What Publicity Can Do

By LOUIS D. BRANDEIS

In the previous articles of this series Mr. Brandeis has described the concentration of power in the hands of the investment bankers by undue multiplication of their functions and by consolidation of banks and railroads. He has discussed the manner in which interlocking directorates have made this possible and the bad effect on the small investor and how this may be prevented through legislation. In this issue he tells how all of us can help.

PUBLICITY is justly commended as a remedy for social and industrial disease. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman. And publicity has already played an important part in the struggle against the Money Trust. The Pujo Committee and its able counsel, Mr. Samuel Untermyer, have, in the disclosure of the facts concerning financial concentration, made a most important contribution toward attainment of the New Freedom. The battlefield has been surveyed and charted. Bankers' Trust Company and the corporation of

COMBINATION and control of other people's money and of other people's businesses. These are the main factors in the development of the Money Trust. But the wealth of the investment banker is also a factor. And with the extraordinary growth of his wealth in recent years, the relative importance of wealth as a factor in financial concentration has grown steadily. It was wealth which enabled Mr. Morgan, in 1910, to pay $3,000,000 for $81,000 par value of the stock of the Equitable Life Insurance Society. His annual income from this investment was limited by law to less than one-eighth of one cent a year; but it gave him control of $504,000,000, of assets. It was wealth which enabled the Morgan associates to buy from the Equitable and the Mutual Life Insurance Company the stocks in the several banking institutions, which, merged in the Bankers' Trust Company and the Guaranty Trust Company, gave them control of $357,000,000 deposits. It was wealth which enabled Mr. Morgan to acquire his share in the First National and National City banks, worth $21,000,000, through which he cemented the triple alliance with those institutions.

Now, how has this great wealth been accumulated? Some of it was natural accretion. Some of it is due to special opportunities for investment wisely availed of. Some of it is due to the vast extent of the bankers' operations. Then power breeds wealth as wealth breeds power. But a main cause of these large fortunes is the huge tolls taken by those who control the avenues to capital and to investors. There has been exacted as toll literally "all that the traffic will bear."

Excessive Bankers' Commissions

THE Pujo Committee was unfortunately prevented by lack of time from presenting to the country the evidence covering the amounts taken by the investment bankers as promoters' fees, underwriting commissions and profits. Nothing could have demonstrated so clearly the power exercised by the bankers, as a schedule showing the aggregate of these taxes levied within recent years. It would be well worth while now to reopen the Money Trust investigation merely to collect these data. But earlier investigations have disclosed some illuminating, though sporadic facts.

The syndicate which promoted the Steel Trust, took, as compensation for a few weeks' work, securities yielding 892,500,000 in cash; and of this, J. P. Morgan & Co. received for their services, as Syndicate Managers, $15,500,000, besides their share, as syndicate subscribers, in the remaining $80,000,000. More recently, bankers' syndicates have, in many instances, received for floating preferred stocks of recapitalized industrial concerns, one-third of all common stock issued, besides a considerable sum in cash. And for the sale of preferred stock of well established manufacturing concerns, cash commissions (or profits) of from 7 ½ to 10 per cent. of the cash raised have been exacted. On bonds of high-class industrial concerns, bankers' commissions (or profits) of from 5 to 10 points have been common.
Nor have these heavy charges been con-

fined to industrial concerns. Even rail-
road securities, supposedly of high grade,

have been subjected to like burdens. At a
time when the New Haven’s credit was

still unimpaired, J. P. Morgan & Co. took

the Interboro, the Worcester & Boston
Railway first mortgage bonds, guaranteed
by the New Haven at 92 7/8; and they
were marketed at 96 1/2. They took the
Portland Terminal Company bonds,
guaranteed by the Maine Central Rail-
road—a corporation of unquestionable
credit—at about 88, and these were
marketed at 92.

A large part of these underwriting
commissions is taken by the great bank-
ing houses, not for their services in
selling the bonds, nor in assuming risks,
but for securing others to sell the bonds
and incur risks. Thus when the Interboro
Railway,—a most prosperous corpora-
tion,—financed its recent $170,000,000
Portland Terminal Company bonds,
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others should underwrite and sell the
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were made, the stock were offered them at a more attractive price there would be less need to pay the underwriters so high commissions. It is another practical protest, if indirect, against the existence of the middleman, which protest is one of the features of present-day finance."

**Publicity as a Remedy**

**COMPUL** bankers when issuing securities to make public that commissions or profits they are receiving. Let every circular letter, prospectus or advertisement of a bond or stock show clearly what the banker receives for his middle-man-services, and what the bonds and stocks net the issuing corporation. That is knowledge to which both the existing security holder and the prospective purchaser is fairly entitled. The banker’s compensation is reasonable, considering the skill and risk involved, there can be no objection to making it known. If it will not be reasonable, the investor will “strike,” as investors seem to have done recently in England.

Such disclosures of bankers’ commissions or profits is demanded also for another reason. It will aid the investor in judging the safety of the investment.

In the marketing of securities there are two classes of risks: One is the risk whether the banker (or the corporation) will find ready purchasers for the bonds or stock at the issue price; the other whether the investor will get a good article. The maker of the security and the banker are interested only in getting it sold at the issue price. The investor is interested primarily in buying a good article. The small investor relies almost entirely upon the banker for his knowledge and judgment as to the quality of the security; and it is this which makes his relation to the banker one of confidence. But at present, the investment banker occupies a position inconsistent with that relation. The bankers’ compensation should, of course, vary according to the risk he assumes. Where there is a large risk the bonds or stock will not be promptly sold at the issue price, the underwriting commission (that is the insurance premium) should be correspondingly large. He should not be paid more for getting investors to assume a larger risk. In practice the banker gets the higher commission for underwriting the weaker security, on the ground that his own risk is greater. And the weaker the security, the greater is the banker’s incentive to relieve his customers of their distress.

**Real Disclosure**

But the disclosure must be real. And it must be a disclosure to the investor.

It will not suffice to require merely the filing of a statement of facts with the Commissioner of Corporations or with a score of other officials, federal and state. That would be almost as effective as if the Pure Food Law required a manufacturer merely to deposit with the Department a statement of ingredients, instead of requiring the label to tell the story. Nor would the filing of a full statement with the Stock Exchange, when incorporated, as provided by the Pujo Committee bill, be adequate.

To be effective, knowledge of the facts must be actually brought home to the investor, and this can best be done by requiring the facts to be stated in good, large type in every notice, circular, letter and advertisement inviting the investor to purchase. Compliance with this requirement should also be obligatory, and not something which the investor could waive. For the whole public is interested in putting an end to the bankers’ exactions. England undertook, years ago, to protect its investors against the wiles of promoters, by requiring somewhat similar disclosure; but the British Act failed, in large part, of its purpose, partly because under it the statement of facts was filed only with a public official, and partly because the investor could waive the provision. And the British Statute has now been changed in the latter respect.

**Disclose Syndicate Particulars**

The required publicity should also include a disclosure of all participants in an underwriting. It is a common incident of underwriting that no member of the syndicate will sell at less than the syndicate price for a definite period, unless the syndicate is sooner dissolved. In other words, the bankers make, by agreement, an artificial price. The agreement is probably illegal under the Sherman Anti-Trust Law. This price maintenance is, however, not necessarily objectionable. It may be entirely consistent with the general welfare if the facts are made known. But disclosure should include a list of those participating in the underwriting so that the public may not be misled. The investor should know who and how he is being defrauded.

Not long ago a member of a leading banking house was undertaking to justify a commission taken by his firm for float- ing a now famous preferred stock of a manufacturing concern. The bankers took for their services $250,000 in cash, besides one third of the common stock, amounting to about $8,000,000. “Of course,” he said, “that would have been too much if we could have kept it all for ourselves; but we couldn’t. We had to divide up a large part. There were fifty-

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seven participants. Why, we had even to give $10,000 of stock to _______ (naming the president of a leading bank in the city where the business was located). He might some day have been asked what he thought of the stock. If he had shrugged his shoulders and said he didn't know, we might have lost many a customer for the stock. We had to give him $10,000 of the stock to teach him stock—we to fix a price which shall net them in cash $95 a share.

Think of the effectiveness with practical Americans of a statement like this:

A. B. & Co.
Investment Bankers

We have today secured substantial control of the successful machinery business heretofore conducted by ______ at ______, Illinois, which has been incorporated under the name of the Excelsior Manufacturing Company with a capital of $10,000,000, of which $5,000,000 is Preferred and $5,000,000 Common.

As we have a large clientele of confiding customers, we were able to secure from the owners an agreement for marketing the Preferred stock—we to fix a price which shall net them in cash $95 a share. We offer this excellent stock to you at $100.75 per share. Our own commission or profit will be only a little over $5.00 per share, or say, $250,000 cash, besides $1,000,000 of the Common stock, which we received as a bonus. This cash and stock commission we are to divide in various proportions with the following participants in the syndicate:

C. D. & Co., New York
E. F. & Co., Boston
G. H. & Co., Boston

Were such notices common, only reasonable compensation would ordinarily be taken; and the investment bankers would “be worthy of their hire.”

For marketing the preferred stock as, in the case of Excelsior Manufacturing Co. referred to above, the investment banker was doubtless essential, and as middleman he performed a useful service. But he used his strong position to make an excessive charge. There are, however, many cases where the banker’s services can be altogether dispensed with; and where that is possible he should be eliminated, not only for economy’s sake, but to break up financial concentration.

The subject to be discussed in the next issue is “Where the Banker is Superfluous”