ABOUT WATERED STOCK

What It is and How It Works — New Legislation Suggested by David S. Kerr

The question of watered stock has been much in evidence recently in connection with the discussion of the new business tax. Very opportune, therefore, is the application in the report on the cost of living, just issued by the federal government, of a statement on the subject by Mr. David S. Kerr, a well-known and practical chartered accountant, and a lecturer on higher accountancy at McGill University. Mr. Kerr says:—"Watered stock is the proportion of the capitalization of the company which is not represented by bona fide assets. For instance a piece of land is worth $50,000. A corporation gives $100,000 of its capital stock for this land. There is then watered stock to the extent of $50,000 in the capitalization of the company. A company buys the businesses of three concerns for purposes of consolidation, a fair and reasonable value of the assets, business and goodwill of these concerns being $1,000,000. If the new company gives capital stock of the par value of $2,000,000 for these, then there is $1,000,000 of watered stock.

Law Not Complied With.

"As under the companies act, it is provided that no watered stock be issued and as frequently it is admitted that the capitalization of certain corporations is 'watered', the conclusion is that the intent of the law has not been complied with, although nominally the law has been complied with. This is usually accomplished by means of contracts which provide for the transfer of businesses or assets in exchange for securities (bonds, preferred stock, common stock) of the corporation acquiring the assets of a total par value far in excess of actual values. Thus the transaction is 'legalized'. But from a practical standpoint, there is no difference between this method of issuing securities and the issuing of stock at a discount, which would not be permitted.

"Economies in management by way of reducing the cost of production, due to efficiency, centralization, standardization, saving in freight, etc., certainly have nothing to do with the question of capitalization. These matters are surely ordinary business considerations. Any concern willing to pay fair remuneration can produce the best available general manager and others to operate its undertaking. Good management obtains in many plants, whether capitalized on an inflated basis or not. Any other situation is bad management pure and simple, and has nothing to do with capitalization.

Does Not Increase Earnings.

"The mere fact that a corporation is over-capitalized, will not, of itself, mean increased profits. If for every dollar of watered stock included in the capitalization there were additional profits in respect thereof, what sane person would fail to adopt the policy of watering stocks? It is too evident that it does not increase the earnings to the extent of one dollar, and therefore reflects no increase in the cost to consumer.

"Take the case of a reconstruction where the new capitalization does not include any watered stock as did the old. Does this mean that the future profits are reduced? Certainly not.

"Watered stock is an objectionable element in the capitalization of corporations. It does not, however, in any way affect the cost of living.

New Legislation Suggested.

"The question now arises, is it feasible to legislate so that the government can pass upon the capitalization of corporations? Might this not be construed as a government approval of the soundness and reasonableness of such capitalizations? This would appear to be the natural impression. Further, why should the government have any say as to the detail of capitalizations? The concern of the government must surely be confined to insisting upon all published balance sheets of corporations showing clearly and separately what amount, if any, of the capitalization is represented by intangible assets such as goodwill, patent rights, franchises, organization, and such like, and upon what basis the amount has been arrived at. If this be provided for by new legislation, it will be a great advantage to both stockholders and public, who could then form a better judgment as to the relative values of the securities, and in addition the government would then be able to prepare intelligent reports regarding the finances of the various industries in the Dominion."

RUSSIAN TRADE

A reprint of the valuable reports on Russian trade by Mr. C. F. Just, Canadian special trade commissioner, has just been issued in pamphlet form by the department of trade and commerce, Ottawa.

A useful economic map of the Russian Empire has been sent out in this country by the Export Association of Canada, Limited, on behalf of Messrs. R. Martens and Company (Inc.), 24 State Street, New York, who have not a Canadian office yet.

SIXTY-SEVEN FIRE COMPANIES CEASE BUSINESS

Practically all of the 67 fire insurance companies, who have been doing business in South Carolina, have withdrawn from the state, because of the anti-compact law that went into effect recently. Policies now in effect will not be cancelled, it is said, but no new business will be written while the law is in force, say the insurance men. The decision to withdraw from the state was reached by the insurance companies at a meeting in New York.

The new law in South Carolina, says a Columbia dispatch, prohibits the organization of fire insurance companies to maintain uniform charges or rates in the state. The insurance men also object to another law that went into effect March 1, imposing an annual license fee of $25 on agents for each company they represent, and taxing single agents 4 per cent. on all premiums paid in to them.

Insurance commissioner McMaster has appealed to the federal government for an investigation. This, it is said, the companies will welcome. The joint action of the insurance companies in refusing to write further business in South Carolina practically ties up the insurance of the state, and to bring relief there is a movement on foot for the repeal of the law. Kentucky and Missouri have both been through fights with the fire insurance companies, and these states repealed the radical legislation and appointed commissions to frame insurance codes.

WILL BANKS HELP TO COLLECT NEW TAXES?

The question of using the services of the chartered banks in the collection of the new tax on business profits came up in the House at Ottawa last week. Sir Thomas White promised to consider the point.

Mr. Robb asked the finance minister if he proposed to collect the taxes through a special staff to be organized in the department of finance. The work, he thought, could be done more economically by using the chartered banks of Canada. "They have branches in pretty nearly every place where business is conducted," said Mr. Robb, "and of course the minister could collect the taxes and get reliable information very much more cheaply than by a special staff engaged for the purpose and which it would be pretty hard to get rid of at the end of the three-year period."

Sir Thomas White thought he would have to have his own officials. "I do not believe it would be advisable," he said, "to delegate to the officers of a bank the assessment of the different businesses. Judgment must be exercised, and we must have the principle of responsibility as between the official and the minister, as between the minister and the government, and as between the government and parliament. It is not like an automatic process of merely receiving money; it is a matter of making assessments, exercising judgment and discharging responsible duties. I do not believe we could devolve it upon any institution even as capable as the chartered banks."

Mr. Carvell supported the suggestion of obtaining the co-operation of the banks. Sir Thomas said he would be glad to consider the suggestion, but he thought "the banks might raise the very reasonable objection that they could hardly be expected to give us information in regard to their clients."

Mr. Carvell said:—"I think the minister should take power in the act to go to the banks and get that information. I can quite understand that in the absence of authority the banks might very properly say, 'We do not like to give away information regarding our clients,' but the minister should take every possible means of obtaining this information, and I know of no way in which he could get it as rapidly as from the banks."