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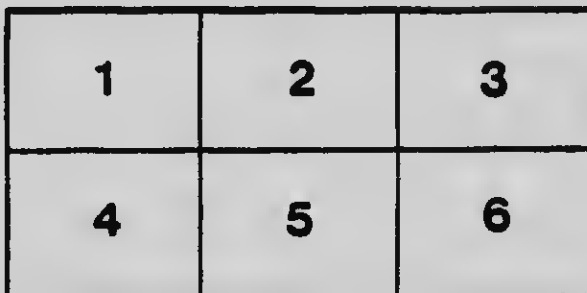
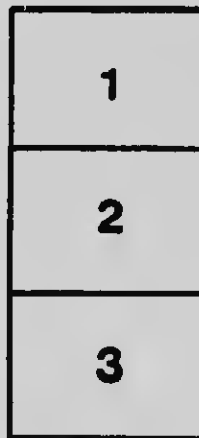
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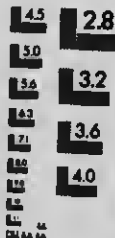
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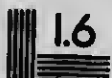
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# ECONOMICS



## LESSON 6



By

SEDLEY ANTHONY CUDMORE, B.A. (Cxon.)

Lecturer in Economics, University of Toronto



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# ECONOMICS

## LESSON VI.

### Large Scale Production: The Limited Liability Corporation.

**I**N the last lesson we discussed the rise and the present position of Canadian manufacturing industries. In this lesson we shall deal in detail with the great tendencies which are apparent in the new type of industry.

In the first place, we find that everywhere in manufacturing what is called large scale production is on the increase. The large establishment is absorbing the trade of the small one.

#### In Agricultural Implements.

This tendency may be illustrated from the case of agricultural implements. We find that in 1901 there were 114 establishments manufacturing agricultural implements in Canada, with a total product of \$9,597,389, or a gross average product of \$84,187 per establishment. In 1906, 88 establishments had a gross product of \$12,835,748, or \$145,860 per establishment. There were 26 fewer establishments in the later year, but the product had increased by more than \$3,000,000. This change in so short a period is rather remarkable.

#### In the Cotton Industry.

Again, take the cotton industry, also dealt with in the last lesson. The number of mills in 1906 was the same as that in 1901—20—but the product had increased from \$12,033,052, an average of \$601,653 per mill in 1901, to \$14,223,447, an average of \$711,723 per mill in 1906. This comparatively short period of five years has been selected because before 1901 Canadian censuses were not taken on

a basis which furnishes figures for such a comparison. In the United States, however, the figures are comparable, and we notice that in 1850 there were 1,094 establishments, with a product of \$61,900,000, an average product of \$56,581; in 1905 there were 1,154 establishments, with a total product of \$450,500,000, an average of \$389,948. In other words, the average establishment of 1905 turned out nearly seven times as much work as that of 1850.

### In Iron and Steel.

The great American iron and steel industry shows the same condition of affairs. In 1850, 468 establishments had a total product of \$20,400,000, an average of \$43,589. In 1905, 605 establishments turned out products of \$905,900,000, an average product of nearly \$1,500,000 per establishment, a figure more than 30 times as great as in 1850.

The tendency towards large scale production evidenced by statistics could be shown to exist in any of the large manufacturing countries of the world. Everywhere during the past half-century in the great manufacturing industries, the size of the individual establishment has been increased, and production, thus concentrated, has come under the control of fewer and more expert "captains of industry" or "entrepreneurs."\*

### In Transportation.

Nowhere has large scale production been more successful than in transportation—for the transportation agency, as we have seen in Lesson 2, is a producer of place utilities. The progress of large scale production is clearly shown by the gradual incorporation of Canadian railways into the three great systems—the Canadian Pacific, the Grand Trunk (and Grand Trunk Pacific), and the Canadian Northern. There were once many small, independent lines

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\*Prof. Bücher, a distinguished German economist, states that the number of employees in establishments having over 50 persons employed increased from 26.3% of the total number of employees in the nation, in 1882, to 36.3% in 1895, and 45.5% in 1907.



of railway both in Canada and in the United States, but these have gradually fallen into the hands of a few great systems. Greater economic efficiency is the result. The large scale concern can use one of its lines to feed another. It can, like the C. P. R. and the C. N. R., organize great steamship services to feed its railway lines and advertise its route and its attractions throughout the world in a way that would be impossible for a smaller enterprise. Thus to-day the C. P. R. has a continuous service from Liverpool to Hong-Kong, each part of which acts as a feeder of the others.

Our individual experience also leads us to this conclusion. We have already seen how such great companies as the Massey-Harris Company and the International Harvester Company have superseded the small local agricultural implement manufacturers in Canada and the United States. In business we see the growth of the departmental store, or the growth of the group of stores controlled by one person or one company, like those of the William Davies Company in Toronto and its environs. Generally it seems that large scale production is on the increase.

### **Growth of Large Scale Production in Canada.**

Our conclusion is opportunely corroborated by the results of the Canadian census of manufactures of 1911, when compared with those of 1901. From these it appears that in the year 1900 the number of manufacturing establishments in Canada was 14,650; in 1910, 19,200—an increase of only 31.12 per cent. The product, however, increased from \$481,053,375 in 1900 to \$1,164,775,532 in 1910, or 142.13 per cent.—a magnificent showing. Dividing the total product in each year by the number of establishments in that year, we find that in 1900 the average product of a manufacturing establishment was \$32,836; in 1910, \$60,637—an increase of 84.6 per cent. In other words, the average product of a Canadian manufacturing establishment has nearly doubled in the comparatively short period of ten years.

### Many Establishments Under one Control.

While this is the case, we must remember that to-day the business unit in many industries is much larger than the single establishment. The Canada Cement Company, for instance, controls from its head office in Montreal the business of various manufacturing plants in different parts of the Dominion. The Massey-Harris Company has also different establishments under its control, as have many great American companies, such as the Standard Oil Company and the United States Steel Corporation or Steel Trust. The concentration in business, therefore, is not to be thought of as fairly represented by the increased size and product of the single establishment alone. Accompanying the tendency to larger production in the individual establishment, there is also the tendency, even greater and more significant, to the grouping of many establishments under one central control.

### Advantages of Large Scale Production.

The next question is the cause of this business concentration. As people usually go into business in order to make money, it may be assumed that any phenomenon so widespread as that of large scale production and the concentration of business implies an economic gain to the producer—the business man. Let us now see where that gain accrues.

#### Economy in Plant.

In the first place, it is a familiar fact that in most industries an increase in the size of the plant reduces the cost of manufacture per unit of product. The value of the site which the manufacturer uses is the same, whether the building he occupies is of one storey or six. The cost of buildings necessary for sheltering machinery and employees is proportionately less in larger plants. The manufacturer can also obtain his motive power more cheaply if he uses a large quantity of it. Thus, in the contracts en-

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tered into between the Ontario Hydro-Electric Commission and the various municipalities which are using Niagara power, it is provided that an increase in the amount of power used by the municipality shall be accompanied by a reduction in the rate per horse-power. The reason is simply this: the line once built, extra power can be transmitted at a comparatively small cost.

So, too, in the case of steam. "Both for first instalment and for running expenses," says Taussig, "a large steam engine costs less for each horse-power than a smaller one; which means economy if the establishment is large enough to utilize all the power supplied."

### Economy in Labor

Large scale production is also economic and efficient in its utilization of the forces of its employees. It can keep one man doing one thing all the time, while in a smaller shop he might not find enough to do in that particular branch which suited him best, and might thus have to pass from one kind of work to another at a considerable sacrifice of time and of dexterity. The subdivision of tasks in each employment—such as in the modern shoe factory—is now often called the complex division of labor, to distinguish it from that division of different occupations which is characteristic of the earlier part of the economic history of our country. "In a clothing or in a boot factory," says Marshall, "a person who sews, whether by hand or machinery, just the same seam on a piece of leather or cloth of just the same size, hour after hour, day after day, is able to do it with far less effort and far more quickly than a worker with much greater quickness of eye and hand who was accustomed to make the whole of a coat or the whole of a boot." There we have the reason why ready-made clothing is so much cheaper than custom-made. The United States Department of Labor estimates that there are 84 distinct processes in the manufacture of men's brogan shoes.

Another most interesting example of the division of

labor possible under the system of large scale production is quoted by Professor J. R. Commons as occurring in the great Chicago packing houses. "It would be difficult," he says, "to find another industry where division of labor has been so ingeniously and microscopically worked out. The animal has been surveyed and laid off like a map; and the men have been classified in over thirty specialties and twenty rates of pay, from 16 cents to 50 cents an hour. The 50-cent man is restricted to using the knife on the most delicate parts of the hide (floorman) or to using the ax in splitting the backbone (splitter); and whenever a less skilled man can be slipped in at 18 cents, 18½ cents, 20 cents, 21 cents, 22½ cents, 24 cents, 25 cents, and so on, a place is made for him and an occupation mapped out. In working on the hide alone there are nine positions, at eight different rates of pay. A 20-cent man pulls off the tail, a 22½-cent man pounds off another part where good leather is not found, and the knife of the 40-cent man cuts a different texture and has a different 'feel' from that of the 50-cent man. Skill has become specialized to fit the anatomy.

"The division of labor grew with the industry, following the introduction of the refrigerator car and the marketing of dressed beef, in the decade of the seventies. Before the market was widened by these revolutionizing inventions, the killing gangs were small, since only the local demands were supplied. But when the number of cattle to be killed each day increased to a thousand or more, an increasing gang or crew of men was put together; and the best men were kept at the most exacting work." This illustrates the advantage secured by so dividing work that expert labor is employed only where necessary, while cheaper labor is used wherever possible.

### **Economy in Supervision.**

Furthermore, by large scale production the expense of oversight is reduced to a minimum. One superintendent and one foreman can direct the industry of a larger number of men than are actually employed in a small estab-

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lishment; one timekeeper, one watchman, and one engineer can usually serve a large establishment as effectively as a small one. Men must be employed in all these capacities in a factory of even moderate size, hence the advantage of distributing their cost over as large an amount of production as possible. At times when competition is keen, such economies as these may make to a business all the difference between success and failure.

### **Economy in Buying and Selling.**

In buying and selling also the large scale establishment usually works to better advantage than the small. It can buy in bulk the raw material necessary for its business, and thus secure it at a price lower than that charged for small orders. Its very size and the strength of its financial position enable it to survive a crisis which would wreck a weaker firm. It does not have to put its product on the market at an unfavorable time. It can manufacture for its stock, store its goods and dispose of them only when conditions have come back to normal.

With all these natural economic advantages, it is no wonder that the large scale establishment has to a great extent superseded the small scale firm in the industry of the country. This is generally the case, even when the legitimate advantages of which we have spoken are not reinforced by illegitimate and monopolistic control of the market. Yet this increasing predominance of large scale production is not without its exceptions—those exceptions which prove the rule. Of these the most important is agriculture.

### **Agriculture the Great Exception to the Rule.**

The United States Statistical Abstract for 1911 shows that, while in 1890 the area of the average farm in the United States was 136.5 acres, in 1910 it was 138.1 acres—practically the same. In Canada during the same period the average area has probably increased, owing to the opening up of the West, where farms are larger than in the

Eastern Provinces. But even in the farms of the West we do not find the same general tendency to large scale production as in the industries of the cities. A farm employing ten men would be considered a very large farm, but a factory with that number is certainly a small factory. And the tendency, as was shown in Lesson IV., is for the labor force on farms to decline rather than to increase in numbers.

There have been large farms in the history of the American continent—the plantations of the Southern States and the "bonanza" wheat farms of the West. But the former have passed away, and the latter are, in the majority of cases, being broken up into smaller areas. This large scale production in agriculture is found usually where the land is quite unused and where one crop—wheat or rice or cotton or sugar—can be grown on the same soil with very little cultivation year after year. When the fertility of that soil becomes exhausted it is abandoned, new soil is taken into cultivation, and the same methods are applied to it. Large scale cultivation is profitable only as long as the soil can be thus "mined," as it is called. When it no longer responds to this treatment, but requires to be "nursed" and treated with fertilizers, then it is to the public interest that it should pass into the hands of some small proprietor who will farm it carefully with a view to its permanent value.

"The magic of property," it is said, "turns deserts into gardens." If a man feels that a piece of ground with all its potentialities is his very own, he will put an enormous quantity of labor and thought into its improvement and cultivation. On the plantation or the "bonanza" wheat farm, the actual cultivator does not feel this passion of ownership, and the manager cannot know as well as the actual cultivator the characteristics of each field and for what crops it is best fitted. Further, the superintendence of a large farm is a very difficult piece of business, since the activities of the establishment are spread over such a large area and are so varied in their character.

On the farm, then, large scale production has not on the

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whole increased, because it is usually inefficient and uneconomic—and especially so after the country becomes at all well settled, since it is no longer impossible for the owner of the large scale farm to exhaust one piece of soil and move on to another. In some sections of the country, where large tracts of land were once carelessly farmed, the soil has become exhausted and full of weeds, and will respond only to careful and fairly skilful cultivation. Hence these large farms are being broken up into smaller holdings and what is known as "intensive" farming—the careful, scientific cultivation of a comparatively small area—is on the increase.

### **Retail Stores a Partial Exception.**

Somewhat similar to the case of agriculture is that of the small retail store, which often survives obstinately in spite of the growth of departmental stores and of great mail order establishments. The reason for its survival is, perhaps, somewhat similar to that for the survival of the small farmer. Just as the latter knows better than anybody else his land and its capabilities, so the former knows his locality and his individual customers better than the great storekeepers can know them. He goes to the same church and the same lodge as they do, he understands their individual likes and dislikes, and adapts his goods to their individual tastes. And since the personal element still counts for a good deal with the average retail customer, so the retail merchant who has this hold on the customer manages to survive in a competition where most of the great economic advantages seem to be on the side of the departmental store. The small grocers in the residential districts of cities survive because they are more conveniently situated for the customers and study their tastes more than can the departmental stores.

### **Conditions of Large Scale Production.**

In general, as we have seen, though with a few important exceptions, large scale production has been gaining ground on small scale production. For this large scale production

to arise, certain primary conditions are requisite. There will, of course, be no possibility of large scale production unless there is a considerable demand for the commodities in question. This goes without saying. A condition not so obvious, but just as essential to large scale production is a large investment of capital. In some cases the investment required is enormous.

For instance, an expert witness told the United States Industrial Commission that to equip an up-to-date iron and steel manufacturing plant large enough to secure the economic advantages arising from the division of labor would require an investment of from \$20,000,000 to \$30,000,000. Who is there that has so much money to invest? And would such a fortunate individual be likely to risk the loss of his great possessions by investing all his capital in a single steel plant which might well be undersold and ruined by an even more gigantic body, such as the United States Steel Corporation?

### Limited Liability Companies.

The enormous investment of capital required by modern large scale production is then rarely, even in these days of millionaires and multi-millionaires, provided by one or even by a few persons, though a small group of persons may undertake to finance the concern, *i.e.*, advance the necessary funds, trusting that the public will buy stock later. The great manufactures, the great transportation lines of to-day are operated by joint stock companies, often with thousands of shareholders. The Standard Oil Trust, for example, had at the time of its so-called dissolution, when its affairs came into the limelight, about six thousand shareholders. The Steel Trust has, I believe, a much greater number.

### An Expanded Partnership.

These joint stock companies are a sort of expansion of the older partnerships. We all understand that three or four men may join their resources and go into a business together. Some of them may be silent partners, simply in-

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vesting their money and receiving periodically a share of the profits earned or sharing the losses incurred. Others may be active partners, receiving a salary for their personal services as well as sharing in the profits or losses. Now, if such a partnership business goes into bankruptcy, perhaps through the defalcation of one of the partners, each of the other partners is liable to the full extent of his property if so much is needed to satisfy the creditors of the concern. This is what is called an unlimited partnership. No matter how many partners are in a concern, every partner is liable for the full extent of the concern's liabilities. Until modern business methods arose in the nineteenth century, it was rarely that the Government allowed the shareholders of a business enterprise any limitation of liability.\*

### **An Unlimited Liability Corporation**

What this theory leads to when applied to corporations doing a modern business is illustrated by the case of the City of Glasgow Bank, which failed with enormous liabilities in 1878. (This failure is well described in Sykes' edition of "Gilbart's History, Principles and Practice of Banking," Vol. II., pp. 364-390.) At that time three of the older Scotch banks were under the system of limited liability, the other banks of Scotland under unlimited liability—that is, every shareholder, just like a partner in an ordinary business, was liable to the full value of his property for all liabilities of the bank. When the City of Glasgow Bank failed the shareholders thus found themselves liable for all the debts of the bank. As a result the majority of them were ruined, as the calls upon them amounted in the aggregate to £2,750 for every £100 share held by them. As a natural consequence there was widespread consternation among the shareholders of other similar banks, and the price of shares declined greatly. No one wanted

\*There were some exceptions. Typical cases of these are the Bank of England and the East India Company. The former was given special privileges because it loaned money to the Government; the latter because of Charles II.'s desire, on his restoration in 1660, to conciliate the great merchants of London.

to invest any money in shares which might involve him in a liability of possibly twenty or thirty times the amount of his investment in case the enterprise failed. The country realized that it was impossible for the banks to continue to exist upon this basis, and in the following year the law was amended so as to allow all banks to register themselves under the Companies Act,\* and thus become limited liability corporations. This was absolutely necessary if banks' shares were to attract investors, as no one wanted to be a shareholder under the previous perilous conditions. The double liability imposed upon our bank shareholders by the Canadian Bank Act is a relic of the older system.

This case of the City of Glasgow Bank illustrates the injustice of holding shareholders responsible with their whole property for the debts of a business over the conduct of which they can have no constant supervision and control. In a small partnership consisting of say three members, it may be reasonable to hold each of them fully responsible for what the others do, but in a great modern enterprise with thousands of shareholders, often widows and orphans who know little or nothing about how the business is being carried on, it is quite unreasonable to claim that they should lose their whole property because of some investment made perhaps years before and almost forgotten by the investor. Such an investment may even have passed by bequest from the hands of the original investor into those of persons who may be ruined instead of benefited thereby.

Thus we have to-day the principle of limited liability in large corporations everywhere adopted. For great modern enterprises an enormous amount of new capital is required. The savings of comparatively poor men amount in the aggregate to far more than the accumulations of the million-

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\*In such a course as this it is unnecessary to trace through its various stages the progress of the movement in favor of allowing the free incorporation of limited liability companies in the business world. The influence of that movement was naturally first felt in the country industrially most advanced—Britain. Its triumph was a slow process. The gradual extension of the principle of limited liability can be traced through different Acts of the British Parliament passed between 1826 and 1879.

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aires, and it is from this source that the bulk of new capital must be raised. Consequently those who are desirous of raising capital issue stocks and bonds which appeal even to the poor man who has only a little money to invest. Thus to-day many companies issuing bonds issue them in \$100 units, while only a few years ago they usually issued their bonds in \$500 or \$1,000 units. The raising of capital is facilitated by the fact that the investor, except in the case of the double liability of banks, can in no case lose more than the actual amount of his investment.

### **Growth of Limited Liability Corporations.**

The growth of limited liability corporations in business is stupendous. In 1909, according to a report submitted by the Commissioner of Internal Revenue to the Treasury Department of the United States, the corporations doing business in that country had issued capital stock to the amount of \$57,886,000,000 and bonds to the amount of \$30,715,000,000. Making all due allowance for stock and bonds issued below par, it is probable that the actual investment in these corporations is at least \$60,000,000,000, or about \$3,300 for every family of five persons in the country. About half the total wealth of the nation is thus held by these corporations, or rather *through* these corporations, for it should not be forgotten that the shareholders are the owners of these corporations and that their number is legion.

### **Advantages of Limited Liability.**

The limited liability company has been of great use to the world during the comparatively short period of its predominance. It has enabled all sorts of people, professional men, widows, orphans, etc., to invest their savings in commercial enterprises and to share the profits of businesses of which they know little or nothing. Unlike the partners in the old-time business, they are able to sell their shares through the stock exchange at any time when they begin to distrust the future of their investment or when they need

the money. It has provided the capital for daring and adventurous undertakings, for achievements which are reckoned among the glories of our age, capital for which could not have been secured if the investor were liable beyond the amount which he actually paid for his shares. Who would have invested, for instance, in the first Atlantic Cable Company, in the Marconi Wireless, in the Bell Telephone, or even in the C. P. R. at their beginnings, if the failure of these various schemes, the risk of which he had to take, had involved him in an unlimited liability for all the debts contracted by these enterprises? No one who realizes the many advantages arising from the working out of this principle in modern business life would think of a return to the old system of unlimited liability.

#### **Disadvantages of Limited Liability Corporations.**

The limited liability corporation, while a necessity in modern business, is by no means an unmixed blessing to society. It has brought with it its peculiar type of evils, though they do not nearly offset its advantages.

Chief among these is the immense waste of capital in the organization of what are called "wild-cat" companies, such as are many of the mining companies of to-day. The investor, or rather speculator, too often prefers the chance of large profits to the six or seven per cent. obtained by investing his savings in more stable and legitimate enterprises. In the aggregate, it is said, the investing public has put more of its savings into *Cohalt* than it will ever get out.

Again, nothing is commoner than for a skilful promoter to buy a business for say \$500,000, capitalize it at \$1,000,000, sell the shares for \$750,000, and pocket a quarter of a million on the transaction. The business is then expected to earn profits on \$1,000,000 capitalization, when the actual investment is only half that sum. Various nations, notably Germany, have tried to prevent such transactions by requiring that the actual investment in the company shall be the basis of its capitalization.

On the whole, people probably paid more attention to the

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character of their investments when these involved them in an unlimited liability. Nevertheless, the almost phenomenal growth and achievements of the limited liability company show that its existence is in harmony with the trend of modern commercial development, and it is undoubtedly a factor of permanent and increasing importance.

## EXAMINATION QUESTIONS

### ECONOMICS.

#### LESSON 6.

1. Give statistics showing the increase of large scale production in Canadian and American manufactures.
2. What reasons would you give for the increase in large scale production in transportation arising through the consolidation of railroads into a few great systems?
3. Secure from some local source figures illustrating the economy in cost of plant and power due to large scale production.
4. Give the facts of the situation in the Chicago packing houses to show the economy of labor in large scale production. Can you find a local parallel?
5. What advantages has the large scale producer over the small scale producer in purchasing raw material and selling the finished product?
6. Discuss the exceptions mentioned—agriculture and retail stores. Why do the exceptions persist?
7. Do you always buy goods of various kinds at the place where the price is lowest? What other motives influence your choice?
8. Illustrate the dangers of unlimited liability in modern business by reference to the case of the City of Glasgow Bank. What do you think of our double liability? Illustrate by the Farmers' Bank case.
9. Trace the rise and discuss the necessity of the limited liability company in modern business.
10. Discuss any disadvantages of limited liability corporations.



