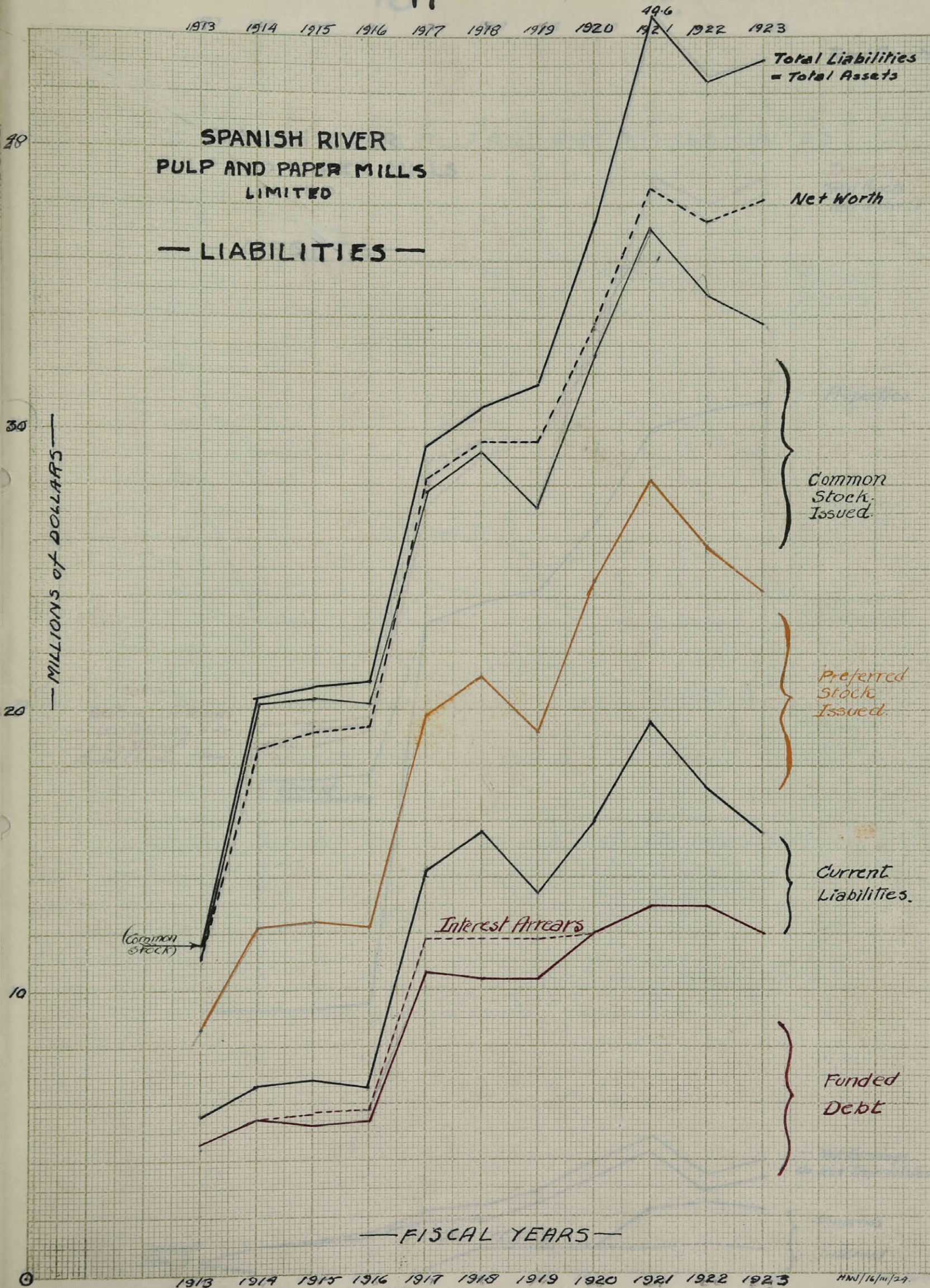
MILLIONS OF DOLLARS



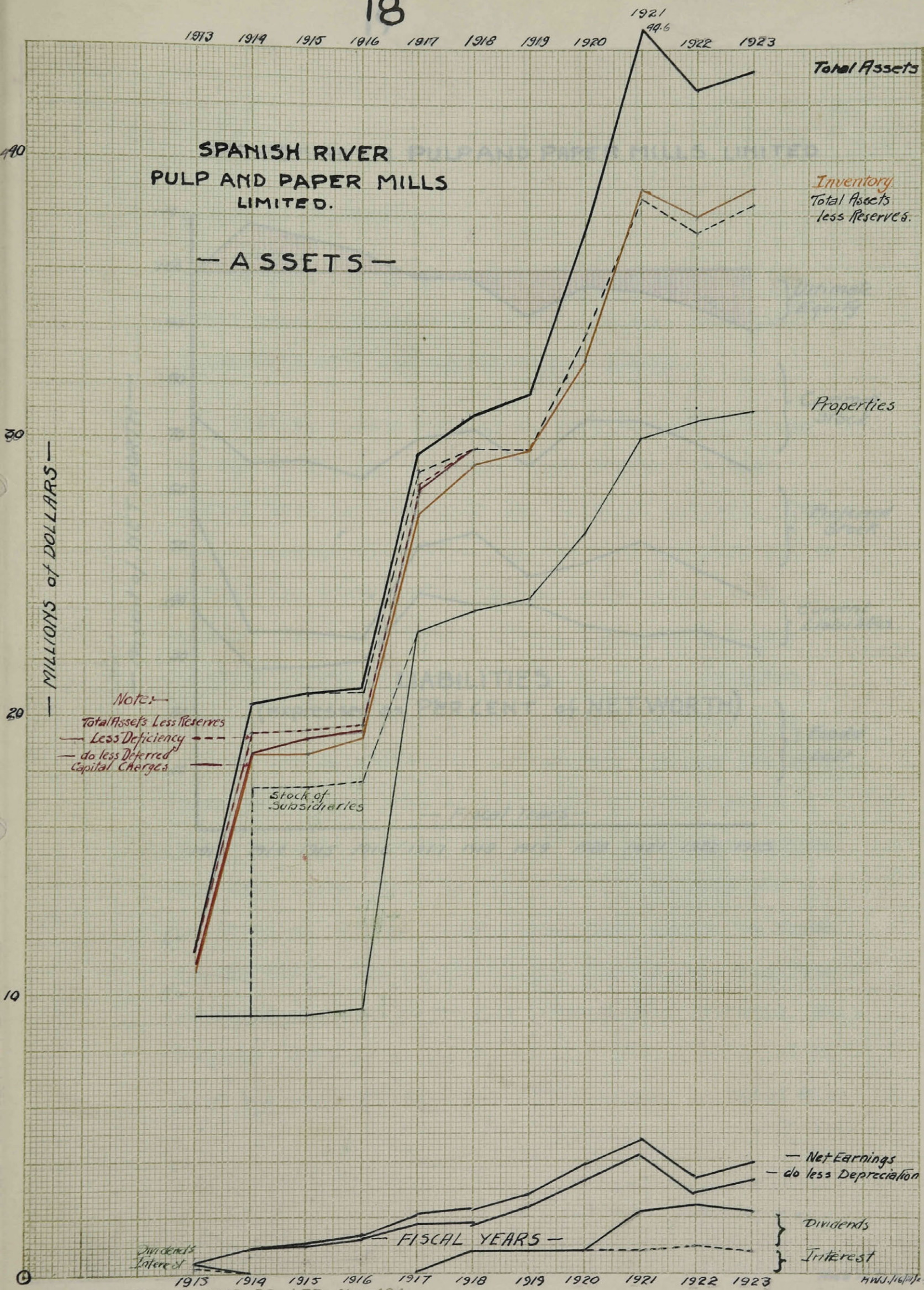






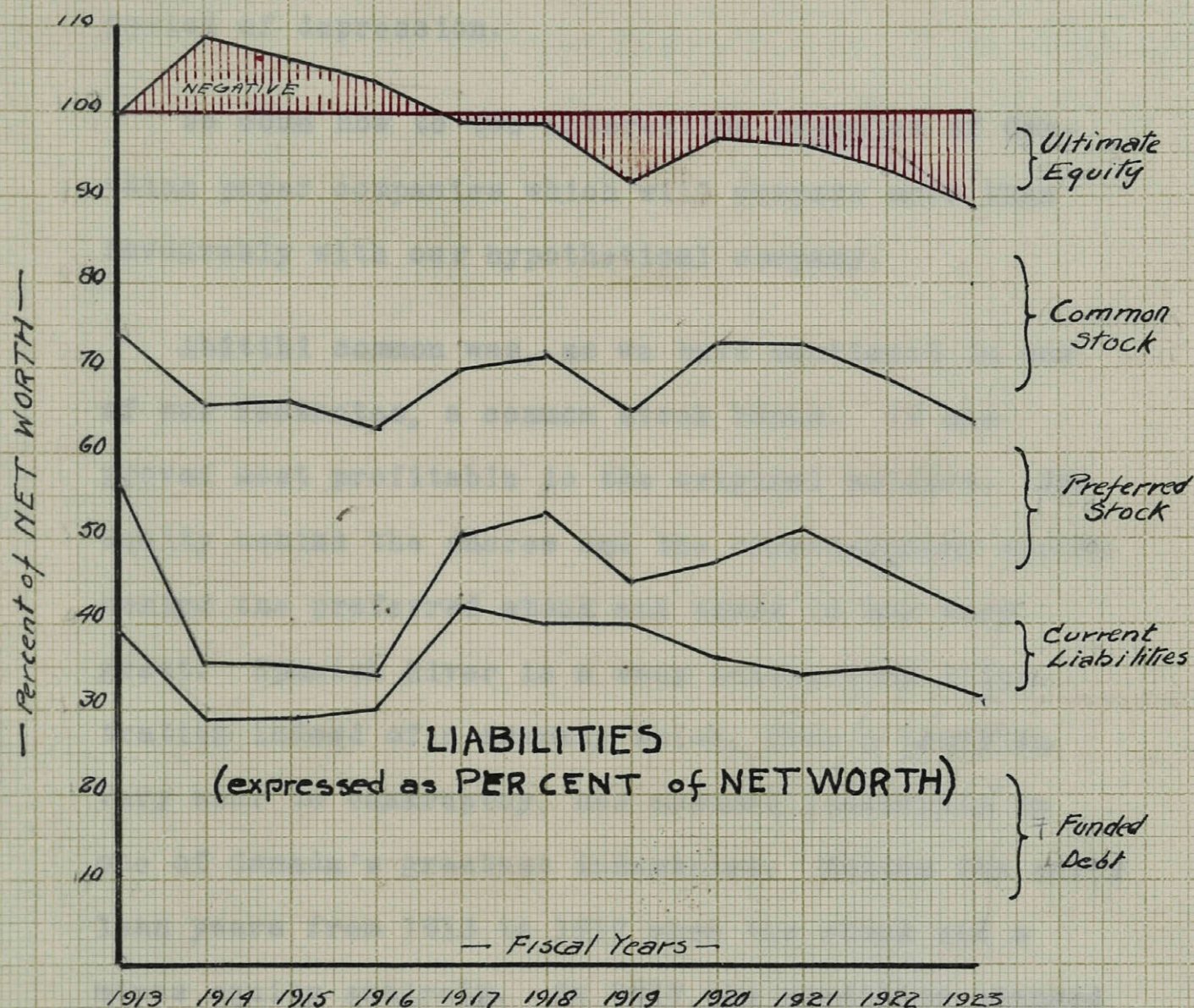








## SPANISH RIVER PULP AND PAPER MILLS, LIMITED





period of depression.

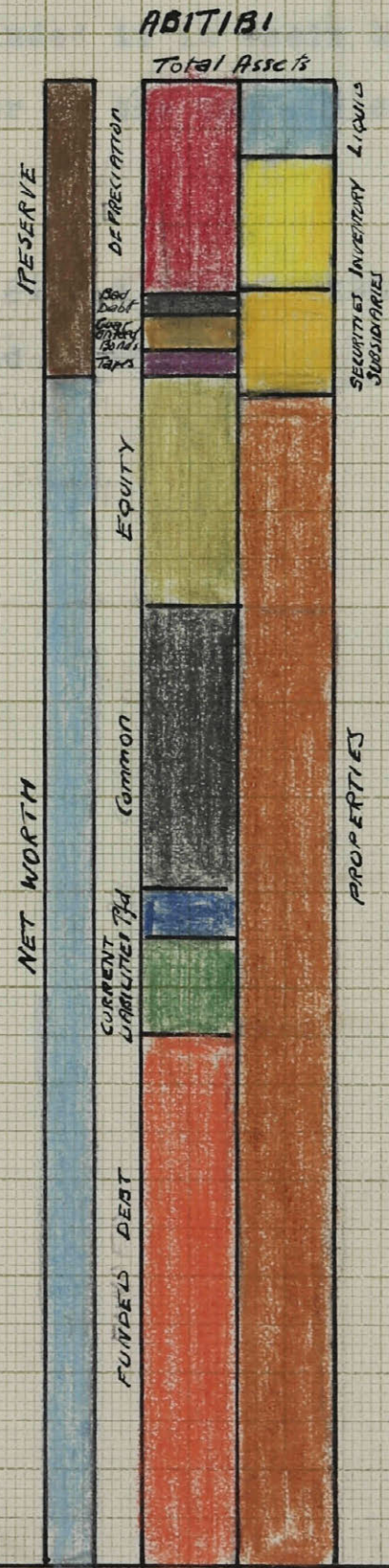
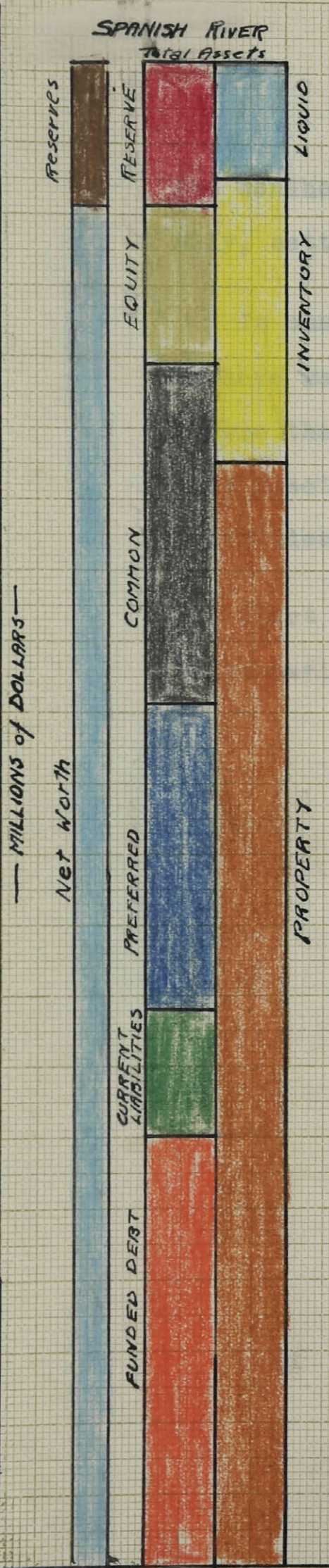
We come now to two interesting examples of Canadian paper companies which will compare more than favourably with our hypothetical company.

Abitibi common was, as we have mentioned in one of our footnotes, a common stock bonus. It has proved most profitable to the original holders. The equity behind the shares and the corresponding equity behind the preferred stock and bonds is now very great. Spanish River is a very interesting illustration indeed of a company which, from a position very near to bankruptcy, has assumed leadership in one of Canada's greatest industries. Notice the early lean years from 1913 to 1917 when the stock had a minus equity entirely. In 1917 the condition changed and from these years to 1923 a steady surplus was built up and during these years, what cannot be shown on the chart, the assets of the company were completely revalued and the properties tremendously improved. This Company, during the period of its difficulties had to pass its bond interest but, after coming to terms with



# COMPARISON OF FISCAL YEAR 1923

SPANISH RIVER PULP AND PAPER MILLS, LIMITED  
 ABITIBI POWER AND PAPER COMPANY, LIMITED





the bondholders, it carried this interest and, finally, settled it to the satisfaction of everyone.

In chart number 18, which shows the assets side, we have superimposed the item of stock to subsidiaries before the Company actually included it in their balance sheet. This gives a broader of the Company's difficulties.

Chart number 20 is added to give a fuller basis of comparison between Abitibi and Spanish River.

## Chapter X.

## IN CONCLUSION.

It is a matter of regret that within the limits of reasonable space it is not possible to discuss further this interesting subject. Examples could be multiplied manyfold, and the fundamental principles alone if fully stated would fill many volumes.

One is confronted in attempting the task, which the writer has in his way completed, with the problem first of all of presentation. In the foregoing it is believed that an original method has been followed, which, if it has necessitated the exclusion of some things relatively important and a great deal that is interesting, has the value, it is hoped, of being more easily readable than the most of textbooks on Corporation Finance.

It may appear that too great a part of the study is devoted to introductory chapters, the connection of which with Canadian Corporation Finance may not be easily

traced. But in this the writer has made concession to his own conviction, rather than to regulation. To him it appears that the method of indirect explanation is by far the more valuable. Corporation Finance is a technical subject, but a full understanding of it comes more easily and more completely by an acquaintance with ideas than it does by an acquaintance with facts. This at least has been the writer's experience.

FINIS.







