· COMMENT ·

On Problems of Corporate Finance

George A. Briggs's article, "What Is Crippling Free Enterprise,"[1] is a good one but does he not oversimplify some of our problems? I can hardly agree with him in the statement that "surplus earnings should be distributed in dividends." Why are we to assume that all earnings must be distributed instead of being ploughed back in part? It seems to me that it is up to the directors to administer these affairs and make their decisions according to the best interests of the company. I am familiar with one corporation which for years had paid a 6 per cent cash dividend, ploughing back further earnings and declaring stock dividends to cover the increased assets of the company. Such a course is far wiser and generally far more profitable to stockholders than to receive the earnings all in cash and then reinvest them. For, under many circumstances, such stock dividends are not subject to income tax whereas if the earnings were all distributed in cash, and then those who wished to reinvest in the company bought new stock, a large part of these excess earnings would be swallowed up by the tax collector. As it is, those who wish to sell and do not wish to increase their holdings, can sell the stock received in dividends and those content to hold the new stock are not bled by the tax collector.

Mr. Briggs also states that one corporation should not be permitted to own stock in another corporation. Generally, perhaps, this is true but it is not as simple as it looks. How about banks and insurance companies? Should they never own stock? I have been studying some reports of the investments of some fiscal corporations and find that some of the most profitable and successful, and ones that are rendering a valuable social service, are large holders of common stocks. Then too there are cases where our laws almost require companies to operate subsidiary companies. Sometimes to disentangle realty holdings it is almost necessary to have separate corporations own real estate in different states or in localities with peculiar tax laws, and then there are cases like that of the Pullman Company where it was almost necessary to disentangle the building and sale of cars from their operation, in order to simplify and clarify problems of the regulation of fares, having bearing on only one part of the combined business. Another case comes to mind of a great corporation

[1] Am. Jour. Econ. Socio., Vol. 6, No. 4 (July, 1947), pp. 505–14.

which incidentally must own and operate a hotel, and for many reasons it is wise to keep that part of the business entirely distinct and separate from non-related activities.

The question of interlocking directorates too is an involved one. In broad and general terms I think such set-ups should be avoided but, where a bank more or less has to take over the control of a business enterprise or when such an institution as a great insurance company owns a large interest in a business, should they not have representation on the board? I am concerned now with a question of an institution which is shortly to come into ownership of a large block of stock in a certain corporation, by inheritance. The holding is very substantial. May not the institution seek a place on the board for a representative of theirs?

I am sure Mr. Briggs and I see these questions in much the same light but I think we must be careful not to oversimplify some of these complex questions.

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