

GOVERNMENT CONTROL OF MERGERS

By R. E. COX

A BURNING question in both the United States and Canada is how to prevent over-capitalization of mergers without unduly hampering the manufacturers who desire to combine for economic reasons. The interests of the innocent investor should be safeguarded. In Great Britain, the law compels those who are floating the bonds and stock of a merger to tell the public the actual cash price paid to the original owners of the properties merged. This is found to be beneficial. It should be possible to go even farther, and allow no merger to be consummated until it had been approved by a government commission similar to the Railway Commission.

With this in mind, the reader will find the following article interesting. Mr. Cox possesses inside information concerning Canadian mergers. That he favours publicity and regulation is an indication that the subject is ripe for fuller discussion.

A QUESTION often asked nowadays is, why are so many consolidations or mergers being effected? There would, in a general way, seem to be three principal reasons why so many industrial consolidations have been put through. They are: firstly, the saving in the buying and manufacturing cost; secondly, the saving in the selling or distributing cost; and thirdly, the readjustment of financial conditions whereby most of the principal banks have given up the practice of financing various industrial concerns for an indefinite period, and are making it necessary for them to get their working capital from the public rather than from the banks themselves.

Viewed from a straight business or manufacturing standpoint, there cannot be the slightest doubt that if carried out on the right basis a consolidation in almost any line of manufacturing in a country that is geographically situated as is Canada, cannot but save enormous wastes both in the manufacturing and selling ends of almost every business.

It has been found advantageous to have the manufacturing done in one part of the country, where labour is abundant and cheaper. On the other hand selling cannot be concentrated, but must cover the whole country from ocean to ocean. For example, dozens of clothing manufacturers in Montreal or Toronto, who are each year sending out their travellers to every province of the country, could naturally make a good deal more money if they got together and, instead of each having a traveller to go to every section of the country, have each section of the territory covered by one particular man. Manufacturers who have been in the business for a quarter of a century figure that the enormous expense in handling a corps of travellers has cut right into their profits. The only thing which prevented many of the consolidations that have now been effected being carried through years ago was that the average manufacturer was greatly hampered by a lack of capital.

Then, again, as companies gradually expanded, the banks of the country had to extend their credit, with the result that in time millions upon millions of dollars were tied up in various trade accounts. While the banks were amply secured by the assets of the companies, still they found out that they had so much money tied up in this way that they did not have enough to handle the new business that was being offered to them. It was in this way that the banks themselves at the outset became the prime movers in the earlier consolidations which were effected, and most of them were so successful from a public flotation standpoint that promoters immediately got busy on dozens of other lines of industry, hoping to either be able to dovetail in on the success of previous ones or satisfied that the particular lines in which they were interested would be even better received than the earlier ones.

Most of the money secured by the different public issues has gone towards paying off liabilities to banks, so that the company, instead of being liable to one financial concern, has its liabilities spread out in the form of capital to four or five hundred investors throughout the country.

ONE manufacturer put it to me before he made up his mind to go into consolidation with another rival concern: "Here we are, both of us, with enormous plants both located in the city of Montreal, and we are manufacturing identically the same lines. In order to be in touch with the markets we have warehouses in Toronto, Winnipeg, and Vancouver; we carry between twenty and thirty travellers, working out from the different points, covering almost identically the same terri-

tory and calling on the same customers. You would not have to know the particular line of business that we were in to know that under such conditions there must be enormous wastes, for if we were both managed from the one central office and only had the one warehouse in the principal cities and the one staff of salesmen, on our selling alone we would be saving over \$100,000 a year on sales of a million dollars."

But then, the mere fact that there were benefits to be derived from such consolidations opened the way for people to take improper or unfair advantage of them. Much of the unfair advantage would seem to come from the temptation there is to over-capitalize a consolidation of various companies. It is just because of such dangers that it would be a good thing for the people who are carrying through the right kind of consolidation to have some kind of regulation by government over all consolidations, so that those which are being put through on a fairly reasonable basis might be passed on, while others that do not afford the investor a fair run for his money could be checked before they got as far as the public flotation stage.

Of course, the man who generally carries through the consolidation is the man with imagination rather than judgment. His imagination naturally enables him to figure out that the country is going ahead at a very rapid rate and that on this account he can discount the growth to a very considerable extent. He reasons that the capitalizations which seem very large at the present time will look very modest ten years from now. The great trouble is to figure out just what goodwill in connection with any business is really worth, for while one man may figure it out at about \$500,000, another may come along and show that it is worth nearer a million and a half dollars. Then, again, the goodwill in certain lines of business is naturally worth much more than in others, just as the market for certain products

varies according to the line of goods manufactured. Who is to say just what proportion of water is to be allowed in any consolidation as compared with the actual cash capital? In certain lines of industry the proportion of two dollars of watered capital for every dollar of actual cash would seem to be about the farthest one might go, yet in others, when due appreciation is given to the value of a connection which a company may have built up throughout the country for its product, this goodwill might even permit the insiders to figure that four dollars of watered capital to every one dollar of cash invested would not be outside reasonable proportions.

Another way to figure it would be to take the earnings of the various companies included in the consolidation over a period of three or four years and see what percentages such earnings would show on the proposed capital of the new consolidation. Provided the average earnings showed 6 per cent. or more, with fair prospects of the earnings being increased to a very considerable extent owing to the savings that would naturally be effected, the basis might be considered reasonable. Where, however, it was found that the earnings figured less than 3 per cent., unless there was some special opportunity for greatly increasing the earning power, it should naturally be inferred that the particular consolidation had been over-capitalized.

Numerous as have been the various consolidations which have been effected during the past few years, there is no doubt that, with the manufacturing centres confined mainly to the east and with the great growing markets of the country situated west of the Great Lakes, the next few years will see even a greater number of practical consolidations carried through than have been effected up to the present time. Of course, if they are to be kept within the proper lines, there must be some control either by the Dominion or the province, and the mere fact of there being some Commission to deal with such matters would likely have the effect of making promoters, and even the practical interests behind companies, more careful as to the basis on which they try to put through various deals. Even this tendency to be a little careful would result in the public gradually having greater confidence in them.

THE TRUTH ABOUT DOMINION COAL

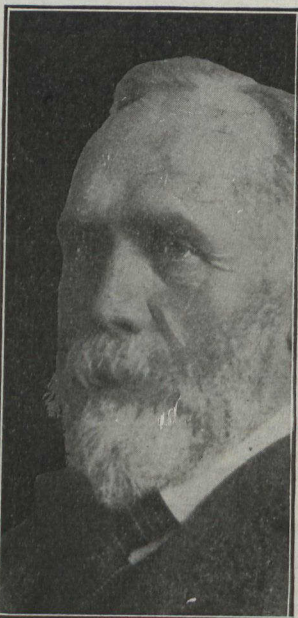
Montreal, 16th September, 1911.

Editor CANADIAN COURIER:

Toronto, Ont.

Dear Sir,—

MY attention has been called to a statement in the financial column of your issue of 19th August last, to the effect that when Dominion Coal Company stock "was selling around 90, shareholders were advised by Mr. James Ross to exchange their coal stock for the securities of the new big Steel Corporation."



MR. JAMES ROSS

Railway builder, coal magnate and general financier. He has had an active career.

... Luckily for Mr. Ross, he got rid of his Coal stock around 95, but the holders of Coal common who have followed his advice are now having the painful experience of seeing their securities selling at about half the price, etc., etc." I think you must have been misinformed regarding this matter, as I did not at any time give such advice, and in justice to myself, I should like you to publish this correction.

If you will enquire into the circumstances attending the sale of 50,000 shares of my Dominion Coal stock in the fall of 1909 to a syndicate that had in view the bringing of the Dominion Coal Company and the Dominion Steel Company under one control, you will find the facts (fully known and canvassed at the time) were as follows:

The offer originally made me for 50,000 shares was *par*, and although I considered the stock worth more I eventually decided, from personal reasons, to accept this offer, but only on condition that the same offer should be made to all the other shareholders. With this condition the purchasing syndicate were unable to comply, because it seemed to them that

it might require more money to finance than they could command, but they put forward as an alternative proposal that if I were willing to accept 95 in place of *par* for my stock they would then make the same offer to all the other shareholders. This arrangement I agreed to, the effect being that I voluntarily sacrificed \$250,000 so that my fellow stockholders might have the same opportunity as I of obtaining cash for their holdings; and you will agree with me that it is rather hard that I should now be blamed for leaving the other shareholders in the lurch when as matter of fact I paid out a quarter of a million dollars to avoid even the appearance of such a thing.

Subsequently, when the basis of exchange into the new Steel Corporation stock, namely, share for share, was promulgated, I was abroad, and although personally I felt that the Dominion Coal Company's stock was worth more than the Steel Company's, I took it for granted that President Plummer had carried out his agreement to submit the question of the relative values of Dominion Steel stock and Dominion Coal stock to their respective auditors, Messrs. Price, Waterhouse & Co., and Messrs. Marwick, Mitchell & Co., and on that understanding I exchanged my remaining Coal stock for Steel Corporation stock; it is now evident, however, that the basis of exchange was not altogether a favourable one for the Coal Company's shareholders.

Yours truly,

JAMES ROSS.

Nine Oldest Members

OF the senior nine members of the House only one Liberal is left, and that is Sir Wilfrid; all the others are from Ontario, and are Conservatives. The order of seniority runs about as follows: Hon. John Haggart, first elected 1872 (unbroken). Sir Wilfrid Laurier, first elected 1874 (unbroken). Dr. Sproule (Grey), first elected 1878 (unbroken). George Taylor (Leeds), first elected 1882 (unbroken). Hon. G. E. Foster, first elected 1882 (broken). David Henderson (Halton), first elected 1882 (broken). Dr. Reid (Grenville), first elected 1891 (unbroken). Colonel Hughes, first elected 1892 (unbroken). W. F. Maclean, first elected 1892 (unbroken).