Corporation Securities

Training for Business
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CORPORATION SECURITIES: THEIR NATURE, POWERS, AND DISTRIBUTION.

BY

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THIS IS TO CERTIFY THAT THE THESIS PREPARED UNDER MY SUPERVISION BY

John Milford Dilavou

ENTITLED: Corporate Securities: Their nature, forms, and distribution

IS APPROVED BY ME AS FULFILLING THIS PART OF THE REQUIREMENTS FOR THE DEGREE

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CHAPTER I.
INTRODUCTION.

The importance of a general knowledge of corporation securities is only realized when we make a study of the past and take a look into the future forms of business. Evolution of the world and its methods makes much more rapid progress than it did a few centuries back. A man who is advanced and modern in education, experience, and business today is cast aside tomorrow for one more modern and better able to fill his place in the industrial world. A new manufacturing establishment equipped with all the modern devices must frequently be altered, before it begins work, because of some late improvement. What does all this mean? It is explained by the fact that we are living in a world of progression and evolution and one filled with a strenuous industrial unrest.

In no other phase of activity is this movement more noticeable and comprehensive than that shown in the changes of the forms of business. In early times every one was his own groceryman, lawyer, mechanic, and laborer. There were no men who gave their whole time to a business, and the only means, by which business was carried on, was through exchange of one article for another. Business had no form. This simple method of exchange was followed or improved by private parties acting as mediums through which people could exchange their commodities without being compelled to find some one with whom they could make a trade to the mutual benefit of all. This method
of some one acting as a medium in return for a small commission is the simplest form of business. The next change was brought about by the unconscious introduction of a medium of exchange. This medium is merely some commodity for which there is a great enough demand to make it readily exchangeable in some proportion for any other commodity. When such a commodity, which has taken many and various forms, became established in a country, people schemed to keep a ready supply of it on hand so that they could readily exchange it in some proportion for any other desired commodity. The presence of this commodity of general demand brought the private business man into existence. His simplest duty was to act as a medium through which people could obtain any commodity by exchanging this medium of exchange commodity for it, or through which they could obtain some of this medium of exchange by offering some other commodity for it. This simple business man was sometimes located in one place and at others he was a travelling peddler, but his object was to exchange his wares for a little more of the medium of exchange commodity than he had originally given for them.

The number of exchanges grew to immense proportions in time and simultaneous with this growth, the business men expanded their business, which called for more and more of this medium of exchange—which might as well be called by its usual term, money—to be used for a working basis. The lack of this medium of exchange or money, together with the increase of the duties, caused people to unite intwos and threes, by throwing their capital and business talent together, thereby creating
what is now known as the partnership. Business continued to increase rapidly in size and volume, and as a result the partnership form was found defective in many lines of business. This latter form is naturally limited in size, because, at common law, which has been approved by all statute law, each member or partner is held liable for the entire debts of the company. Thus if one of the firm by poor judgment or poor business methods should involve the firm in any way or should himself become bankrupt, thereby making the firm insolvent, the other partner or partners would be held for all the debts of the partnership insofar as they were able to meet them, even though they had taken no part in the mismanagement. Each partner is free to act as agent for the firm and any business he may transact or any contracts he may make are binding upon the firm. From its very nature therefore it is evident that a business of partnership form is necessarily limited in size. It gave way partially during the last century to the joint stock company, but this form has, on the whole, proven more or less unsatisfactory, the liability being the same in most cases as in the partnership.

Capital has tended to amass itself into large establishments in increasing proportions. The partnership has been shown to be limited in size and usefulness and the joint stock company has proven very little better; but, to meet the great economic move to amass capital, has come the form of business known as the corporation. This is the most modern form, having first come into use about the middle of the last century. It safely permits enlargement of a business to any size, limits
the liability of the members, has a perpetual existence, allows, its members to sell their interest readily without in any way affecting the business, and in fact it has largely replaced the partnership form because it eliminates practically all the defects prevalent in that form.

This great economic change from the partnership to the corporate form first showed itself in the railroad industry. A railroad of any considerable length takes a large amount of capital to build and operate it. More in fact than any one person or almost any group of persons possessed at the time extensive railroad building began, or about fifty years ago. At that time the economic condition of this country was not as good as it is now, and fraud was much more prevalent, while wild cat banking was very common. It is not strange, therefore, that dishonesty and mismanagement commonly entered into the managing and overseeing of railroads. The partnership form which held all partners liable for all the debts caused through fraud of one of them naturally made capitalists slow to invest their money in railroads and run the risk of losing it as well as the rest of their private holdings, without some chance of large returns. The corporate form, which went a long way towards remedying these evils by limiting the liability of owners and decreasing the chances for fraud by transferring the managing to a board, while the size of the business could be increased indefinitely, might be said to have literally forced itself upon the railroads among which it made great headway.
This change of form was not so noticeable nor rapid in the industrial branches of business. Manufacturing establishments were not so large and were owned for the most part by one or a few capitalists who kept close watch on their business, a thing which was impossible in railroads. As industrial establishments continued to increase in size, however, the partnership form was found to be very unwieldy, and, as a result, the corporate form is succeeding it merely because it is better adapted to present conditions. This change began to show itself some twenty-five years ago or about thirty years after the corporate form was introduced into the railroad industry. Since then it has made rapid progress and today the industries having the corporate form produce over one-half of the manufactured products of the United States. The manufacturing department of the Census Report for 1900 gave the value of the total products of selected industries to be $13,004,400,143.00 of which $7,733,582,531.66 was produced by industries under the corporate form. The largest producers of course were the iron and steel products and the food and kindred products companies, the latter including, breweries, distilleries, flour mills, etc. The iron and steel incorporated companies turned out products to the value of $1,508,493,141.00 or over 85% of a total of $1,793,490,708.00, and the food products incorporated companies turned out products to the value of $1,414,098,944.00 or over 60% of the total which amounted to $2,277,702,010.00. These figures are taken from industries best fitted for corporate organization, but they show the tendency of almost all kinds of business
establishments to take on the corporate form. Agricultural pursuits is probably the most glaring exception to the rule because they by their very nature tend toward disintegration of ownership and management.

The United States has been in the past preeminently an agricultural nation. The growth of the agricultural industry is limited in two directions. First, in the amount of available and productive land, and secondly, by the demand for agricultural products for consumption. Because of these two limitations the intensity of farming in the United States is limited by the demand for the product together with the ease and cheapness that other agricultural countries, such as Canada, India, and Australia can produce their products and ship them to this country. On the other hand the people are not limited in their manufacturing pursuits. They, by their industry and intelligence, can produce manufactured products as cheaply as any other nation, and, since manufactured products are so varied that the demand for them can be made to constantly increase, it is safe to assume that the manufacturing industry in the United States will continue to grow in an ever increasing proportion. We may conclude therefore that the former supremacy of agriculture in this country is gradually being superseded by manufacturing which has a limitless expansion, while the demand for the manufactured products may be made an ever increasing one. This discussion may seem to be wide of the subject in hand, but, when we consider that nearly all of the increase in amount of manufactured products will come from
plants organized under the corporate form we realize its importance. The launching of every new concern under the corporate form or the change of old concerns by incorporating them means that just so many more securities are placed on the market for investment. If, therefore, manufacturing is to be the main industry in the United States and, if it is to be carried largely by incorporated and security issuing concerns, it is very evident that the people must look in the future more and more to stocks and bonds for investments.

The securities of manufacturing concerns are not at present nearly so important for investment as railroad securities, but we must consider that railroads are already well expanded in this country and offer comparatively little opportunity for further expansion, while the industrial and manufacturing interests present an unbounded field for expansion and combination.

An editorial in a Wall Street Journal expressed the idea very well in an issue of March 3, 1901 by the following statement. "It is certain as anything in the future that industrial securities will form the principal medium for speculation in this country. The field for formation of corporations is vast, and varying degrees of skill in management, coupled with the succession of good times and bad times, will make constant changes in values which will be discounted by movements in prices of stocks". The growth of industrial corporations during the last seven years has been nothing less than phenomenal. According to the figures given by Mr. Moody in his late book, "The Truth About the Trusts", the capital including bonds of all indus-
trial corporations found prior to 1898 was $1,196,724,310.00 while the capital stock issued, including bonds and excluding unissued stock up until January 1, 1904 of 318 important industrial trusts embracing some 5288 distinct plants was $7, 246,342,533. Adding to this amount the capitalization of the industrial corporations organized during 1904, which, as given by the New York Journal of Commerce amounted to $761,755,000, we have a total of nearly $8,000,000,000 worth of securities. Since 1898 therefore the increase has been at the rate of nearly $1,000,000,000 each year. This means that at least a large per cent of money which has been invested directly in manufacturing concerns and largely owned by those directly managing them is now in charge of the directors and managers while the investors receive in turn merely receipts or certificates of shares which gives them certain very limited but essential rights and liabilities in the concerns in whose securities they invest.

Perhaps a large proportion of the securities are as yet in the hands of persons who previously owned and managed the industrial plants in which they now have an interest, but with these older men, who cling to their old businesses for sentimental reasons, out of the way the investors and managers of large corporations will become two distinct and almost separate classes. This condition of separation is already beginning to show itself and we have only to look at the transactions taking place on the New York Stock Exchange, which is the place where nearly all the investments in and transfers of
stock take place, to see the truth of the statement. Consider first the amount of stock transactions on this one exchange alone and we will see that since 1890 an almost incredible increase has been made in the number of shares changing hands annually. The following figures were collected from the columns of the New York Journal of Commerce and Commercial Bulletin and show the number of Shares of stock and amount of bonds changing hands on the New York Stock Exchange annually since 1890.

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Shares of Stock</th>
<th>Amount of Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1890</td>
<td>59,441,301</td>
<td>$374,342,120</td>
</tr>
<tr>
<td>1891</td>
<td>72,725,864</td>
<td>$389,906,700</td>
</tr>
<tr>
<td>1892</td>
<td>86,850,930</td>
<td>$501,398,200</td>
</tr>
<tr>
<td>1893</td>
<td>77,964,965</td>
<td>$299,372,327</td>
</tr>
<tr>
<td>1894</td>
<td>49,275,736</td>
<td>$352,741,950</td>
</tr>
<tr>
<td>1895</td>
<td>66,440,576</td>
<td>$495,904,950</td>
</tr>
<tr>
<td>1896</td>
<td>54,490,043</td>
<td>$352,815,650</td>
</tr>
<tr>
<td>1897</td>
<td>77,248,347</td>
<td>$529,343,000</td>
</tr>
<tr>
<td>1898</td>
<td>113,466,383</td>
<td>$847,654,000</td>
</tr>
<tr>
<td>1899</td>
<td>172,968,184</td>
<td>$823,723,400</td>
</tr>
<tr>
<td>1900</td>
<td>175,218,312</td>
<td>$564,202,100</td>
</tr>
<tr>
<td>1901</td>
<td>252,723,292</td>
<td>$886,754,100</td>
</tr>
<tr>
<td>1902</td>
<td>188,503,403</td>
<td>$883,425,050</td>
</tr>
<tr>
<td>1903</td>
<td>161,102,101</td>
<td>$684,771,000</td>
</tr>
<tr>
<td>1904</td>
<td>185,215,251</td>
<td>$</td>
</tr>
</tbody>
</table>

During the present year the transactions have rapidly increased and they have averaged, up to the present time, over 1,000,000 shares for each business day.
Most of the transactions in the above table were transfers of railroad stocks and bonds but this is explained by the fact that railroad securities have been dealt in for half a century so that they have stability of value and the confidence of investors, while the industrial securities are practically new on the market and, because their value has not been determined, they are subject to the wild speculation and sharp fluctuations in value through which almost every new undertaking goes before settling itself to a value in harmony with its surroundings. The other reason for the present nonimportance of industrial securities, as has already been mentioned, is that many persons, who owned and managed the plants before they became incorporated, are still living and for personal reasons, still retain a controlling interest in the stock, so that they can continue to take an active part in the management and workings of the business. The tendency, however, is for outside investment as rapidly as these previous owners can be supplanted. The following table shows the amount of transactions in industrial securities alone on the New York Stock Exchange during the last ten years, excepting 1897, the figures not being obtainable for that year. (See next page)

The table shows an increase in transactions of shares in ten years of 225 per cent or in another way two and one-fourth times while the bond transactions have increased from practically nothing to $346,824,000. This proves that industrials are fast becoming an important factor in the investment world. Therefore since the railroad industry is largely developed and
since all the new industrial movements are adopting the corporate form of organization, it is very probable that the relative increase in importance of industrial securities will be much more rapid in the future than it has been even in the last ten years; and that the quotation of these securities on the stock exchanges of the country will be watched with a keener interest than is given and kind of securities today. As a result of this growth, the stock exchanges will become the places where the slight fluctuations of any commodity will be measured by the amount of fluctuations of the stock indirectly representing that commodity.
CHAPTER II.

THE NATURE OF CORPORATION SECURITIES.

After having taken a general survey of the past and present forms of business and determined the importance of the securities of the modern forms in the investment world, it is necessary to consider the value of these securities and determine as nearly as possible their relative importance. Almost every corporation issues two general classes of securities, viz., stocks and bonds. Bonds, as a usual thing, bear a certain fixed rate of interest which must be paid regularly, and they are secured by the tangible assets of the company issuing them, thereby making them generally safe as an investment. Their good security, and the regularity with which they draw interest tends to make them sell at a higher price and draw a lower rate of income than the less secure stocks. They are the most gilt edged kind of securities in existence and therefore do not flutuate in price as readily nor as widely as the stocks which are secured only by the working value of the plants issuing them. Of course there are all grades of bonds whose value, providing they draw the same per cent interest, is determined by their security. Thus a bond issued by the United States Government will command a higher price even at a lower rate of interest than the bonds issued by any one of the South American Republics. For the same reason the bonds of the Standard Oil Co. are more valuable and secure for investment than the same kind of bonds issued by the Amal- gamated Copper Co. Speaking generally, however, bonds are the
safest kind of securities and are therefore the kind in which those people invest, who are willing to accept a low rate of interest, but who are not willing to assume very much risk.

The other class of securities, stocks, are more speculative in their nature because they draw their income and are secured upon an entirely different basis. A corporation has two kinds of values. The one is that value measured by the visible assets of the company or the value of the realty machinery, and the rest of the possessions, which have a material value in the open market under all conditions. This value is by far the most stable one and the one on which the real security and stability of value of bonds rests: The other value, from which most of the discussions as to the evils of capitalization spring, is the working value of the plant based upon its earning power. If the bond issue does not amount to the total value of the visible assets stocks are issued to cover the rest of this value and also the working value of the plant. Stocks are issued frequently in larger amounts than the earning power of the company can justify even at its highest point of prosperity. If the working value of a concern is estimated too high and securities issued to cover the estimated value, the stock will become highly speculative until finally the fault is remedied by reorganization at a lower capitalization or in some cases by utter disbandment. Thus we see that while bonds represent an absolute amount of value, the stocks represent a proportionate amount of the capitalization of the company and vary greatly in value. The speculative feature of stocks and the stability of the value of bonds

is very plainly shown by a chart of Prof. M. H. Robinson's which I shall copy here.

Take for example a representative company between the years 1893 and 1903 and let this company issue a representative amount of stock and bonds. In the figure let $CEDF$ represent the amount of bonds issued, $ACDB$, the amount of preferred stock and all above the line $AB$ the amount of common stock issued. Using $EF$ as a base line and a certain scale on the perpendicular lines plot the curve $cd$, representing the material value of the plant and $ab$, representing the earning value. This shows very clearly the difference between the two value previously mentioned.

The par or face value of the bonds as represented here is always below the material value of the company and as the bonds have prior lien on the assets their principle is practically secure. The preferred stock, however, is issued in a large measure above the material value of the concern and it depends upon the power of the company to earn enough to pay regular dividends. The distance between the lines $cd$ and $ab$ represents this value. In this particular case between 1893 and 1895 the company was not able to pay full dividends upon the preferred stock. Now, if the company should fail and distribute its assets, the amount the preferred shareholders would get is represented by the distance between the line $CD$ and $cd$. 

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**Diagram Description:**
- **Common Stock:** $a$ to $b$
- **Preferred Stock:** $c$ to $d$
- **Bonds:** $e$ to $f$
- **Par or Face Value:** $AB$
- **Material Value:** $CD$
- **Earning Value:** $ab$

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**Mathematical Representation:**
- $AB = \text{Common Stock Issued}$
- $CD = \text{Par or Face Value of Bonds}$
- $ACDB = \text{Amount of Preferred Stock and Above}$
- $EF = \text{Base Line}$
- $cd = \text{Material Value of Plant}$
- $ab = \text{Earning Value}$
- $CEDF = \text{Amount of Bonds Issued}$
at the time of foreclosure. Thus it is easily seen that speculation enters into the price of preferred stock both from the standpoint of dividends and assets. Going above the line AB, the company issues common stock whose value is nil so far as assets go, and depends upon the curve ab reaching above the line AB to make it of value by payment of dividends. Common stock is highly speculative therefore from the standpoint of dividends and worthless as regards material assets, making it open to stock gambling and manipulation much more than any other kind of securities. This diagram helps to make plain the fact that different kinds of securities are issued upon entirely different bases and vary, from a speculative standpoint, so that they are catered to for investment by different grades and classes of investors.

Only three general classes of securities have been mentioned although there are many others. Most companies issue at least two kinds of stocks, although there are some which issue only one kind or general stock. If such is the case, the shares are issued without any preference over each other, each share representing a certain proportion of ownership in the company and its management. Of fifty leading companies which were studied, eleven issued only one kind of stock, among which were the Amalgamated Copper Co., American Express Co., Diamond Match Co., Standard Oil Co., and International Harvester Co. The International Harvester Co. has a special provision whereby if any more stock is issued, that already in existence shall become 6% cumulative preferred stock while the
new stock shall be common. Four of the eleven companies have no bonded indebtedness nor underlying bonds, and most of them are conservative in management and pay large regular dividends. This is especially true of the Pullman Palace Car Co., Diamond Match Co., Westinghouse Airbreak Co., and practically all of the eleven excepting the Amalgamated Copper Co. It is safe to say therefore that at present those industrials issuing only one class of stock are not speculative but very conservative and relatively sure of paying dividends regularly.

Thirty eight of the fifty companies previously mentioned issued two kinds of stock while one issued three kinds. Where there is more than one class of stock the common stock already mentioned is always included. The common stock as was said before is the most speculative and represents the contingent value measured by the possible earning power of the plant, and is often issued to cover what is known as good will, patent values, franchises and frequently is issued as a bonus to trust companies in order to secure guarantee for sale of preferred stock and bonds. Almost the entire purpose of common stock therefore is to pay for a contingent interest and must necessarily be speculative. The certificate issued to the owners is worded very generally and usually appears in something like the following form.

1Incorporated under the Laws of the State of-----.

(Name of Corporation)

Common Stock, $-------------.

Preferred Stock. $-------------.

1A. L. Ringo; Corporation Hand Book. pt. 5.
This certifies that ------- is owner of ------- shares of One Hundred Dollars each of Common Stock of ------- Co, fully paid and non-assessable, transferable on the Books of the Corporation, in person or by attorney, on surrender of this Certificate properly endorsed.

The Preferred Stock of this Company is entitled to receive, and this Company is bounden to pay, from its net earnings, a dividend of eight per cent per annum, semi-annually, before any dividends shall be declared or paid on the Common Stock of this Company.

In witness whereof the duly authorized officers of this corporation have hereunto subscribed their names and caused the Corporate Seal to be hereunto affixed at -------, New Jersey, this --- day of -------, A. D. 19---.

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President.

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Sec'y.

Common Stock is issued in greater or less quantities in many cases regardless of money values, and, as shown by the diagram given some pages back, is dependent for its value upon the ability of the company issuing it to pay dividends upon it, and also the value which might be placed upon it because of its powers of voting etc., rather than upon the assets. It often contains the promoters profit and is frequently unloaded on the public at an enhanced value to enrich the coffers of the promoters and manipulators at the public's expense. Common Stock therefore is too speculative and its value is too
contingent for the small investor to put any dependence in.

The other great class of stock also depends largely upon the ability of the company to pay dividends regularly upon it. It is usually true that a company, if conservatively capitalized is able to earn enough each year to pay interest on its bonds and the regular rate of dividends on preferred stock. There might be a dull year due to industrial depression when there is a legitimate excuse for not paying dividends on preferred stock, but such years are rare. A conservative company will issue common stock to absorb the marginal dividends. Preferred stock is also safer than common in that it generally has prior lien upon the assets of the company, a fact which will be discussed in the following chapter. The certificate of this class of stock is essentially different from that given for common, but is usually similar in form and contains most of the provisions given in the following.

1(Place of Incorporation)

(Name)

Common Stock.$------.

Preferred Stock.$----.

This certifies that--------is the owner of----shares of One Hundred Dollars each of the Preferred Stock of the

---------- -------Co., fully paid and non-assessable, transferable only on the Books of the Company in person or by attorney on surrender of this certificate properly endorsed.

Before dividends shall be declared or paid on Common Stock of this Company the holder of record of this certifi-

cate of Preferred Stock is entitled to receive and this Company is bounden to pay from its net earnings, a fixed yearly dividend at 8% per annum, payable semi-annually on the ---day of --- and ---day of--- of each year. After the Common Stock of this Company shall have been paid a yearly dividend of 8%, then this Preferred Stock shall also participate pro-rata with the Common Stock in any additional dividend from the net earnings of that year. In witness whereof duly authorized officers of this company have hereunto subscribed their names and caused the Corporate Seal to be affixed at -------, New Jersey, this ---- day of ------A. D. 190----.

President.

Sec'y.

The idea gained ground in 1895-1901 to issue preferred stock in the place of bonds so that in case of a bad year the company could not be thrown into the hands of receivers owing to default of interest. This has, since 1901, tended to decrease, because it is cheaper for a company of good financial standing to issue a certain amount of bonds. There is a way to issue preferred stock in place of bonds and still retain the regular preferred stock by issuing a first and second preferred. This plan was carried out by the Pope Manufacturing Co., when it bought out the American Bicycle Co.

Preferred stock is classified in a different way much more frequently. That is cumulative and non-cumulative accord-
ing as to whether the dividends if omitted one year will be paid out of the following year's earnings before any dividends shall be declared or paid on the common stock. Of the fifty companies mentioned before, thirty nine issued preferred stock, and, of these thirty-nine issued cumulative while only seven issued the non-cumulative preferred. All modern certificates of cumulative preferred stock clearly state that they are such by a clause similar to the following: "The holder of this certificate of Preferred Stock is entitled to receive a fixed yearly dividend of 7% before any dividends shall be declared on Common Stock". The rate of dividends on cumulative preferred stock is higher at the present time than on the non-cumulative. As near as can be estimated the rate on the former is approximately 7% while the non-cumulative calls for a dividend of a little over 6%. Preferred stock represents that class of securities between the common stock on the one hand and bonds on the other, and therefore it appeals to that class of investors who are willing to assume a little risk in order to reap the benefits of a slightly higher rate of interest on the investments, than is obtained by investing in the secure bonds, but who are not willing to risk the speculative element found in the common stock.

A very important form of stock which in use in England, but not used in this country, is what is known as Founder's Stock. Promoters have been very prominent in starting large corporations and especially in bringing about the consolidations of small plants into large corporations. The promot-
ers always assume a great deal of risk in accomplishing or attempting to accomplish the floatation and consolidation of companies, and if successful, they naturally expect a large recompense. In the United States their method is very simple. They offer the owners of the different plants or establishments a certain amount of stock, or as an alternate a certain amount of money in return for their plant, claiming, of course that the other competitors are coming into the consolidation, and that it will be best for all concerned to get into line. The promoter figures on what the plants can be bought for and at what price the securities will sell at trust companies very frequently guaranteeing to take a certain number of shares or amount of bonds at a certain price with the intention of selling them out to their customers. The promoter then sets to work to buy up the plants either through exchange of shares or by paying cash. If, after he has fulfilled all his obligations, bought up the necessary number of companies, and provided the guaranteed working capital, there is any stock left which he has not used, and which in fact he has never intended to use, it represents his profit or pay for promoting the company. Trust companies very frequently act as both promoters and underwriters and thereby reap a double profit. The plan for payment of the promoter in England is different. The duties and obligations are very similar but their pay instead of getting all they can make by fleecing the public or outwitting the independent owners is a definite amount represented by a special kind of securities or Founder's Stock. In this way
it is very easy to tell exactly what the promoter is getting in return for his efforts. This kind of stock is issued sometimes as purchase money in taking over a business or to pay for the good will of the same. It may be given preference during its existence as to dividends and assets, and is usually retired within a limited time, either by paying cash for it or by exchanging it for a certain specified amount of some kind of stock.

The following is a sample form of a certificate of a Founder's Share of stock.

No.----. 1(Where incorporated) Shares.----.

(Name of Corporation)

Capital Stock.§----.

This certifies that --------is holder of ---- Founder's Shares numbered----,----,----,----, respectfully, of One Hundred Dollars each of the Capital Stock of -----------Co., transferable only on the books of the Company in a manner prescribed by resolution, and recorded in the Company's record, upon the surrender of this certificate, properly endorsed.

Said Founder's shares are subject to the provisions of a certain agreement date---,--- 19--, providing for insurance of Founder's Shares to an amount not exceeding in par value the total sum of $------- and subject to redemption as in such agreement specified. The holder hereof acknowledges notice of all the provisions of such agreement, and by acceptance of the certificate hereby assents to and agrees to be

bound by the provisions therein contained.

In witness whereof, the duly authorized officers of this corporation hereunto subscribed their names and caused the corporate seal to be hereto affixed at ----, Seal. ----, this--day of----,19----.

________________________
President.

________________________
Sec'y.

A form of Stock rarely issued, is known as Guaranteed Stock, and, as the name suggests, much attention is given to its security. It is issued by the unanimous consent of the stockholders for a fixed definite period of time, and its purpose is to provide some ready and needed money. It draws a certain specified rate of dividends to be paid before any distribution of the net earnings of the company is made, and, of course, has a prior lien over all other stock on the assets of the company. During its existence it is given power to elect a majority of the directors. The provision for its retirement usually stipulates that it may either be exchanged for other kinds of stock, or cancelled in cash at its par value. The certificate is much the same as that of the preferred excepting that it contains the provisions stated above.

When stock is in a certain condition the name Treasury Stock is applied to it. This term is frequently misinterpreted and misused, and in fact it is hard to find much harmony among the writers in the use of it. Often it is used to indicate stock which a company purposes to sell and is put into the hands of the treasurer of the company for that purpose.
I intend to define treasury stock in a way that the eminent corporation lawyer, Mr. James B. Dill explains it. He says in answer to a letter, "I cannot refer you to any authority on this question.--- The term treasury stock is the most thoroughly abused, least understood term in the corporate nomenclature". In view of this difficulty an attempt will be made to explain when stock can be rightly termed treasury stock. Any class of stock may be treasury stock under certain conditions. First; it must have been issued by the company and value received for it. That is, it must have been issued, sold, and in return must have been wholly or partly paid up. To become treasury stock therefore it must have been wholly out of the hands of the company issuing it, and legally held by an outside owner. Lastly it must have by some means or other legally come back into the company's possession. If a company has legally acquired some of its stock, which had taken the course described above, provided it has power to acquire its own stock, such stock may be called treasury stock in the real meaning of the word.

Stock is sometimes placed in the hands of a trustee by the shareholders, to be held in trust as security for a loan to the corporation, in which case it is called trustee's stock. A company for example, wants to issue some bonds, secure a loan, or obtain something, which creates a valuable obligation. Not having anything which will readily stand mortgage they draw up an agreement with a trustee, usually a trust company, by which the trustee agrees to fulfill the re-
quirements that causes the obligation, providing the corporation will deposit with them a certain number of shares of stock to be held in trust by them and their assigns as collateral security, so long as security is needed or until the obligation is waived. The agreement as drawn up contains all the details entered into, regarding the rights of the corporation and the powers of the trustee. The trustee of course, acts as a medium through which the bonds or other securities are sold to the public at large. Power is therefore given to the trustee in place of the officers of the corporation, to sign the certificates of the trustee's stock. It only gives those holding the stock a legal title to hold it under the provision of the trust agreement. The following form will give some idea of what a trustee's stock certificate is.

Form for Trustee's Share.

No----. (Where incorporated) Shares----.

Name of corporation.

Authorized Capital Stock $------.

Stock Trusteed. $----------.

"This certifies that ---------is equitable owner of------shares of par value of $------each of the capital stock of ---------Co., the legal title to which shares is vested in and is to be held until the ------day of---- ----by----, trustee, and by his successors, in trust under the provisions of a trust agreement in writing executed on the ------day of

"...

and on file in the office of -------(Some Trust Co)

1A. L. Ringo Corporation Hand Book pt. 5.
of _______. The interest in said stock represented by this certificate is transferable only on the books of the trustee by the holder thereof in person or by attorney, upon surrender of this certificate in compliance with the provisions of said trust agreement, and all the rights and interests of the parties, who may at any time have interest in this certificate, or the shares of stock represented by this certificate, are to be governed, regulated, and controlled wholly by the terms of the said trust agreement and every holder of this agreement or any interest herein or hereunder, holds and agrees to hold the same subject to all provisions of the said trust agreement.

In testimony whereof, the said trustee, has issued this certificate under his hand and seal this______ day of______.

_____________
Trustee.

The class of securities for the person to invest in, who is willing to accept a low rate of interest, but is not willing to take much risk, is bonds. A few reasons why bonds should be issued at all might be mentioned here. For a period of about five years, 1897-1902, there was a strong tendency to issue an extra amount of preferred stock to take the place of bonds, for the reason that if the company passed through a period of depression, during which it was unable to pay dividends, the holders of the securities could not throw the company into the hands of receivers as it was possible for bondholders to do. The fallacy of this argument is easily
Bondholders may be called creditors of a company while stockholders are in a way partners in and debtors to it. The duties of the managers are in the interests of the stockholders after the bonded liability is satisfied. Therefore if the managers can increase the earnings in any legitimate way their obligations to the stockholders compels them to do so. The borrowing credit of any corporation is good at a low rate of interest up to a certain limit. If the managers of a company can use this borrowing power to make a profit they should do so. Beside the idea of a profit there is another reason for issuing bonds and that is, that it reaches a unique class of investors who will not invest their money in any other kind of securities. Therefore a company should issue some bonds in order to reap a profit because of the low rate of interest, and to attract investors who will not invest in any other class of securities. Of the fifty companies previously referred to twenty-three had a direct bonded indebtedness. Eight had some underlying bonds, while nineteen had no bond obligations.

The first step toward issuing bonds is to find a trust company or trustee to float them or guarantee their sale at a certain price. The company draws up its mortgage or other security and deposits it with the trust company together with power to sell and sign bonds on that security. Bonds belong to one of two general classes, viz., registered or coupon, a company usually issues some of each. Registered bonds are so called because they are registered by number together with the owner on the books of the company, and cannot be trans-
ferred except by the bond certificate being sent in to the company and a new one issued in the name of the new owner. The bond certificate generally gives only a brief idea of the security on which it is issued, the complete details being given in the agreement with the trustee. The bond certificate usually states that they are secured as "particularly described in said mortgage or deed of trust" entered into with the trust company, or words to that effect. Sometimes nothing is said of the security further than that it is a part of the authorized issue of a certain amount, subject to an indenture with a certain trust company. The following form is that of a registered bond and shows in a general way what is to be expected on its face.

1UNITED STATES OF AMERICA,
State of New Jersey.

Company.

Registered Fifty-Year Four Per Cent. Gold Bond.

$--------. No.--------.

-------------Company, a corporation created and existing under the laws of the State of New Jersey, and herein-after termed "the Company", for value received promises to pay to-------------, or registered assigns on the first day of-----, A. D.----------, at its office or agency in the city of New York, the sum of -------------dollars in gold coin of the United States of the present standard of weight and fineness, and to pay interest thereon from the first day of------or the first day of------, as the case may be, next preceding

1Dill on corporations.
the date hereof, at the rate of four per cent, per annum, such interest to be payable to the registered holder hereof at said office or agency in like gold coin semi-annually on the first days of ______ and ______ in each year. All payments upon this bond, both of principal and interest, shall be made without deduction of any tax or taxes which the ______ company, its successors or assigns, may be required to pay, deduct or retain therefrom under any present or future law of the United States or of any state, county or municipality therein.

This bond is one of a duly authorized issue of coupon and registered bonds of the ______ Company, the aggregate amount whereof is limited so that there shall never at any one time be outstanding bonds of said issue for an aggregate principal sum exceeding $________. All of which bonds have been issued, or are to be issued, under and in pursuance of, and are to be secured ratably by , and are subject to, an indenture dated ________, A. D._______, duly executed by the ______ Company to the _______Trust Company, as trustee, under which indenture certain shares of stock have been and are to be deposited with said trustee; and a charge is imposed upon present and future net income, earnings and profits of the _______Company; and hereby reference is made to said indenture with the same effect as if herein fully set forth.

No recourse shall be had for the payment of the principal or interest of this bond against any stockholder, officer or director of the ______ Company, either directly or through
the --------Company, by virtue of any statute or by enforce-
ment of any assessment or otherwise; any and all liability of
stockholders, directors and officers of the --------Company
being hereby released.

This bond is transferable only in the manner pre-
scribed in said indenture on the books of the --------Com-
pany at its office or agency in the city of New York, upon
surrender and cancellation of this bond; and thereupon a new
registered bond will be issued to the transferee in exchange
therefor on payment of the charge provided in said indenture.

Upon surrender and cancellation of registered bonds
for the principal amount of $1,000 or any multiple thereof,
coupon bonds of a like amount of principal with all unmatured
coupons attached will be issued as provided in said indenture.

This bond shall not become or be valid until authen-
ticated by the certificate endorsed hereon, duly signed by the
trustee under said indenture.

IN WITNESS WHEREOF, the --------Company has caused
these presents to be signed by a vice-president, and its cor-
porate seal to be hereunto affixed and to be attested by its
secretary or assistant secretary, this --------day of--------
A. D. ------.

----------------------------------
Company.

by

----------------------------------
Attest: Vice-President.

----------------------------------
Secretary.
Coupon bonds differ from registered in that they are transferable without changing them and the name on the books of the company, and in that they have attached to the body of the bond interest coupons which are negotiable and payable to bearer. The two kinds of bonds answer different purposes. Mr. Thos. L. Greene in his little book "Corporation Finance", says, "The one form or the other is preferred according as the holder wishes to make a permanent investment secured against theft or destruction, though the sale of a registered bond is a matter requiring some little time and trouble—or prefers a form which, in the language of Wall Street, is a 'good delivery' for instant sale at any time". Corporations therefore, make both coupon and registered bonds in proportion to the demand of the buyers. The difference in the form of the two kinds of bonds will be seen by comparing the following form of a coupon bond with the registered bond just given.

UNITED STATES OF AMERICA.

State of New Jersey.

---------------Company.

Fifty-Year Four Per Cent. Gold Bond.

$-----.

---------------Company, a corporation created and existing under the laws of the State of New Jersey, and hereinafter termed "the Company", for value received promises to pay on the first day of -------A. D. -e------, at its office in the City of New York, to bearer, or, if registered, to the registered holder of this bond, -------thousand dollars in gold coin of the United States of the present standard of weight

*Dill On Corporations.*
and fineness, and to pay interest thereon from ----, 19---, at the rate of four per cent, per annum, such interest to be payable at such office or agency in like gold coin semi-annually on the first days of -------and------ in each year, but only upon presentation and surrender of the respective coupons for such interest hereto attached, as they severally mature. All payments upon this bond, both of principal and interest, shall be made without deduction of any tax or taxes which the Company, its successors or assigns, may be required to pay, deduct or retain therefrom under any present or future law of the United States or of any state, county or municipality therein.

This bond is one of a duly authorized issue of coupon and registered bonds of the Company, the aggregate amount whereof is limited so that there shall never at any one time be outstanding bonds of said issue for an aggregate principal sum exceeding $-----; all of which bonds have been issued or are to be issued, under and in pursuance of, and are to be secured ratably by, and are subject to an indenture dated---- ----, A. D.-------, duly executed by the Company to the ---- -----Trust Company, as trustee, under which indenture certain shares of stock have been or are to be deposited with said trustee; and a charge is imposed upon present and future net income earnings and profits of the Company; and hereby reference is made to said indenture with the same effect as if herein fully set forth.

No recourse shall be had for the payment of the principal or interest of this bond against any stockholder, officer
or director of the Company, either directly or through the Company by virtue of any statute or by enforcement of any assessment or otherwise; any and all liabilities of stockholders, directors and officers of the Company being hereby released.

This bond shall pass by delivery unless registered in the owner's name on the books of the Company at its office or agency in the City of New York, such registry being noted on the bond by the bond registrar of the Company, after which no transfer shall be valid unless made on said books in the manner prescribed in said indenture and similarly noted on the bond; but the same may be discharged from registry by being transferred in like manner to bearer, after which transferability by delivery shall be restored; but again, from time to time, it may be registered or transferred to bearer as before. Such registration, however, shall not affect the transferability of the coupons for the interest hereon, by delivery merely, and payment to the bearer thereof shall discharge the Company in respect of the interest therein mentioned, whether or not the bond shall have been registered.

This bond, with the coupons for all interest installments which shall not have matured, may also, as provided in said indenture, be exchanged for a registered bond without coupons.

Neither this bond nor any coupon for interest thereon shall become or be valid until the bond shall have been authenticated by the certificate endorsed hereon, duly signed
by the trustee under such indenture.

IN WITNESS WHEREOF,------Company has caused these presents to be signed by the vice-president and its corporate seal to be hereunder affixed, and to be attested by its secretary or assistant secretary, and coupons for such interest bearing the engraved facsimile signature of its treasurer to be attached hereto, this------day of------, A. D. ----.

--------------Company,

by

--------------
Vice-President.

Attest: ------------
Secretary.

Having discussed the two general classes of bonds it might be well to say a few words regarding a few of the minor kinds. Bonds vary in price, the standing of the company and the rate of interest being the same, according to the kind of a mortgage which secures them. It is this element which divides bonds into so many sub classes and especially is this true of bonds of large industrials. Thus if an issue of bonds of a well standing corporation is secured by a first mortgage on the plant or some valuable part of it they may generally be depended upon to be a first class investment. This kind of a mortgage secures the majority of bonds issued by the industrial companies. There is an essential difference that should be noted here between a bond of an industrial corporation and one secured by a mortgage on a piece of land or a farm. If a
farmer becomes insolvent, the bondholders expect and do get their money because the farm can be sold for more than the face value of the liability. Corporations, however, are capitalized most of the time for much more than it would take to replace them and, due to having changed hands several times the bonded debt often amounts to more than the defunct property would be worth on the market. In this case the bonds depend for their security upon the value of the corporation as a business. If the corporation makes a profit the bonds are safe because their interest is paid; otherwise not. This is a peculiar condition, very prevalent at present, and many, who are able to judge, think that the remedy for this so called overcapitalization will come very severely with the first sharp business depression, and will work itself out by a general reorganization at a lower capitalization. The first mortgage bonds, as before stated, have first lien upon the property and because of this fact the people have confidence in them and invest in them as gilt edged securities. Another kind, the first consolidated mortgage bonds have as security first lien upon the consolidated company subject to the prior lien of the bonds previously issued by the individual companies. Besides these, and following in line of security, are the second and third mortgage issues, which are self explanatory. Consolidated companies frequently take in concerns which have a bonded indebtedness of their own. These underlying securities are called prior lien bonds because they have preference over the consolidated companies and are for this reason the safest of all
the industrial bonds and usually sell at a premium. A company formed by consolidating many smaller companies claims to be worth more than the combined value of the individual companies. Whether this is true or not bonds are frequently issued over and above all the underlying bonds and bonds on different parts of the property, to cover this so called value of the combination, and are given the name of blanket mortgage bonds. They are not first mortgage bonds and are not as a general thing looked upon as first class securities. Nevertheless a Company should grow industrially and, if it is not too heavily mortgaged this class of bonds should be safe for investment. Sometimes they are issued with a provision for retiring those bonds which have a prior lien when they become due, so that in the end the blanket mortgage bond becomes a first mortgage in reality.

Many corporations aim to make their bonds more secure by providing a sinking fund out of the net earnings of the company. This provision seems to be a good one for the investor but if the company is in good standing there is little need for it, because the company will retire any unnecessary bonds as soon as possible. If it is not in good standing the probability is that the provision will have very little effect, if the company has not earned the money to provide such a fund. Another form of bond not in good favor is the income bond, so called because it attempts to combine the lien of a mortgage with the contingency of interest. The objection to this class is that while it provides that no interest shall be paid un-
less earned, it gives the directors arbitrary power to decide whether the interest has been earned. Trust bonds have become fairly popular among industrials and are also looked upon very favorably by trust companies. They are secured by depositing with a trust company bonds of an underlying company or some other form of security, and are usually issued for a short time. The last subclass which will be considered is the debenture bonds. This class is more prevalent in England than in this country, because investors here do not look upon the bonds as first class. They are secured by the earning capacity of the company in that in case of failure to pay interest the control is turned over to the debenture bond holders. Therefore while the provisions are different from the mortgaged bonds, in reality the remedy, in case of failure to pay interest, is the same or even better, because it does away with the litigation and court expenses.

The securities which have been dealt with and the most of whose forms have been given in this chapter are the ones with which the public will have to deal more and more. In them are securities suitable to the investment of every class of investors from the stock gambler to the legitimate and timid investor who fears the loss of money. The stockholder is a partner in the corporation and his interest is a proportionate one measured by the proportion of the number of shares he holds to the whole issue. The bondholder on the other hand is a loaner of money and wishes to assume as little risk as possible, and to take no direct part in the management of
the company. His interest is not a proportionate one but is a concrete and definite loan for a certain specified amount. In a representative company we have found that bonds are safe as an investment and draw a lower interest than any other kind of securities; the preferred stock is comparatively secure but the holder runs the risk of loss in case of an unusually intense industrial depression; finally the common stock absorbs the marginal earnings and is dependent for its value entirely upon the earning power of the company, and therefore, because of its lack of security and small chance of drawing dividends, it contains the gambling and highly fluctuating element of all securities. The other classes of securities discussed are merely sub classes or modifications of these three general classes.
CHAPTER III.

POWERS OF CORPORATION SECURITIES.

We shall now enter upon one of the most difficult parts of this discussion. It is not the intention to give a technical legal discussion of the powers embodied in securities but to give in a general way a few of the more important powers and liabilities conferred upon a holder of the different classes of securities. What laws are given will be limited for the most part to those of the State of New Jersey, since they are the ones which control the majority of the larger corporations at the present time.

The natural presumption which must be taken for granted here, is that stocks are issued and invested in because of their earning powers. Many people invest especially in common stock of some corporation either to obtain control of the management or for speculative purposes, but in the present discussion this kind of investors are considered a menace rather than a benefit in the industrial world. If then the main reason for investing in stocks is to get returns in form of dividends, it will do well to consider the rights of the different classes of stock to receive dividends. The New Jersey law regarding dividends on preferred stock is very plain. In the first place no dividends shall be declared on any kind of stock except out of the net earnings of the company. The one universal rule of companies is to allow the dividends on preferred stock to be paid before any dividends are paid on the common. Preferred carries with it the right to a certain
per cent of its par value to be paid out of the annual earnings of the company before any other dividends are declared. If it is cumulative preferred the party holding the stock is the rightful owner of the per cent of dividends for which the certificate calls every year. If the company fails to earn the necessary amount for dividends one year that back dividend hangs over from year to year until all arrears are paid up, and, so long as such arrears remain unpaid, no dividends can be declared on common or other stock. If the preferred stock is non-cumulative such right to back dividends does not exist.
The directors decide whether dividends shall be paid in any year out of the earnings of the company. The question naturally arises here, whether the stockholders of a company can in any way compel the declaration of dividends out of the earnings or surplus. The general rule is to allow the directors considerable liberty in deciding whether to declare dividends out of the net earning or surplus or to keep it in the company.
In 48 Alt. Rep. 912, the court held that a single stockholder can not by a bill in equity compel a corporation to declare a dividend merely because is has a large surplus. Nevertheless, if a board of directors unscrupulously refuses to declare dividends without showing reasonable cause for not so doing, equity will support a case to compel the declaration of a dividend. The following are the words of the court in the case of Laurel Springs Land Co., vs, Fougeray, 50 N. J. Eq. 756; "The power of the court of Chancery to order directors of a trading corporation to make a dividend of unused profits
when they improperly refuse to do so, is undoubtedly". The above rule will hold good for all kinds of stock but let us return to preferred. The right of preferred stock to dividends usually ends when it receives a certain per cent on the par value as provided for in the certificate, but in a few cases other provisions occur. For example some companies provide that, after a certain amount has been paid in dividends on the common stock, the rest of the dividends declared shall be divided pro-rata between the two classes of stock. There is a peculiar provision made by the Royal Baking Powder Co., in case of default of dividends on the preferred stock. The preferred stock is not ordinarily given any voting power in this company but if the regular dividends are not paid on it for four months, $50,000 of it can call a meeting, elect directors, and carry on business the same as a duly appointed receiver. Often provisions are passed making it difficult to increase the stock which will make the dividends on that already issued less secure. Thus the Rubber Good Manufacturing Co., provides that no mortgage debt shall be created without a two thirds vote of the preferred shareholders. Many companies cannot increase the capital stock with a large per cent of each kind of stock assents to it. Other companies provide similar and other provisions, which are always found in the certificate, but they cannot be discussed here.

The right of the holders of common stock to dividends is on the whole very simple. As a general rule they are entitled to all the dividends declared after the regular dividend
on preferred stock has been paid. This fact gives the directors of a company a good show to use their power in furtherance of self interest, by declaring or refusing to declare dividends on the common stock when the earnings are large enough to justify it. A company very frequently does not earn enough to pay dividends on its common stock and sometimes in severe industrial depressions those on the preferred stock are defaulted. Therefore, if the directors are heavy owners of preferred stock it is to their interest to charge a large amount of earnings after the regular dividends on the preferred have been paid to surplus, so that in times of depression the preferred stock dividends may not be discontinued. On the other hand if the directors happen to be heavier holders of common stock, they will always pay dividends on the common if the earnings of the company will permit it. The bylaws of some companies limit the amount of dividends to be declared on common stock. The International Harvester Co., provides that "not over 10% per annum shall be declared on the common stock so long as important bonds are outstanding". The British Columbia Packers Association certificate of stock declares that, after the regular dividends have been paid on preferred stock, the balance of the net earnings to the sum of 25% of the whole net earnings shall be set aside to retire preferred stock before any other dividends shall be declared. Excepting the small per cent of companies making special provisions regarding their stock the general rule is that the common stock receives all the dividends declared after the preferred stock dividends have been
paid, regardless of how large the amount may be.

The classes of stock issued temporarily frequently have a right to dividends prior to the preferred and common stock. The reason for this is evident. This stock has been declared in return for some specific service or to raise some necessary money, and, being a temporary issue, must be attractive in order to draw capital to it. Thus Founders Shares, so prevalent in England, are issued to pay the promoter for his services and have first call on the dividends during the time they exist. Guaranteed stock, which is issued to raise some necessary money temporarily, also has prior rights to dividends over other kinds of stock. These special and temporary classes rarely appear in the investment world and need only be mentioned here.

Stockholders are considered partners in a corporation and it is very natural therefore that they should have some power either directly or indirectly in its management. A bondholder's interest is limited to receiving the interest and ultimately the principle of his security. The stockholder's interest extends to seeing that the company in which he is a partner is managed to his best interest through a board of proficient and capable directors, and to pass upon some of the more important business of the company such as must necessarily be acted upon by the stockholders. Vice Chancellor Green in 52 N. J. Eq. 219 sums; up in a general way the rights of the stockholders in the management of a company, in which he says: "It may sometimes be necessary in the transaction of some kind of
business of a corporation to have the consent of all the stockholders or of a certain proportion of them, and resolutions giving such consent or advice have the effect of empowering the directors to act. But the board of directors is the legal executive, recognized as such not only in practice and on principle, but by statute. In another decision it is decided that if stockholders disapprove of the legal action of directors their only remedies are to elect new ones at regular elections or to sell their shares and withdraw. The main activities of a stockholder in the management of his company is through his voting power. The laws of New Jersey in absence of other provisions, provides that voting shall be cumulative, and all classes of stock shall have equal voting powers. By cumulative voting in election of directors is meant that the stockholder is entitled to a certain number of votes in proportion to the number of shares of stock he owns, all of which he may cast for one person or divide them up among as many persons as he wishes. A stockholder votes in other matters in proportion to the number of shares he owns. Although rights to vote are limited to a very few important matters it is very essential that these rights should be allowed and unimpaired in all cases, for, as one judge puts it, "A share of stock represents the rights which its owner has in the management and profits of a corporation."

The corporation through its directors calls meetings of the stockholders at least once a year in the state of incorporation, in order that new directors may be elected and other necessary business brought before the stockholders. Sometimes
during the year meetings are called to act upon some important matter which has arisen, and certain definite rights are due to the stockholders in regard to these meetings. Thus notice must be given in due time, usually twenty days before the meeting is called, stating the time and place, and the business which is to come up at the meeting. Most states have passed statutes making it necessary that stockholders meetings shall be held in the state in which the company is incorporated. Statutes have also been passed prohibiting any more business from being transacted than is stated in the notice. Every corporation has a stock book in which the names of all the shareholders and number of shares owned by them is kept. No changes can be made on this book for transfers of shares which have been made twenty days prior to the day of the stockholders meeting. The secretary shall make all necessary changes in the book ten days before the meeting is called and place it where it may be available to any stockholder during business hours. The provision prohibiting a person to vote who comes into possession of stock within twenty days is to lessen the danger of buying stock on margin a few days before the election in order to control the business and elect directors; and the provision compelling the stock book to be kept open is to give the stockholders a knowledge of who may vote, and thus lessen the chance for fraud. As has been mentioned before no business shall be voted upon at a meeting unless the stockholders had been given notice that such business was to come up. This permits a stockholder to stay away from the meeting and yet run no risk of
having some important business passed upon, of which he had no notice. Another almost universal rule, and a rule by law in New Jersey, is to allow stockholders to vote by proxy. Securities are becoming distributed more and more among the people in small amounts and at distances far from the state in which the meetings take place. This fact makes it almost impossible to get a quorum together, and the difficulty is overcome by allowing the stockholders to vote by proxy in writing. Besides the election of officers, the right to give the company power to issue more securities, buy real estate, and transact other important business, are reserved for the stockholder to decide on at a meeting called for the specific purpose.

The voting trust might well be explained at this point. This plan of voting was first used by the railroads. Nearly every railroad in the United States has gone through its period of insolvency. The bondholders, knowing that great expense and delay would be incurred by buying in the railroad property through the court, formed the voting trust. That is, the stockholders turned their stock over to a trust composed of a few persons and received in return a trust certificate acknowledging such deposit, and quarantining the original stockholders any dividends which might be declared during the life of the trust. In this way the management is placed in a few hands and is secure during the existence of the trust, the result being a definite and secure policy and a concentrated attempt to bring the company back on a paying basis. The vot-
ing trust is cheaper and more proficient than a receivership and management through the courts, and has made its way among industrial companies. A very good example of a voting trust is the Pope Manufacturing Co., whose stock was held in trust for five years after it succeeded the American Bicycle Co. The courts are very strict in their interpretation of the legality of voting trusts which are not issued for a specific object and not open to the entire body of stockholders. Thus the voting trust agreement with the shareholders of the Distilling Co. of America was held illegal because it was not for a specific object and did not allow the shareholders the right to revoke the contract at any time.

While it is true that most companies give equal voting privileges to all classes of stock and the New Jersey laws make similar provisions, unless otherwise provided in the certificate of incorporation, examples are not lacking where the different classes of stock have different voting rights. Guaranteed stock for example has power to elect the majority of directors during the time for which it is issued. On the other hand preferred stock of some of the companies of strong financial standing do not permit the preferred stock to have voting power so long as dividends are paid regularly. Such is the case with the American Thread Co. and the Royal Baking Powder Co. Most of the companies making such provisions were found to be corporations whose preferred stock is almost as good as bonds and whose common stock draws high dividends and is held by a few men who wish to keep control of the company and reap the
benefits of a good investment. Treasury stock, which has been discussed has no voting power while it remains such because it is dead stock and represents neither an asset nor a liability.

A company very seldom disbands when it becomes insolvent because it is worth much more to the creditors as a running that as a defunct concern. The stockholder has a latent right, however, to share the assets of the company if such winding up should take place. Unless otherwise specified the New Jersey courts have held that the preferred stock has a preference over the common as regards assets, and this rule is generally followed by corporations. However, the American Sugar Refining Co., allows its common stock to share assets equally with the preferred. Guaranteed stock is always given prior claim to the assets over other classes of stock.

A few other rights given to stockholders will be mentioned briefly. In case a company is insolvent a stockholder may apply to a court of chancery for a writ prohibiting the officers from carrying on business, receiving or paying out any money, and the court if the facts are as stated will grant such an injunction and take steps toward the appointing of a receiver, to wind up the business of the company or bring about a compromise with the creditors. A stockholder having lost or destroyed his certificate unavoidably may apply for a new one and, if it is refused, he may compel the corporation to show cause for not issuing one, by applying to the circuit court of the county in which the principal office is located. Other
rights might be mentioned but space will not permit further discussion.

A profit which should not be overlooked in buying stock of a company is that derived through subscription rights. When a company in good standing, especially when its stock is selling above par, wishes to increase its capital stock or issue other securities, it usually gives its stockholders the right to subscribe for the new issue at par or below the market price so that they may get the benefit of the low prices of the new securities. A growing and prosperous company is liable to do this at any time, and whenever it does the stockholders have a chance to reap a profit by subscribing and then reselling the stock. A no more striking example of this can be found than the Illinois Central R.R., which in 1902 issued some stock allowing the stockholders to subscribe for it at par while the market value of the stock was standing at 173. This company has allowed its stockholders two other similar privileges since 1887. A privilege somewhat similar was allowed to the employees of the United States Steel Co., in 1903 to subscribe for preferred stock at reduced rates while at the same time the company guaranteed to take the stock back at a certain price with a specified time.

A stockholder in a company is liable only to the extent of the par value of his stock. If he receives it as full paid and non-assessable when as a matter of fact it is not full paid he is liable for the balance to the creditors of the company, but not to the company itself. This is a very import-
ant provision to holders of stock issued for a bonus or good
will because it does not permit the company to assess the stock
after it is once issued as full paid and non-assessable. Stock
issued in return for property, etc, is neither liable to assessment
nor to creditors of the company unless fraud entered in its issue. Collateral holders such as executors, administrators,
or those holding stock as security are not personally liable
for unpaid subscriptions or to creditors of the company.

The above discussion gives in a brief and general
way, the powers granted to and the liabilities assumed by the
holder of different classes of stock. Attention will be turned
for a few minutes to the powers and liabilities of bonds.
Bondholders are looked upon as lenders of money having no per-
sonal interest in the company to which they have lent the money,
excepting to see that the provisions of their contract is car-
ried out. The bonds draw a certain per cent interest, which is
always paid prior to the dividends on stocks, and is secured by
mortgage or lien on a specified part of the company. So long
as the interest is paid and the provisions regarding the secur-
ity carried out, the rights of the bondholder are exhausted.
Speaking legally, so soon as these provisions are violated or
not carried out the bondholders rights resume. Most bond
agreements allow the holder power, through the courts, to throw
the company into the hands of a receiver and wind up the busi-
ness in case the interest is defaulted or the principle not
paid when due. If it is an income bond the holder has a prior
lien for the interest on the earnings of the company, and as
other bonds, it has a first claim upon the assets of the company in case a receiver is appointed and the company's assets sold. Sinking fund bonds provide for a sufficient amount to be set aside each year out of the earnings of the company to retire the bonds at their maturity, and the holders of such bonds have a right of action in case such fund is not provided. The above rights are the ones legally held by the bondholders, not but in practice they are usually carried out. A running concern, as was explained in the first part of the chapter, is worth much more than a defunct one, and therefore since many companies are not worth as defunct concerns, as much as the par value of the bonds it is essential that the company be kept running in order to pay interest on the investment. Even though the idle concern should be worth as much as the bonds, litigation and delay are expensive and very good things to avoid. The bondholders of a defaulting company generally try to come to some agreement with the stockholders, whereby the bondholders are given stock for their defaulted interest and sometimes for part of the bonds, or by some similar move the company is kept running without litigation and delay. The issue of more stock is not to be recommended, however, because in all probability, the company is already water logged and the issue of more stock tends to increase the troubles. A much better plan, especially if the company is hopelessly watered, is through reorganization by having the bondholders stay their interest for a time and by the stockholders giving up some of their stock thereby squeezing out the water and again placing
the company upon a paying basis. A bondholder has practically no liabilities except to assume the risk of the investment. Some peculiar rights sometimes accompany the issue of bonds. Voting privileges have been known though they are of rare occurrence. The much criticized—and questionably managed United States Shipbuilding Co., gave voting privileges to $10,000,000 worth of bonds in order that Mr. C. M. Schwab might have a voting control of the company. A few companies have given the bondholders a right to elect directors in case of default of interest, a measure which often tends to decrease the danger of bondholders throwing the company into the hands of a receiver.

In summarizing we see that the rights of stockholders are limited to the powers of elected directors, whose duties are to manage and carry on the business in the interest of the stockholders, and to voting upon important matters which arise from time to time, such as the increase of stock, issuing of bonds and other securities, and making any radical changes in the business, etc. The liability of the stockholders is limited financially to the extent of the par value of the stock owned. Bondholders are not considered partners liable to the company or its creditors, but are rather creditors themselves to whom the company is indebted. Their general rights are to see that the company carries out its duties as debtor and in case of failure, justice can be obtained through the courts and receivership or by compromise. These few points which have been briefly mentioned should be known by all investors in securities.
CHAPTER IV.

DISTRIBUTION OF CORPORATION SECURITIES.

The proportion of the different classes of securities issued by the most important corporations has not, up to the present time, been fixed by the purely economic laws regarding the best interests of the company; but has been altered to further the interests of the promoters and underwriters. Too much attention has been given to the speculative value of securities, and not enough to value based upon sound economic business principles. It is almost the exception to find a company floated during the years 1899-1901, the time of greatest activity in this line - when the promoter did not capitalize it for above what it should have been in order to attract outside concerns and furnish himself and the underwriters a large bonus; and after the company was floated to sell the securities which he held, to the public at more than they were worth before their real value had been determined. This personal interest and not an economic one has largely determined how the different kinds of securities are proportioned and in what amounts they are issued. Any general conclusions therefore which might be made in this Chapter, regarding the proportion of securities must necessarily be based upon what would be considered a representative company, floated at a nominal capitalization and for the best interests of the stockholders, both present and future.

A corporation is supposed to be able to earn a pure profit on the capital invested over and above a nominal rate of inter-
est. If it is successful in doing this, the best interests of the stockholders demand that some bonds shall be issued. To illustrate, take a company needing $100,000 to buy and carry on a business in which it can earn 12% on the investment. If the company issues $100,000 of stock including no water, it will pay 12% annually in dividends. Now instead of issuing $100,000 in stock suppose it issues only $75,000 in stock and $25,000 in 6% bonds. The company would still earn $12,000 as before, $1500 of which would pay the interest on the $25,000 bond issue, leaving $10,500 or 14% for dividends on $75,000. In this way the company with the same amount of capital could pay 2% higher dividends on the stock than it previously had done. Therefore if a company can by issuing a conservative amount of bonds increase the rate of dividends on its stock it should in the interests of the stockholders do so. The mooted question is how much shall be issued in bonds. This depends largely upon the standing of the company. Speaking, generally a company should never issue bonds in larger amounts nor at a lower rate of interest than will be sold on the market at par. The reason for this is that it injures the credit and financial standing of a company to sell its first class securities below their par value. If necessity should arise, as it frequently does, to sell bonds below par, the reason can usually be traced to either an already heavily bonded debt or to a previous mismanagement. There might possibly be times when a company is compelled to do this, because of an intense industrial depression or poor financing, but such cases are rare. Mr. Thos. L. Greene,
states in a concise way, the test for the borrowing capacity of a company, in his little book on "Corporation Finance" in which he says: "The practical test of this limit of borrowing is found by a consensus of opinion in answer to this question. To what amount can commercial paper or bonds be floated at par, and at the ruling rate of interest for such borrowings". Theoretically bonds could be issued at par and at the ruling rate of interest up to an amount equal to the substantial value of the material assets of the company. Speculation, public opinion, and other disturbing elements must always be considered, however, when determining at what bonds and other securities will sell. A company may issue bonds, at the prevailing rate of interest, up to that amount on which in the minds of the investing public the interest will be paid regularly, and for which there will be a ready market at par value or above to turn them into money.

Stocks as before stated represent only a proportionate interest in a company and not a definite amount. Because of this, many financiers say that stocks may be issued to any amount without in any way encroaching upon the investing public or falling into the faults of mismanagement, because as they say the stock will be valued by the investor according to its real rather than its face value. The market and not the par value tends to reflect the true worth of the stock. There is much to be said contrary to these statements because excessive over-capitalization opens a way for fraud in the management and in the payment of dividends; and in the majority of cases results
in reorganization of the company at a lower capitalization.

A company should be capitalized upon its real value without water, or upon its earning power, the earning power to be determined by an average of the earnings for some eight or ten years. Having decided how large the capitalization should be it might do well to try to find in what proportion the capital stock should be divided between the common and preferred. Out of thirty-five industrial companies considered nineteen authorized an equal issue of both classes of stock, thirteen authorized more common than preferred, while in three cases the majority of the authorized issue was preferred stock. In most cases where two classes of stock are issued the provision is for an equal amount of each. Common Stock frequently represents good will for patents and payment for services of trust companies and promoters. During 1899-1901, promoters were very prominent and much in evidence and were paid for the services by what they could retain for themselves, in floating the company. They, therefore, frequently caused more common stock to be issued than preferred, they retaining the surplus in payment for services. This fact probably explains in a large measure the existence of more common that preferred stock in so many cases. If a company is capitalized upon the basis of its earning power the preferred stock should not be issued in larger amounts than the company is able to pay dividends on at all times, while the common stock should take up the speculative element and its value should be measured by the ability of the company to pay dividends upon it rather than by its par value. The general
rule therefore is to base the issue of the preferred stock upon the steady earning power of the company, and issue as much common as preferred, such stock to be used to pay for all the good will and bonus of the company and to absorb all the surplus earnings.

The last question which will be discussed in this paper has to do with the distribution of securities among the people as a whole. While there has been a rapid movement toward consolidation of industry there has been a concurrent movement toward the segregation of ownership. Mr. C. R. Flint in his testimony before the Industrial Commission said: "It is evident that while there is centralization of manufacture going on there is a decentralization of ownership; that there are a hundred times as many people interested in our industrials now as there was twenty-five years ago, and there probably will be at the end of another ten years a hundred times as many more".

The small man is being crowded out of active business but he is given a chance to reap some of the profits due to amassing large amounts of capital into corporations by investing in the securities. This small investor is necessary to the life of the corporation, for it furnishes a place, which is essential to the life of a people, for the investments of small amounts of money and gives the laborer a chance to become a partner in the business in which he is employed. Mr. J. B. Dill in an article in the Annals of the American Academy of Political and Social Science, volume 15 says; "The industrial movement must stand or fall by the proposition whether industrials are or are not to become an investment for the small capitalist".----- The
entire country is demanding secure interest bearing investments in small denominations". "Good industrials are open to investment and it only remains for the public to learn what is good for investment and what is only for speculation and the gambling of Wall Street will ultimately decrease and in its place legitimate investments of small capitalists will be formed."

These statements are from two to five years old, but they show that a movement is rapidly gaining ground whereby the securities of these large companies are more and more becoming owned by small investors, and less by the large capitalists and stock manipulators. Much has been written about the large companies being largely owned and controlled by moneyed men. To prove the unreliableness of this statement I wish to reproduce a table showing the percentage of stock in the hands of the largest stockholder and of the five largest stockholders of twenty-three industrial combinations. The table was drawn up by Prof. J. W. Jenks of Cornell University, while he was connected with the Industrial Commission in its investigation of the great trusts.
PER CENT OF STOCK HELD BY LARGE HOLDERS, FOR 24 COMBINATIONS.

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<td>1</td>
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<td>2</td>
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<td>22</td>
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1 Bulletin No. 29, Department of Labor.
The above table which is five years old shows that, at that time, on an average 19.71% of the common stock and 16.81% of the preferred stock of the twenty-three companies, was in the hands of one man, while 32.91% of the common and 27.77% of the preferred stock was held by the five largest stockholders. These actual figures go to prove that even five years ago the stock was fairly well scattered, and it is safe to assume that stock is generally more scattered today than it was then. Of course in such companies as the Royal Baking Powder Co. and the Otis Elevator Co., the stock is held by one of a few men, but such companies are the exception. Railroads have shown a tendency toward decentralization of ownership even more than industrial companies. An article written by Samuel Heubner some time back claims that the Illinois Central had 6526 shareholders, 5194 of which owned less than one hundred shares of stock each, although they owned considerable over a majority of the stock of the company. The Atchison, Topeka and Santa Fe had 13,147 stock holders many of whom were small holders. The general conclusion to the article is that the average tendency of all stock is to distribute itself in the hands of more holders. Some corporations try to get their stock distributed as much as possible. Thus the United States

\[1\] A. of A. A. Vol 22 pp. 63.
Steel Co. is as open as possible in stating the facts about the business and the company's policy, and, as a result, its stock is widely distributed. At the beginning of 1904 it had 79,957 different shareholders. This company as well as the Swift Packing House Co., and others make special inducements to their employees in order to get them to subscribe for stock in the company.

Combination of industrial companies was most active during the years 1899-1902. At first the people trusted the promoters' judgement and placed confidence in the stock which they caused to be issued. The promoters soon found this out and took advantage of it by issuing large amounts stock and after booming it up to abnormal prices by false and misleading statements, unloaded it on the public. As a result the people have lost confidence in what is said and look upon the securities of new companies with a great deal of suspicion. This is shown by the falling off in the number of consolidations and floatations during the years 1903-1904. Nevertheless conditions brightened somewhat toward the end of 1904 and at present the condition is very much as the Journal of Commerce and Commercial Bulletin for January 2, 1905 states: "The new year offers brighter prospects for legitimate industrials, especially those organized on a conservative basis; but it does not offer encouragement to promoters who desire to launch new enterprises on anything like the inflated capital basis of the past". Thus it is evident that more and more people are turning their attention to industrial securities for investment, but the chances
of the promoter, whose designs are selfish and aims illegiti-
mage, to successfully float a companies' stock is constantly
diminishing.

The stock of the majority of the leading industrials
was proportioned in classes and issued in such amounts as would
best serve the promoters and underwriters instead of being pro-
portioned and issued upon economic principles in the interests
of present and future owners. The people are anxious to invest
their money and small savings in good and sure securities and
will as soon as given a chance throw millions of dollars into
the industrial field to be used in a legitimate and conservative
way for production. So long as promoters and underwriters float
companies and issue large amounts of securities whose value is
extremely doubtful the natural progress toward distribution of
securities among small investors and consequently industry will
be greatly retarded. There is a strong tendency at work to ignore
these illegitimate promoters and it only remains for investors
to find the sound securities, to make the speculative stock
and that based upon wind conspicuous by lack of persons to in-
vest in it.
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