

Statistical and Social Inquiry Society of Ireland

Permanent Finance for Public and Private Companies

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The whole financial pattern of industry in Great Britain has changed completely since the beginning of this century. Sixty years ago, with a few notable exceptions, the whole of industry was conducted by small family businesses financed by the families concerned from their own resources or those of their friends. Only a handful of industrial and commercial companies had their securities quoted on a Stock Exchange. The Stock Exchanges then dealt principally in British Central and local Government Securities, railway and public utility stocks and in the Bonds of foreign countries. Now the volume of British Government Securities has ballooned through official spending, in peace as well as in two wars, the railways have been nationalised, a great many Foreign Bonds have disappeared somewhat ignominiously and a great many British industrial and commercial companies have become public and sold their shares to the general public by means of a Stock Exchange quotation. At the same time the principle of limited liability has flourished and there are a great many private companies which for their own good reasons wish to remain private. This does not necessarily mean that they can or should finance themselves entirely from their own internal resources. Accordingly, I have been given the very broad subject of "Permanent Finance for Public and Private Companies" to talk about tonight. I believe that of a total of somewhat over 300,000 companies registered in the United Kingdom some 12,000 are public companies.

Obviously, I can only attempt to treat my very wide subject in somewhat general terms. Perhaps it will be best if I do not speak for too long, so that you can bring out any points which may be of particular interest to you in asking questions, which I will attempt to answer.

Let me first tell you something of the Issuing Houses Association. I come here as its Chairman for the time being, an office which I consider it a great honour to hold. This Association was started at the end of the last War to act as a consultative and advisory body to represent the interests of banking houses and other institutions acting as issuing houses for loans and other issues, and

to maintain touch with such institutions as the Bank of England, the Council of the Stock Exchange and the Council of Foreign Bondholders on questions affecting new issues and existing issues. There are over 50 members of the Issuing Houses Association (I cannot remember the exact number because take-over bidding seems to be as rife in the issuing business as elsewhere!) The members range from the great merchant banking houses, some of which are of considerable age, to quite small companies carrying on industrial issuing business. The Association does not seek to fetter, prescribe or regulate the manner in which its members carry on their respective businesses.

Most of the Issuing Houses are, of course, in London, but there are, I think, two in Birmingham, one in Glasgow and one in Lancashire. It is obviously for consideration whether you should not have some sort of special organisation for dealing with new issues in Ulster. I am ignorant of the position here. Several great companies here have been floated with London and local quotations. Maybe there should be more with purely local quotations and maybe there is capital here which should be invested locally. These are your problems.

The issuing business itself is necessarily liable to fluctuations, activity varying with the general activity in trade and industry. Partly for this reason, most Issuing Houses also carry on other business, such as that of Bankers, Accepting Houses, Investment Trust Managers and Registrars. These act as stabilisers.

The Issuing Houses would maintain that all issue business should be done through them because they can act as principals in all that they do, simply trying to do the right thing for an agreed fee. This is a powerful argument. Actually, all the issue business is not done by Issuing Houses; a considerable amount is done by stockbrokers acting on their own. They, however, cannot really claim to act as principals, because their primary business is earning commissions on buying and selling securities! I do think though, that there is great advantage in going to an Issuing House for your financial requirements whether you represent public or private companies. They have a great deal of expertise which it is usually worth employing and their employment does not, of course, cut out the stockbrokers. Most stockbrokers welcome being associated with Issuing Houses.

A word here about the cost of raising money. The British is undoubtedly the cheapest market in the world. I usually say that it costs about $2\frac{1}{2}$ per cent. to raise £100,000. Percentage-wise, of course, the larger the issue the lower the percentage. Where Issuing Houses are concerned they probably seek to retain 1 per cent. net themselves on the money raised, but in very large issues the percentage is often substantially less. There is, of course, no mystery about costs. They are all discussed with the client before an issue is made and a summary of them is set out in a prospectus.

The prime function of an Issuing House is to act as an intermediary between those who need capital and those who are willing

to provide it by investing. It has to balance the scales very expertly.

The first thing which a new client must expect the Issuing House to enquire into is creditworthiness and, in particular, present and prospective management. The Issuing House is always backing management and, unless it is satisfied on this vital score, it should not act. Some Issuing Houses put representatives on the Boards of companies which they sponsor, but, for myself, I would say that, if there is any need for this, the Issuing House should not do the business. Where a business falls down on this vital question of management it is, of course, commonly possible to meet its financial requirements only after it has been amalgamated with another business with strength of management.

Having satisfied itself as to the management of a new client the Issuing House will seek an Accountant's Report on the company. Unless the auditors are one of a few leading firms specialising in new issue work, such a leading firm will normally be brought in to make an independent report. This will not usually cause any professional jealousy.

At the same time a firm of solicitors specialising in new issue work will usually be consulted to draft appropriate Articles of Association and so on.

From the Accountants' Report and the legal drafts the Issuing House will be preparing the prospectus document, whichever of various forms this may take—Prospectus, Offer for Sale, Placing or Introduction.

The names concerned with any issue are of great importance in selling the shares. It is very important to have, as well as a leading Issuing House, well-known accountants, solicitors, brokers and valuers where appropriate. It is not possible to quantify the value of having the best, but it is never wrong to do so.

With public companies as well as with private ones, the work of the Issuing House is by no means confined to the actual making of issues. The relationship between client company and Issuing House is a continuous one and the Issuing House is available to advise on all manner of subjects not directly related to issues upon which the Directors of the average industrial company will not be expert. These subjects include amalgamations, acquisitions, re-organisations, capitalisations of reserves, dividend policy and the presentation of annual accounts. In fact, in the majority of cases the client company finds great value in being able to rely on all these subjects on the expert advice available from the Issuing House and very close personal relations grow up between the Directors of Issuing Houses and the Directors of their client companies.

In this connection it may be worth mentioning that there is some tendency for client companies to retain Issuing Houses as their financial advisers on the basis of annual fees. This has some taxation advantage and the fees for actual issues may then be agreed on most favoured nation terms.

Industrialists as a class may be suspicious of financial people, but the fact is that the financial people have a very important

part to play in the development of industry. Their part is highly constructive and the smart Alecks of industry who seek to bargain among financial people and think this clever, are taking a very short-sighted view. Having chosen a good Issuing House or broker, an industrialist is well advised to stick to him and rely upon his advice unless, of course, by the flow of time the quality of those in charge of the financial house falls. The quality of those in charge of any business, commercial or financial, can change equally quickly.

When a company has become public, the ways of raising further money are increased because it is then in a position to confine further new issues to its existing shareholders. This can be done either by "rights" issues, or by offering prior charges, such as Debenture Stocks, Loan Stocks, Unsecured Notes or Preference Shares to the existing members. The procedure for issues to existing members is considerably simpler than that for issues to the general public, because it is not necessary to comply with all the prospectus requirements of the Companies Act. Also it may be thought that the costs of issues confined to existing members are reduced. In particular, it is not necessary to do any newspaper advertising, which is a very expensive item in the cost of issues to the general public. On the other hand, when you are confining issues to the existing members of a company, you are inclined to be lenient on terms. Better terms are normally obtainable if an issue is made to the general public.

A word about underwriting. Particularly, perhaps, when issues are made on what appear to be attractive terms to existing members of a company, but also generally in the case of good companies which regard themselves as superior to everyone else in their particular line of business, the question of whether it is necessary to underwrite arises. All I would say about this is that from time to time, when someone declares war over the weekend, or drops an atom bomb, or merely puts the Bank Rate up 1 per cent., the commonsense of paying the very moderate premium for insuring that your company gets the money which you reckon it needs is very sharply underlined.

Most public issues are either substantially oversubscribed because, under our present system of taxation, the "stags" are attracted to them in the hope of some small tax-free capital profit, or they are left to a considerable extent with underwriters. It is rare for an issue to be exactly subscribed or to be left, say, 10 per cent. with underwriters. The stags are sometimes criticised, but as we are organised at present, they play a vital part in the new issue business.

Another matter worth mentioning is the cost of buying registered shares. This is really appalling. The two per cent. Stamp Duty is a crippling imposition. This, together with the jobbers' turn and other expenses, makes the cost of buying registered shares very high. There are many people who go for new issues, free of Stamp Duty, for this reason.

I have been talking, so far, principally about new issues for public companies, both when they first become public and also

about further issues after they have taken the initial plunge. There is no absolute rule, but if a Company is earning less than, say, £100,000 per annum, subject only to tax, it is doubtful whether it should seek to obtain a London Stock Exchange quotation for its shares. This yardstick is a very variable one, but normally there will be little market in the shares of a company earning less than £100,000 per annum, subject to tax, and it is always arguable that such a company should remain a private company and seek to meet its financial requirements privately.

When the Macmillan Committee reported before the last war, it was found that there was a "gap", in which were, on the one hand, large companies with growth potential, but no impressive past records, and on the other small companies not suitable for public flotation. As a result the Finance Corporation for Industry and the Industrial and Commercial Finance Corporation were set up to deal with these two Macmillan Gap problems. The large gap problem presumably continues to exist, but I doubt whether the small gap problem is so much with us today. This is where I turn to talk about the problem of finance for private companies which, either because of their size, or because of the inclinations of those involved in their management, want to obtain finance without ceasing to be private companies.

The concern of such companies is twofold, i.e. (1) how to obtain finance for expansion of the businesses and (2) how to provide the proprietors with capital outside the companies concerned, often with considerable emphasis on the question of providing for Death Duties. The Industrial and Commercial Finance Corporation and its associated Company, Estate Duties Investment Trust Limited, play a great part in this field, but also most Issuing Houses are equipped to deal in varying degree with the financial needs of private companies which wish to remain private but still raise funds. A pioneer in this field was Charterhouse Industrial Development Company Limited, but there are others and I make no excuse for naming Safeguard Industrial Investments Limited, managed by my own London and Yorkshire Trust. Another specialist in this field is Private Enterprises Investment Trust Limited.

When a private company, which wishes to remain private, approaches one of the specialist institutions which I have mentioned, it must expect to undergo the same sort of accountancy investigation as a company becoming public. It must also expect to be delved into similarly as regards management, present and future. It must also expect to have to sell its securities on a realistic basis. A few years ago the sort of investment companies that I have mentioned expected to provide finance for private companies on a double figured dividend yield basis two or three times covered by earnings, i.e., a dividend yield of 10-12 per cent. covered by earnings of 20-30 per cent. This has to-day been modified and, according to quality, the dividend yield required may now be $7\frac{1}{2}$ to 10 per cent. well covered by earnings. As to the amount which Issuing Houses or their associated companies will provide for private companies or their proprietors there are really

no rules, but perhaps if more than £100,000 is involved one would expect some sort of consortium to be formed, i.e., an investment of over that figure by a single outside investor would be unusual.

The great point which needs emphasising, so far as Issuing Houses and their associate companies and investment in private companies is concerned, is that this business is not one of money lending. That is a question for bankers and others. From the Issuing House point of view, each deal is a partnership deal involving the outside investor in participating in the equity of the client company in one way or another in the event of success. Our initial investment may not be in Ordinary Shares, but perhaps in Convertible Debentures or Convertible Preference Shares, but the emphasis is always on taking a part in the equity if the client company grows. There is no point in trying to disguise this and no point in minimising the merit, from the point of view of the private company, of having a powerful sleeping partner who will give support at all times to a growing private company. The feeling of security to be derived from having such a rich sleeping partner is a very real asset. Another point is that private companies to-day have to face the problem of surtax direction. It may be of considerable help to them to pay a relatively high rate of dividend on the shares or Debentures sold to outsiders in order to justify to the Special Commissioners their total distributions while they wish to remain private companies.

Issuing Houses are, as a rule, only willing to provide finance for private companies if they have reached a reasonable size. As a rough yardstick, it may be said that a company earning less than £25,000 per annum, subject only to tax, is liable to be a one man show. If this is so, the investment may fall down on the vital question of management.

In connection with private companies as well as companies which they have floated to the general public by way of public issues, one of the surprising things which Issuing Houses have to face is the personal connections which develop. If a deal is a good one, i.e., in the best interests of all concerned, it gives rise to very close continuing personal friendships. Accordingly, the constitutions of Directors of Issuing Houses have to be very strong! The Directors of client companies, public or private, are apt to regard their periodic visits to London as occasions. The wretched Directors of Issuing Houses are probably based on London, so that, if they don't look out, they may be faced with a multiplicity of parties every night. The fact that they have to decline some of these parties should not be misunderstood by their client companies!

I suppose all businesses have to be conducted with the most meticulous attention to accuracy and detail. This is certainly true of the business of Issuing Houses in raising money for public and private companies.