INTERESTING INFORMATION
FOR
Earners, Savers and Investors

Industry, Thrift, Banking, Insurance, Investments

VALUE OF THE SURPLUS

"The reorganization to come after the war" is one of the nightmare prospects hanging over "business as usual," and most businessmen realize that some sort of reorganization will be necessary. It may be, however, that the reorganization taking place during the war will prove to have taken most of the sting out of any after-effects. The dislocation which came to industry in the midsummer of 1914 was due to the unexpectedness of the war. Had there been two or three years of warning the situation would have been different. If every one interested is putting his house in order in anticipation of trouble when peace is signed, it is not unreasonable to expect comparatively smooth sailing.

There is no doubt that manufacturers and businessmen in general have been obliged to meet unusual problems during the past two years and a half. Most of them would have been considered insurmountable difficulties three three years ago, yet they have been solved without great difficulty. Closer watch has been kept on costs, means of increasing production have been found, materials never before considered have been put to use, ways and means have been multiplied through sheer necessity. Will not this refining process through which business has gone and is still going prove that serious dislocation is not necessary at any time?

An interesting article by W. W. Swanson, Ph. D., in the Journal of Commerce, treats of one phase of business which has been too often neglected in the past in Canada, that of the creation, management and distribution of surplus. This neglect has been the cause of many business failures. Too many corporations overlooked the necessity of assuring stability of dividends and of business, discounting the future in their surfeit of revenue, with the result that they were not able to provide for the lean periods. The necessity for creating and handling a surplus properly is thus defined by the writer:

"During the merger period, 1909-1913, when many large combinations were formed in Canada, most of the assets taken over from the constituent companies, were capitalized at their full value, and hence it may be said that very few Canadian companies, outside of the banks, have acquired a surplus through inheritance. Neither have many corporations in this country, at the time they were consolidated out of the various constituent companies, created any considerable surplus by the sale of stocks and bonds above par. A few corporations have disposed of some of their fixed and semi-fixed assets no longer required in the business, but the sums realized in that way have not generally been set aside and ear-marked for surplus account. In only a few cases, and, notably, in connection with our banks, have surplus funds been built up by the revaluation of assets, or by the bringing into light of concealed assets on the balance sheet. In almost every instance surplus funds have been acquired through the slow, but most desirable process of saving, and it is in that direction that our hopes must be placed in the future for the development and augmentation of surplus funds in connection with the industrial corporations of this country. It may be remarked in passing that the American trusts were in no wise more provident than Canadian industrial combines, with respect to the building up of a surplus, at the commencement of their career. The most notable exception to the general policy pursued is found in the iron and steel concern in which Mr. Andrew Carnegie and Mr. Frick were interested. By following relentlessly the practice of putting back into the business the larger part of the profits earned, Mr. Carnegie built up such a wonderfully productive plant that he was able to sell out to the United States Steel Corporation for $300,000,000 on his own account, as well as for such sums in addition as to make millionaires of many of his associates. The Standard Oil Company is another exception to the general rule that has been followed in the United States, with such results as our readers well know.

A SPECIFIC USE.

"Once it has been determined upon to create a surplus, the next point to consider is the specific use to which it should be put. Should it be regarded mainly as a 'rainy-day fund' to meet emergencies when earnings fall off, to the end that dividends may be maintained, or should it be put back into the business, according to Mr. Carnegie's plan, to increase earning power? Concerning this problem there is much dispute between two opposing schools of thought among economists and businessmen in general. The Cunard Steamship Company, as well as the Hamburg-American Line, have followed the former practice, and have set aside each year a considerable part of their earnings as a sort of insurance fund. The Cunard Company has about one-third of its assets invested in securities outside of the steamship business, the object being to draw upon this fund to make up any deficit that may otherwise occur in years of depression when ocean traffic has fallen off. The theory is that if the surplus is invested over a wide range of high-class securities, it is hardly likely that income from that source will show a corresponding decline with that in the regular business in which the Cunard Company is directly engaged. This policy undoubtedly makes for permanency in the declaring of dividends, but, on the other hand, it is obvious that if the surplus is invested in high-grade securities, a rate of interest is realized not much higher than can be secured at the bank. Moreover, if a company that follows this practice should ever be forced into liquidation, its creditors—the bondholders—would gain at the expense of stockholders, who are entitled to all that the company can make. This undoubtedly is a serious defect in the 'rainy day' theory of the management of the surplus, and explains why most companies either distribute the net earnings above expenses of operation, depreciation and reserve to the stockholders to whom, of course, the whole net income really belongs. This is the policy generally practiced by English corporations, and in a few notable instances—especially by the Pennsylvania Railroad—in the United States. On the other hand, most American and Canadian corporations are convinced of the necessity of building up a surplus whether they translate that belief into practice or not.

STRIKING EXAMPLES.

"The majority of corporations on this side of the water which have enough foresight to create a surplus put it back into the business. The most striking examples in Canada are found in connection with our banks. The Bank of Montreal, the Canadian Bank of Commerce and the Royal Bank of Canada have each accumulated large surplus funds, which they have reinvested in the ordinary business of banking. This has given the three institutions mentioned a commanding position in Canadian finance, and has placed them, indeed, among the strongest financial corporations in the world.

"It is evident that if a surplus is merely turned back into the business, earnings are made more stable and dividends kept at a steady level, or at least made more uniform. In behalf of this practice it may also be pointed out that no individual could hope to make as good use of his share of the surplus fund as the corporation can do for him.

A STOCK DIVIDEND.

"The corporation, however, may decide to declare a stock dividend to the end that it may itself retain control of the surplus, but distribute to stockholders all the earnings. As has often been pointed out, stock-watering is quite a different matter from over-capitalizing a company. There is no valid reason why a corporation that can pay eight per cent on each $100 par value of stock should not issue two shares on which it will pay a four-per-cent dividend. It is sometimes forgotten, however, that this may be very desirable from the stockholders' point of view, because two shares at four have a greater speculative value than one share carrying an eight-per-cent dividend."

BUSINESS OF THE STOCK EXCHANGE

Stocks are the paper representatives of transportation, industrial, mining, commercial, and other properties. The stock exchange is an organization of professional traders or brokers, which conducts speculation and investment in these securities. The chief functions of the stock exchange are to provide a wide, permanent, and at all times, available market for the sale of stocks, bonds, and other securities, and to establish the market or current prices for such securities based upon the best available information.

The stock exchange is in reality the primary market for capital, and that in New York has been admitted to be the most important financial institution in the world. There from day to day, and hour to hour, during session, is registered the average of the best expert opinion as to what properties are worth. The stock exchange of London, England, is about 200 years old, and still holds first place among the exchanges, in that securities listed and traded in there represent a larger par value, more international interests, and a wider range of national, state, industrial and other corporate securities throughout the world. This exchange has occupied the present quarters one hundred and fifteen years, and has a membership of about 6,000, while that of Paris is but 70, and New York 1,100.

A membership in the Paris Bourse is worth $400,000, while the same privileges in New York's exchange range from $30,000 in dull times to $90,000 when trading is active.

For the ten years ending 1912 the average annual sales of stocks amounted to 196,500,000 shares, with a par value of about fifteen and a half billion dollars, and the average sale of bonds about $800,000,000.

Quotations on the stock tickers, found in brokers' offices, banks and elsewhere in all large cities, and brokers' offices throughout the country, are furnished by attendants to telegraph operators stationed on the floor of the exchange and a few minutes after a transaction has occurred on the floor the name of the security and the price may be read in Boston, Philadelphia, Chicago, Denver, San Francisco and London, Ont.

Evidence of the trading which warrants maintaining high rent offices, private telegraph lines and other heavy overhead expenses, is rarely seen in the offices. The large traders are never "seat warmers," as the bulk of the office frequenters are known in New York and Chicago. Their business is privately given over the phone or by letter, and such orders are never alluded to by the attendants in charge of filling same on the exchange.

Some of the largest traders in New York are very rarely seen even in the vicinity of Wall Street. Large fortunes are won and lost in the stock market every year, but losses are more often made by timid traders, with thin purses and a restricted credit at their bank, coupled with an intense desire for gambling movements. The intrinsic value of a security or its great earning possibilities and future enhanced value by development has little interest for the nervous, erratic trader. He never buys for investment, consequently is always acting in properties he knows little about other than that they are active and frequent fluctuations offer better chances for quick profit. This class of trading pays the commission house the same as any other, but is not nearly as satisfactory in that it takes more attention and necessitates closer watch on margins.