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THE DEVELOPMENT OF FINANCIAL MANAGEMENT
LITERATURE (1895-1960)

DISSERTATION

Presented in Partial Fulfillment of the Requirements for
the Degree Doctor of Philosophy in the Graduate
School of The Ohio State University

By

Constantine Danellis, B.Sc., M.B.A.

* * * * *

The Ohio State University
1965

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PREFACE AND ACKNOWLEDGMENTS

I wish to express my deep appreciation and gratitude to Professors E. F. Donaldson and John K. Pfahl of The Ohio State University. Their brilliant teaching and guidance initially attracted me to the fascinating field of business finance and made the writing of this dissertation possible. My heartfelt thanks are offered to Professor Frances W. Quantius of The Ohio State University and Professor William H. Pietsch of Sacramento State College for their liberal assistance and encouragement.

One of the early writers in the field, E. E. Lincoln, once wrote:

There are few really new things under the sun, though there may be new ways of interpreting apparently familiar facts. The most important discoveries are usually made in the best known fields and are merely the result of a patient and constructive examination of the data which have long been accessible to all, but the significance of which has not been fully appreciated.

Though I make no claim of any "important discoveries" in this study, nevertheless, I believe that this dissertation contains material that may be useful to the student of the subject.

Three years ago when I was considering the importance of my dissertation topic, the final solution to my problem was the affirmative answer that I gave to this self-asked

question: "Would I, as a graduate student and fledgling teacher of business finance, have benefitted had I had access to a study of this sort?" On the optimistic assumption that I was a representative student of finance, I proceeded to undertake this study.

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CHAPTER I

INTRODUCTION

Thousands of young Americans are currently enrolled in courses on Business Finance and Financial Management in the nation's colleges and universities. Scores of doctorates are awarded in the field yearly. Long are the lists of new books on this subject. This dissertation aims to trace the historical development of business finance literature in this country in the last seventy years. This first chapter includes statements relating to the purpose, justification, scope, methodology and limitations of this dissertation.

I. Purpose

The basic purpose of this dissertation is to trace the historical development of business finance literature in the United States in the present century.¹

The word history is in itself ambiguous. It covers (a) the totality of past human actions and (b) the narrative or account we construct of them now. The massing and linking of facts is essential, but even more important is the way in

¹For the exact meaning of the term "business finance" and other related terms, the reader is referred to the appropriate material in Chapter II of this dissertation.

which these facts are interpreted. History is needed because men, when faced with the need for taking an important action, first recall experiences previously undergone in closely similar circumstances and, after noting the differences between the current situation and that of the past, allow their action to be guided by the knowledge so derived.

Societies have not the same facilities for the automatic recall of past experience. They have no organic memory that can store experiences and produce them when required. This is why, from time immemorial, men have had to tell each other and their dependents the narrative which keeps these experiences available for comparison as a preliminary to unusual actions.²

As the finance scholars active in the past fifty years or so give way to younger men, there arises the need for a written "narrative" of the development of business finance thought for those who have had no direct experience with it.

A doctoral dissertation has been written on the development of management thought and one on the development of marketing thought by Professors John F. Mee and Robert Bartels respectively.³ The objective of the writers was to

²G. T. Renier, History: Its Purpose and Method (London: George Allen Unwin, Ltd., 1950).

³John F. Mee, "A History of Twentieth Century Management Thought" (unpublished Ph. D. dissertation, Dept. of Business Organization, The Ohio State University, 1959); Robert Bartels, "Marketing Literature--Development and Appraisal" (unpublished Ph. D. dissertation, Dept. of Business Organization, The Ohio State University, 1941).

trace the progressive stages through which the sciences of management and marketing progressed as their theories were developed and as their methodology became refined. Subsequently Professors Mee⁴ and Bartels⁵ each wrote a book based on their dissertations. In his book, Professor Mee asked that chronological and comparative studies be made in other areas, including finance, represented in a school of business.⁶ Professor Ezra Solomon, in 1963, put forward what he called an introduction to current thinking in the field of financial management. In the preface of his book he makes some interesting and thought provoking observations on the historical development of the subject.⁷

A voluminous dissertation on the development of theory in corporation finance was completed at the University of Illinois in 1962 by Atef Ebied.⁸ Although the Ebied dissertation treated the general problem of the development of theory in the social sciences and traced the historical development of some specific concepts in business finance in a

⁴John F. Mee, Management Thought in a Dynamic Economy (New York: New York University Press, 1963).

⁵Robert Bartels, The Development of Marketing Thought (Homewood, Illinois: Richard D. Irwin, Inc., 1962).

⁶Mee, op. cit., p. 32.

⁷Ezra Solomon, The Theory of Financial Management (New York: Columbia University Press, 1963), p. 3.

⁸Atef M. Ebied, "An Inquiry into the Development of Theory in Corporation Finance - A Tentative Statement of the

commendable manner, it did not contribute the kind of knowledge that the two dissertations mentioned above did in their respective fields.

Dr. Ebied surveyed and tested the technical facts and concepts of business finance "in an effort to synthesize them into a more workable holistic framework."⁹ He credits the business finance literature of the past sixty years with having given students and financial managers facts about the methods and tools used in business finance in an able manner. But this covers only the what and the how and not the why, he argued. He aimed at advancing a tentative statement of the theory in business finance. In developing such a theory Ebied sought out the origin and development of various concepts such as: "capital," "income," "depreciation" and others. No reasons were advanced for the development of the different concepts. Even more important, literature of such allied disciplines as economics, accounting and the law were examined primarily at the expense of business finance literature as such. Of 494 books included in the Ebied bibliography, only 38 have the phrases "corporation finance," "business finance," "financial management," or anything similar in their

Scientific Construct, the Conceptual and Propositional Framework" (unpublished Ph. D. dissertation, Dept. of Economics, University of Illinois, 1962).

⁹Ibid., p. 2.

titles that would allow them to be classified as business finance books. Yet, in spite of this inadequate representation of finance books in his dissertation, Ebied is ready to indict the business finance literature as a whole and to state that "the businessman is excused in losing confidence in or minimizing, the value of finance literature."¹⁰

The above points to a need for an examination of the business finance literature and a discussion of its historical development. The need for a critical examination of business finance literature is reinforced by the recent criticisms of business education in the nation's schools of business.

Current dissatisfaction with the quality of undergraduate business education is widespread and acute. It is virtually inevitable that this should be so. We have already seen that it is practically impossible to do in the four undergraduate years what the undergraduate business schools try to do, to provide both a general and a professional education of satisfactory quality.¹¹

Under existing conditions business schools do many things which ... other institutions are quite capable of doing themselves. Typically, work is offered in secretarial science, elementary bookkeeping, or other routine office procedures which have no legitimate place in a four year college program. Specialized courses in fields like marketing or production are often

¹⁰Ibid., p. 7.

¹¹Robert A. Gordon and James E. Howell, Higher Education for Business (New York: Columbia University Press, 1959), p. 132.

concerned with relatively simple techniques which have little analytical content or educational value.¹²

In general, the charge has been made that traditional business education has placed undue emphasis on the description of routines and procedures, a kind of knowledge that is subject to quick obsolescence. The content and quality of academic course work in business finance have given rise to dissatisfaction because of their alleged lack of analytical substance and an undue emphasis on descriptive detail.¹³

Suggestions for improvement of the content and change in the emphasis of business finance courses from the descriptive to the analytical have recently been made by a number of authors. This movement has been called the "new approach" to the study of business finance.¹⁴

Before a wholesale acceptance is made of the "new approach", it would be judicious to examine past literature in order to ascertain the validity of the criticisms levied against it.

II. Scope

To study the historical development of business finance thought, a careful compilation of sources must first be under-

¹²Frank C. Pierson and others, The Education of American Businessmen (New York: McGraw-Hill Company, Inc., 1959), p. x.

¹³Solomon, op. cit., p. 6.

¹⁴For an explanation of this and other appropriate terms, see the discussion in Chapter II of this dissertation.

taken. In this dissertation an extensive and as nearly exhaustive as possible bibliography of books and articles in the field is presented.

Professor Mee's book¹⁵ gives an excellent account of the genesis of the management movement in general and a chronological bibliography of management thought. As opposed to Mee, the emphasis in this dissertation is on books in business finance and more specifically the management of the finance function in business. Only those books bearing such words as "business finance", "corporation finance", "financial administration", "financial management", "managerial finance", or something similar in their titles are included for examination.¹⁶

The literature is analyzed to discover any evidence of relationship between ideas and concepts and the social, economic, political, and technological environment of the period. In addition, the literature is examined so that the following question may be answered: "In what way have the different writings in business finance over the years been of practical use to the financial manager?" It is conceded that important and relevant new ideas may have originated in the literature of different disciplines. Business finance

¹⁵ John F. Mee, Management Thought in a Dynamic Economy (New York: New York University Press, 1963).

¹⁶ A discussion on the reasons for this choice is found in Chapter II.

literature only is emphasized in this study so as to keep it in manageable proportions.

A study of this sort may give rise to criticism of the methods of classification used and omissions and validity of the interpretations made. Such criticism, however, will be welcomed, as it may well provide the stimulus for further research and discussion that cannot but add in a significant way to the present knowledge of the subject.

It is this writer's hope that this dissertation may be the foundation of a definitive published work on the subject that may be used by the student of business finance in courses on the development of business finance thought. In its present form, this dissertation is believed to hold little attraction for any but advanced students of the subject.

III. Methodology

This is primarily a library research project. Titles of books examined are taken from two sources: (1) Cumulative Book Index - World List of Books in English Language, for books published from the turn of this century to 1962, and (2) Library of Congress Catalog - Books: Subject, for publications from 1950 to 1963. In both sources the titles are found under the general headings of (a) Corporations, (b) Finance, (c) Business, (d) Management. Those books that were unavailable in the libraries of The Ohio State University

were examined by the writer in the Library of Congress, Washington, D. C.

The titles of the majority of the articles reviewed are found in the Index of Economic Journals under its classification index number 14, Business Organization - Managerial - Economics. Journals examined include:

- American Economic Review
- American Economic Association Papers and Proceedings
- Business History
- Business History Review
- Controller, The
- Economic Development and Cultural Change
- Economic History (Supplement to Economic Journal)
- Economic History Review
- Economic Journal
- Economic Papers
- Economic Record
- Economics (First Series)
- Econometrica
- Harvard Business Review
- Journal of the American Statistical Association
- Journal of Business
- Journal of Economic and Business History
- Journal of Economic History
- Journal of Finance
- Journal of Political Economy
- Quarterly Journal of Economics
- Review of Economics and Statistics

IV. Plan of Study

Definitions of vital terms used in this dissertation are found in Chapter II. A discussion of the reasons for the choice of these definitions is included. Some new terminology is also proposed.

In Chapter III the literature of the period from 1895 through 1919 is examined; Chapter IV covers the literature

from 1920 to 1929 inclusive. In Chapters V and VI the literature of the thirties and forties respectively is examined. The literature of the fifties and the first three years of the sixties is examined in Chapter VII. Each of the Chapters III through VII contains the following:

- (1) The economic, industrial, and technological climate of the period,
- (2) A brief discussion of the background and contributions of the major and minor writers of the period,
- (3) A discussion of new concepts introduced in that period, those that survived into the next period and their relationship to concepts introduced in the preceding periods, and
- (4) A summary of the chapter.

In Chapter VIII a brief summary of the findings and conclusions of this dissertation is presented.

An appendix is also provided. It contains a selected, chronologically arranged bibliography. The Bibliography is exhaustive and the entries are arranged in alphabetical order.

CHAPTER II

SOME TERMS DEFINED

One objective of the present investigation is to trace the origin and development of the use of certain concepts, and the terms that express them, over the years. Consequently, a summary of the definitions presently used by writers in business finance is included toward the end of this treatise. A problem exists, however, in that the terms describing the discipline which is under investigation are not firmly established in their usage. It therefore becomes imperative that attention be paid in this chapter to a few terms that are used throughout this dissertation and which define the field of knowledge whose development is the subject of this study.

I. The Term "Finance"

The basic term "finance" is derived from the Latin finis which means "end." It originally was, and sometimes still is, used to refer to monetary matters. Its use may be traced to the times of the Roman Empire where disputes arising in trading were tried before an established authority and the parties abided by its decision, thus putting an "end" to the whole affair.

Differences, it was found could be settled by a payment of money. Since the payment ended the strife, it became known as a fine. Here, then, is a connection between finis and money, so closely related that today monetary affairs are financial affairs.¹

Webster's New Collegiate Dictionary gives the following etymology and definitions of the word "finance:"

(1) Pecuniary resources, especially of a government. (2) The science and practice of raising and expending public revenue. (3) To conduct the finances of; to provide capital for.

However, a more up-to-date view of "finance" would be broader, including, in addition to legal money, all "means of payment:"

Finance is that part of the practical affairs which is concerned with money taken in a broad sense, to include not only that which is legally money (such as coin and paper money) but also bank credit or "credit money." Without suggesting that a word of such extensive practical application can be adequately defined by any simple formula, we may indicate its significance by saying that finance is "the art of providing the means of payment."²

This definition is more useful than the one given by Webster in so far as it includes all "means of payment."

¹Milo Kimball, Principles of Corporate Finance (New York: Longmans, Green and Co., 1939), p. 1.

²Sir Ralph G. Hawtrey, Encyclopedia Britannica Inc. (Chicago, Vol. IX, 1963).

II. Private, Business, Corporation Finance³

Professor A. Griswold suggests⁴ that finance as a field of study separate from economics developed in the latter part of the nineteenth century. The first "finance" courses were in international finance and government finance. Schematically, the place of early finance courses in the late nineteenth century in American universities was as follows:

Later, the increasing use of the corporate form of business organization made writers turn their attention to the field of business finance.

In 1903, Professor Frederick Cleveland of the Wharton School of Finance and Business noted that until that time, the terms "finance" and "funds" had been associated with public needs and wants. He, with Professor Edward S. Mead, was then writing a series of essays on "Private Finance" in

³It is of interest that in the Greek language there is currently no word for finance or business finance, and the field is designated as "business economics."

⁴John A. Griswold, in Frank C. Pierson and others, "Finance," The Education of American Businessmen (New York: McGraw-Hill Book Co., Inc., 1959), p. 393.

which he defined "finance" (without adjectival qualification) as that branch of business which has to do with the getting and spending of the funds necessary to the equipment and management of enterprise.⁵

Following World War I the public showed an increased interest in investments. In 1917, William H. Lough referred to "investing" and "banking" as "sister subjects" of business finance. Financing dealt with how to raise funds, what securities to issue, and how to use the proceeds of the sale. Investing, he said, is the process of supplying funds to the business undertaking for permanent use and banking for temporary use.⁶ Later the terms "financial management" and "financial administration" were used to define the area of business finance with emphasis on an internal management viewpoint as distinct from that of the outsider — investor, supplier or creditor of a business.⁷

The majority of the books, however, continued to use the terms "corporation finance" or "business finance" till the decade of the 1950's. The term "private finance" was no

⁵Frederick A. Cleveland, First Lessons in Finance (New York: Daniel Appleton and Co., 1903), p. 7.

⁶William H. Lough, Business Finance (New York: The Ronald Press Co., 1917), p. 4.

⁷Lucius W. Guernsey, Internal Financial Management (Boston: American Institute of Finance, 1922); James O. McKinsey, Financial Management (Chicago: American Technical Society, 1922).

longer used since it was believed to be overinclusive (i.e. "private finance" could refer to either business or personal finance which is the finance of the individual or the family unit). Figures I and II help to clarify the relationship of finance to corporation finance, business finance and financial management. It should be noted that "business finance" is a part of the broad subject of "finance." "Corporation finance," though only a part of "business finance," is frequently inappropriately used when the term business finance should be used. "Corporation finance," in turn, is broken down into different parts, one of which is the subject of "financial management" (Figure II). In both figures, financial management is placed near the bottom of the schematic representations. The interest of the writer of this dissertation is in financial management. Since financial management, however, is a part of corporation finance which, in turn, is a part of business finance, these last two areas are examined in addition to financial management. Books bearing, therefore, such words in their titles as corporation finance, business finance, financial management, financial administration, or managerial finance have been included in the list examined and analyzed in this dissertation.

In Figures I and II, terms have been underlined by the writer in order to point out the relationship between

FIGURE I

COMBINED FINANCE UNDERGRADUATE
AND GRADUATE CURRICULA, 1922 to 1939^a

^aFrank C. Pierson and others, The Education of American Businessmen, (New York: McGraw-Hill Book Company, Inc., 1959), p. 394.

FIGURE II

COMBINED FINANCE UNDERGRADUATE
AND GRADUATE CURRICULA 1946 to 1958^a

* Economics courses generally accepted toward finance concentration.

** Courses generally listed in finance curriculum and sometimes given in finance department.

^aFrank C. Pierson and others, The Education of American Businessmen (New York: McGraw-Hill Book Company, Inc., 1959), p. 396.

"financial management," "business finance" and "corporation finance."

III. "Traditional" and "New Approach"

Professor Pearson Hunt was probably the first to use the term "traditional approach." Reviewing Arthur S. Dewing's fourth edition of The Financial Policy of Corporations in an article in 1943, he uses the term to describe the main emphasis of the literature of corporation (business) finance until that time. He notes the increased interest in corporations after World War I and remarks that

In such environment it was only to be expected that the subject matter of studies in corporation finance should emphasize the matters of greatest interest to investment bankers, rather than to the treasurers of operating companies or to an observer in some ivory tower. Thus the traditional approach to the subject matter took up the topics of the forms of corporate securities, of promotion and the financial plan, of evaluation, of expansion with special reference to the holding company, of the determination and administration of income and of failure and reorganization, in the way in which it has become familiar to all readers in the field.⁸

It is the emphasis on periodic events and outsiders' viewpoints that Hunt termed the "traditional approach" and

⁸Pearson Hunt, "The Financial Policy of Corporations," Quarterly Journal of Economics, 57:305, February, 1943.

which by and large prevailed over others in the writings up to the decade of the 1950's.⁹

In contrast to the "traditional approach" an emphasis on the internal viewpoint as distinct from the outsider's viewpoint would constitute the "new approach" in finance as exemplified by writings in the late fifties and sixties, and discussed in Chapter VII of this dissertation.

IV. Financial Management

With the publication of Professor Robert W. Johnson's Financial Management in 1959¹⁰ the "new approach" that Professor Hunt asked for in 1943 was finally given recognition in the title of a college textbook. This trend was clearly recognized by 1959 by Professor Griswold who remarked that

⁹"Corporation finance deals with the financial problems of corporate enterprises. These problems include the financial aspect of the promotion of new enterprises and their administration during early development. The accounting problems connected with the distinction between capital and income; the administrative questions created by growth and expansion; and finally the financial adjustment required for the bolstering up or rehabilitation of a corporation which has come into financial difficulties. Three phenomena of our time have constantly augmented the social importance of corporation finance: the extent to which business today is corporately organized, the widening distribution of corporation ownership and the increasing tendency to separation of ownership and management." Arthur S. Dewing, "Corporation Finance," Encyclopaedia of the Social Sciences, III and IV (1954), p. 423. It should be noted that this concept of "corporation finance" makes no mention of the administration of day-to-day financial affairs of corporations. This was originally written for the 1934 edition of the Encyclopaedia of the Social Sciences.

¹⁰Robert W. Johnson, Financial Management (Boston: Allyn and Bacon, 1959).

Financial management has grown immensely in importance through enrichment of content... and is given major emphasis in most schools by their stated aim of preparing business executives. In fact, it may be said that gradually the emphasis on management decision-making is broadening the field of corporation finance and turning it away from the traditional legalistic descriptive method of teaching.¹¹

Though financial management is not a new concept,¹² the position that it has recently attained is of such proportions for it to be safely termed "the new approach" to corporation or business finance.

The author's reflections on financial management

There are indications that "financial management" is not similarly understood by all writers in the field. Some authorities argue that the "traditional" approach dealt primarily with the treatment of major, episodic, financial events in the life of the business enterprise, and therefore desire more extensive and enlightened treatment of the day-to-day problems of the financial manager. On the other hand, there are those who see in the approach promulgated above the danger of giving the teaching of business finance a vocational character and who contend that such training is better

¹¹Griswold, op. cit., p. 397.

¹²Cf. James O. McKinsey and Stuart P. Meach, Controlling the Finance of a Business (New York: The Ronald Press Co., 1923); Charles L. Jamison, Finance (New York: The Ronald Press Co., 1927).

accomplished on the job. These writers' conception of financial management, recognized implicitly in their writings, is that of a theoretical discussion mainly centered on the field of capital budgeting.

Such confusion is viewed by this writer as being due to a mistaken notion of the place and function of a firm's finance function. There is bewildering disagreement not only about who performs these activities traditionally viewed as the finance functions, but also which of the activities are actually performed by financial managers.¹³ Only if the importance of the finance function in the firm is clearly understood can valid discussion of the content and emphasis of university courses in business finance and financial management be understood.

Professor Weston, after examining the wide variety of titles of executives in charge of financial activities, concludes that the finance function is not clearly defined, and therefore does not convey a generally understood set of specific activities performed by the financial manager. His data further indicate that the financial manager may be engaged in such activities as stimulating sales, assuming the responsibility of personnel management, acting as director of

¹³J. Fred Weston, "The Finance Function," Journal of Finance, September, 1954; 9:265-282.

public relations, and performing a host of other such activities obviously not financial in nature.¹⁴

Much of the confusion in identifying the finance function in the firm and in providing an academic definition of the scope of financial management lies in the failure to distinguish between two basic and distinctly different kinds of financial activities. On the one hand are those activities (and their management) which involve the acquisition and the administration of funds, and, on the other hand, those which are concerned with the use of financial tools and methods by top management in planning, organizing and controlling the operations of the entire business. Contact with investment bankers, commercial banks and other negotiated sources of funds, collection, safekeeping and disbursement of cash, and preparation of cash budgets are among the activities in the first category. Their effectiveness requires the services of a specialist, as does the performance of "production" or marketing," both of which are usually managed by specialists. On the other hand, long range planning and decisions for the acquisition of fixed assets are traditionally viewed as functions of "top management." These are activities that transcend functional lines where major decisions are made concerning the business as a whole. The fact that in a profit

¹⁴Ibid., p. 269

making competitive economy such decisions are made by the use of financial yardsticks (such as the rate of return on investment) does not make them similar to the functions described above, and they should not, therefore, be called "financial decisions." Professor Raymond P. Kent calls those activities dealing with the raising, receipt, disbursement, protection, and custody of funds "incidental finance functions."¹⁵

In recent years, finance writers have greatly emphasized the development of a theory, concepts and tools of financial management as they pertain not to what has been called above incidental finance functions (similar in a specialized nature to the "production" and "marketing" functions) but rather to the assistance and staff advice that the finance men provide to top management in the formulation of major business decisions. Professor Ezra Solomon in The Theory of Financial Management¹⁶ distinguishes between the narrow definition of financial management and a wider concept which is "...directly concerned with production, marketing and other functions within an enterprise whenever decisions are made about the acquisition or destruction of assets."¹⁷ Nevertheless, he devotes almost the whole of the book to the second concept, completely

¹⁵Raymond P. Kent, Corporate Financial Management (revised edition, Homewood, Illinois: Richard D. Irwin, Inc., 1964), p. 66.

¹⁶Ezra Solomon, The Theory of Financial Management (New York: Columbia University Press, 1963).

¹⁷Ibid., p. 3.

neglecting the management of the "incidental finance functions." This writer believes that the recent de-emphasis by many authors of text books of the incidental functions is misdirected. While it is true that the area of "financial management" has not been adequately emphasized in the past, it would be inadvisable to remedy this at the expense of the "incidental financial functions." Both areas should be the subject of attention of academicians and practitioners alike and should be studied by finance students.

In conclusion, financial management has been used to refer to one or both of two things. One is the management in a firm of some specialized operations long viewed as strictly financial in nature. Second, the top management's use of financial methods to measure the financial attractiveness of alternative plans of major action and to control the organization's "purse strings." For purposes of clarity, it is proposed that the term "incidental financial functions" be used to define the first mentioned set of activities, and that management of the "executive finance function" be used for the management through financial methods. The "finance function" can similarly be broken down. First, it would apply to those activities performed by specialists in one or more departments of the firm. Secondly, it would cover the staff activities of finance men for other specialized departments or, even more frequently, for top management.

These refinements in terminology are made in the sincere belief that presently used terms are too inclusive and therefore inadequate for proper communication and understanding among finance men, practitioners and academicians alike,

V. Meaning of terms as used by the writer of this dissertation

In accord with the reasons and the discussion given earlier in this chapter, the following terms are used in this dissertation with the indicated meanings.

Finance; that area of human activity which deals with money and other means of payment.

Private finance; the finance of businesses, families or individuals; non-government finance.

Business finance; the financial affairs of business enterprises; part of private finance.

Corporation finance; part of private finance. The financial affairs of corporations. In some instances, however, corporation finance is used synonymously with business finance. A broad grasp of the theories, procedures, institutions, problems and policies that are used by corporations is very helpful also in the administration of firms of a non-corporate form.

Financial management (Managerial finance); the management of the financial affairs of business. That would include both the management of the finance department and the management of the financial affairs by top management (cf. the discussion on p. 20 to 25 in this chapter).

Traditional approach; the main emphasis of the earlier literature of business finance on periodic events, the outsider's viewpoint, mainly descriptive, and covering such topics as the forms of corporate securities, promotions, the financial plan, holding companies, determination and administration of income and failure and reorganization (cf. p. 18 in this chapter).

CHAPTER III

THE BEGINNINGS

1895-1919

In this chapter the books and articles on business finance for the period 1895 to 1919 are reviewed and analyzed. This period covers the emergence of literature on business finance and ends with the publication of Arthur S. Dewing's The Financial Policy of Corporations in 1920, which marks the beginning of a second, more mature stage in the evolution of finance literature.

I. The Period

The earliest book quoted from this period, Principles and Practice of Finance, was written in 1895.¹ For several reasons the year 1919 is chosen as the last in this period. Nearly all finance books in this period were written by men who considered themselves as being economists, lawyers, or accountants. (In subsequent years, the students of these authors considered themselves educated as "finance men.") Arthur S. Dewing's The Financial Policy of Corporations

¹Edward Carroll, Jr., Principles and Practice of Finance (New York: G. P. Putnam's Sons, 1895).

(1920) published for use in colleges, marks the beginning of a new era of financial sophistication bred mainly by the complexity in financial practice that arose as a result of the rapid industrialization and the adoption of the corporate form of business organization by other than manufacturing concerns. Developments during World War I also contributed to this sophistication.

A. The corporation

The use of the corporate form of organization for profit seeking concerns was initiated in the United States in the 19th century. Early joint stock companies were principally non-profit organizations for promoting religious worship, philanthropy and education. Beginning with the passage of the State of New York law in 1811, general incorporation laws were substituted for the previous practice of negotiating with the state legislature for a special charter. Loose, general incorporation laws, initially in the States of Delaware and Maryland and later in Nevada gave an added impetus to the adoption of the corporate form. The majority of early corporations were in the transportation field. By 1900, however, two-thirds of all manufacturing was done by corporations, a percentage which rose to 69.2% by 1929.²

²The discussion on the economic characteristics of the various periods in this and following chapters is based on

B. Investment banking

During the final thirty years of the nineteenth century, banks developed the practice of demanding a share in management control of borrowers before granting credit. Between 1879 and 1890, investment bankers undertook a significant share of railroad financing, exerting influence on management and promoting combinations in railroads. From 1891 to 1900, investment bankers promoted consolidations in the railroad, utility and industrial fields.

C. The First World War

World War I not only brought about changes in the productive processes of the country because of the great demands it made on them, but also influenced the investment market. During these four years the investment market handled an unprecedented volume of securities, including "Liberty Bonds" issued by the Federal Government, all of which had the effect of encouraging a widespread public acquaintance with securities issues. The war is also significant because of the great boom in business activity, fed initially by Allied orders and later sustained by American participation in the war.

the Encyclopedia of American History, Richard B. Morris (editor) (New York: Harper and Brothers, 1961).

D. The Federal Reserve System

In 1913 the Federal Reserve System was established primarily to remedy the defects of the national banking system. The major defects of the banking system prior to the establishment of the Federal Reserve were the inelasticity of the currency and the need for a "lender of last resort" to aid commercial banks confronted with a drain on their pyramided reserves such as occurred in the panic of 1907. Supplemental to this principal function is that of collecting and interpreting information bearing on economic and credit conditions. In addition, the Federal Reserve System performs the function of the examination and supervision of member banks, and the provision of cash-balance and payment services to the member banks, the government and the public.³

E. The school of business movement

The period up to 1919 also covers the beginning and early development of formal business education, a movement which greatly influences the business finance literature.

As mentioned elsewhere in this dissertation, the function of collegiate schools of business is not discussed by this writer. However, since the majority of later books

³Board of Governors of The Federal Reserve System, The Federal Reserve System (Washington, D. C., 1963), pp. 2-5.

were written expressly for use by college and university students of business, an examination of the philosophy governing the schools of business would be expected to shed light on the literature of the period.

The first collegiate school of business, the Wharton School of Finance and Commerce, was established in 1881 at the University of Pennsylvania.⁴ In 1916 the American Association of Collegiate Schools of Business was organized.

II. Books

The following characteristics distinguish the book literature of the period, 1895 to 1919, from the literature of other periods.

(1) The background and qualifications of the authors are varied. Their academic qualifications range from first degrees to terminal and professional degrees, and their backgrounds are in law, accounting, economics, and business.

(2) The writing was done primarily for practitioners (accountants, lawyers, businessmen) who wished to acquaint themselves with the comparatively new form of business

⁴The first collegiate schools of business were as follows: 1881 Wharton School of Finance and Commerce; 1898 College of Commerce and Politics, University of Chicago; 1898 College of Commerce, University of California; 1900 University of Wisconsin, School of Commerce; 1900 Amos Tuck School of Administration and Finance, Dartmouth College; 1900 School of Commerce, Accounting and Finance, New York University.

organization, the corporation.

(3) The approach to the subject is predominantly descriptive. Instruments and institutions are examined, and simple rules of thumb for use of corporate securities are promulgated.

The main contribution of the authors of this period was that they broke away from other disciplines and recognized a new field, that of business finance as such.

A. Edward Carroll

Carroll's Principles and Practice of Finance⁵ is the earliest book surveyed in the body of literature. In addition to describing the nature and functions of a number of financial institutions, the author devotes a chapter to an examination of such financial instruments as bonds, stocks, warrants and receivers' certificates. This he justifies by stating that, while the treatment of bonds and stocks "is a rather recent development of finance, it constitutes today one of its most important divisions."⁶ His treatment, however, is no more than a simple description of the legal and accounting nature of these instruments.

⁵Carroll, loc. cit.

⁶Ibid., p. 209.

B. Thomas Greene

Writing only two years later, Thomas Greene subtitled his book "A study of the principles and methods of the management of the finances of corporations in the United States with special reference to the valuation of securities."⁷ He notes the facility that the corporation form affords the owner who wishes to sell his business. His advice is, "incorporate and sell it piecemeal." Greene also discusses some rules of thumb for placing valuation on stocks, and he notes that every corporation must adopt such forms of accounts as suit its particular business. This should be done so the management will know exactly what is being done in every detail and at what cost. He is making the same plea for the usefulness of the accounting system to the manager, rather than to the outsider, that will be made half a century later.

C. Frederick A. Cleveland

Cleveland was a member of the Commission on Efficiency and Economy appointed by President Taft in 1911 to carry out a survey of administrative organization that recommended the establishment of a national budget, and paved the way for the Budget Act of 1921. A lawyer by training and vocation, he wrote two books on finance while on the faculty of the Wharton

⁷Thomas L. Greene, Corporation Finance (New York: G. P. Putnam's Sons, 1897).

School of Finance and Commerce.⁸ It should be noted, however, that, with the exception of the titles, the two books are identical in every other respect. Cleveland defines finance as "that branch of business which has to do with the getting and spending of the funds necessary to the equipment and management of enterprises." To him, apparently, business finance has attained such importance as to give to the unqualified term "finance" the definition of "business finance."

D. Harry C. Bentley

A certified public accountant, Harry C. Bentley wrote a book⁹ which, in his words, was designed "to provide a reasonably complete and conveniently arranged manual for the use of the corporation treasurer and all others interested in corporate finance and accounting." He suggests that the treasurer was originally the official whose special duty it was to receive, care for, and pay out the corporate funds. As corporations grew in size and complexity, the duty of keeping the accounts of the firm was delegated to another financial officer, the comptroller. He predicts that in time the accounting function will again come under the organization's

⁸Frederick A. Cleveland, First Lessons in Finance (New York: Daniel Appleton and Co., 1903); Frederick A. Cleveland, Funds and Their Uses (New York: Daniel Appleton and Co., 1903).

⁹Harry C. Bentley, Corporate Finance and Accounting (New York: The Ronald Press Co., 1908).

chief financial officer.¹⁰ He also notes that the term "capitalization" in corporate matters refers to the total authorized capital stock, whereas in economic discussions of finance it also includes bonds.¹¹ "Capital" he defines as the net value of the corporation's assets, a concept used by the accounting profession of that period.

E. Edward S. Mead

In the first edition of his widely used textbook in corporation finance,¹² Mead, a professor in the Wharton School of Finance and Commerce, states: "Corporation finance aims to explain and illustrate the methods employed in the promotion, capitalization, financial management, consolidation and reorganization of business corporations."¹³ In this way, he initiates the trend for the content of textbooks of corporation finance for years to come. He states also that he made no attempt to deduce from the facts of "corporation finance" any laws or principles. He described the methods employed in corporation finance, indicated the working rules of procedure and management which govern these methods, and showed some of the dangers

¹⁰Today we see this come true as more companies appoint as chief financial officer the Vice President of Finance, and the Comptrollers' Institute of America recently changed its name to the Financial Executives' Institute.

¹¹Bentley, op. cit., p. 391.

¹²Edward S. Mead, Corporation Finance (New York: D. Appleton and Co., 1910).

¹³Ibid., p. viii.

which lie in ignorant and careless financial management. In subsequent editions of the text, reflecting progress in refining the treatment of corporation finance and social and institutional changes, the following additions or elaborations in treatment, among others, were made: discussion of capitalization; a chapter on holding companies rewritten in light of decisions by the Supreme Court; additional material on sinking funds; a summary of the nature and the structure of the business corporation; an extended discussion of no-par stock; and a discussion of "blue sky" legislation and activities of the Post Office Department in checking the sale of fraudulent issues.

Of particular interest is Mead's opinion on the subject of par values. "It is not necessary that shares shall have any par value. The value of the shares depends upon the earning power of the company issuing the shares and this earning power, while dependent to a large extent upon the amount of money or property contributed to the company, primarily depends upon the ability with which this property is administered by the directors and the officers of the company."¹⁴

¹⁴Ibid., 1915 edition, p. 45

F. Hastings W. Lyon¹⁵

An accountant by training, and having five years experience in the investment banking business, Lyon was a Professor of Finance at Dartmouth and then at Columbia University. His books used a descriptive approach to the treatment of the instruments of corporate finance, capitalization, and financial reorganization.¹⁶ It is likely that he was the originator of the trend in financial textbooks to refer to what was generally known as "financial leverage" as "trading on equity," a term which, he suggested, is derived from the legal concept of "equity of redemption." In addition, Lyon treated in a pioneering way such subjects as capital structure (which he called "capitalization"),¹⁷ the variables determining the extent to which a firm can trade on the equity and control. As regards the different types of securities to use, he thought that: "The desire to apportion the element of risk,

¹⁵See also Chapter V, page 92.

¹⁶Hastings W. Lyon, Capitalization: A Book on Corporation Finance (Boston, New York, Chicago: Houghton, Mifflin Co., 1916); Corporation Finance (Boston, New York, Chicago: Houghton, Mifflin Co., 1916).

¹⁷It should be noted that early writers on finance used the terms capital structure and capitalization interchangeably to express the different sources of a firm's capital. As we shall see later, it was not until the fifth decade of this century that the differentiation between capitalization and capital structure became complete and clear.

income and control involved in an enterprise largely accounts for the numerous forms of securities."¹⁸

G. Charles W. Gerstenberg

Charles W. Gerstenberg, holder of a law degree and chairman of the board of a publishing firm, was on the faculty of New York University when he wrote his three books.¹⁹ Gerstenberg taught at the School of Commerce, Accounts and Finance at New York University between 1912 and 1924 when he left to become Professor of Constitutional Law at St. Lawrence University. His 1915 work, Materials of Corporation Finance, was designed, in his words, to "provide a field of vigorous training in finance." It is a book containing documents and problems dealing with various phases of the field of corporation finance, such as (1) kinds of business associations, (2) organization and legal management of corporations, (3) kinds of stock and rights of stockholders, (4) corporate bonds, notes and mortgages, (5) control of the issues of securities by the state, (6) sale of stocks and bonds to the stockholders and to the public, (7) prospectuses, (8) promotion, (9) inter-corporate relations, and (10) financial management and

¹⁸Lyon, op. cit., Corporation Finance, p. 2.

¹⁹Charles W. Gerstenberg, Materials of Corporation Finance (New York: Prentice Hall Inc., 1915); Problems in Private Finance (New York: Prentice Hall Inc., 1916); Organization, Management and Financing of Corporations (New York: Prentice Hall Inc., 1920).

provision of working capital. Significantly, this last item was not to be given serious attention by writers in finance for the next forty years or so.

In Problems in Private Finance (1916) Gerstenberg discusses seven so-called principles of business or private finance. Among them is his claim that the ultimate aim of the business should be to make divisions of profit among the owners at reasonably regular intervals and amounts.²⁰

H. Hugh R. Conyngton

The first four editions of Conyngton's work, Financing an Enterprise, appeared under the pseudonym of Francis Cooper.²¹

²⁰The first six general principles are (1) The project should not be undertaken until estimates have carefully been prepared of the amount of capital required for permanent investment in (a) physical property, and (b) working funds. (2) No attempt should be made to raise funds until a complete financial plan has been carefully worked out. (3) No attempt should be made to raise funds until carefully prepared estimates show that the enterprise will be economically sound, i.e., will be able to pay operating expenses, to pay capital charges on funds raised, to maintain the integrity of the investment and to provide a fair margin to compensate the projectors and insure future success. (4) In the management of the business care should be taken to see that there is always a sufficient supply of liquid funds available to pay debts as they become due in the ordinary course of business. (5) In managing the outflow of funds, allowances should be made for future extension of the business, future variations in gross income and maintenance of the investment. (6) If, in the course of the financial management, it becomes evident that the foregoing principles are being violated, the business will have to be readjusted or entirely reorganized or liquidated.

²¹Francis Cooper, Financing an Enterprise (New York: Ronald Press Co., 1906, 1907, 1909, 1915).

It was in the fifth edition in 1921 that the author's real name was revealed.²² Conyngton was a lawyer and, like Gerstenberg, he was also chairman of the board of directors of a large publishing firm. An indication of the kind of public to which the early books on finance were addressed can be ascertained by the subtitle of Conyngton's book: "A manual of information and suggestions for the promoters, investors, and businessmen generally." Conyngton devotes several chapters to the subject of "capitalization." He recognizes that "capitalization" always serves as a means of apportioning interest, and usually but not by any means invariably, serves also as a measure of value."²³ The intention of the law, he wrote, is that every dollar of issued stock must represent a dollar of value received by the corporation. However, wide discrepancies between the issued stock and the corporate assets are found from the very day of incorporation. He then advances reasons why, of the two states of overcapitalization and undercapitalization,

²²Hugh R. Conyngton, Financing an Enterprise (fifth edition; New York: Ronald Press Co., 1921).

²³Ibid., p. 308.

the first is more preferable.²⁴ He also discusses in detail various methods of capitalization.

I. William H. Lough

William H. Lough received his Master's degree in economics from Harvard University in 1902. From 1905 to 1910 he taught finance and transportation at New York University. He was one of the founders of the Alexander Hamilton Institute and its first vice-president from 1910 to 1915. His small book, Corporate Finance, was first issued in 1909 and then again every year from 1911 through 1914.²⁵ In 1917, an enlarged volume entitled Business Finance was published. In its preface, he claims that the literature on the subject of

²⁴"While the initial capitalization of an enterprise with shares of specified par value should be based on the actual values involved, close accuracy is often impossible when the undertaking is of a speculative nature. Variations within limits, however, are not serious. In case of a material overcapitalization of an enterprise to be financed, the promoters will find well-informed investors wary of the offering, and to overcome this reluctance they will be forced to increase the inducements. In case of a material undercapitalization the same face value of stock would probably have to be given for the needed funds as would be given if the corporation were more justly capitalized, which is in effect paying more for the money. Of the two, if within the bounds of moderation, a capitalization in excess of the present values is usually preferable."
ibid., pp. 313, 314.

²⁵William H. Lough, Corporation Finance (New York: Alexander Hamilton Institute, 1909, 1911, 1912, 1913, 1914).

business finance is so scanty that his book would of necessity break new ground. And indeed it did. He discusses forms of business organization, other than the corporation, at great length. In a separate chapter, he examines the different bases of capitalization, indicating his preference for capitalization on the basis of future earnings. Finally, in the chapter on budgets and financial standards, his discussion of the subject shows a sophistication that is more typical of the literature of the following decade. Lough defines "accounting" as recording and analyzing results that have been achieved, and "financing" as getting positive results on such matters as how to raise money, what securities to issue and to whom, and how to use the proceeds of such sales. He considers "investing" and "banking" as "sister subjects" of finance, the first having to do with the process of supplying capital to business and public undertakings for permanent use, and the second for temporary use.

III. Articles

In the first two decades of the century, periodical literature abounded with articles evaluating the development of and problems facing the rapidly multiplying business schools at that time. Many of the points advanced can be found in articles and discussions today, half a century later.

Pioneers in college business education were busy justifying the place of business schools in the nation's

universities. Medical schools, said Leon C. Marshall, are not founded primarily for physicians to command good salaries, but so that society may be served, and, while law schools aid in making lawyers who will be wealthy, the imposition of bar examinations shows that it is the interest of society and not individuals that is dominant. Business schools, while they could indeed help some men become wealthier, would also benefit society.²⁶

To the charge that business is an art and cannot be taught, the answer was that dutiful attendance at the best medical or law school would not make a good general practitioner or lawyer.²⁷

William A. Scott,²⁸ noting that a significant number of undergraduates in business at the University of Wisconsin stayed on for only their first two years, urged the establishment of two-year junior colleges to serve these students. Today, fifty years later, we see the mushrooming of junior colleges in this country.

²⁶ Leon G. Marshall, "The College of Commerce and Administration of the University of Chicago," Journal of Political Economy, 21:97-110, February, 1913.

²⁷ Edward D. Jones, "Some Propositions Concerning University Instruction in Business Administration," Journal of Political Economy, 21:185-195, March, 1913.

²⁸ William A. Scott, "Training for Business at the University of Wisconsin," Journal of Political Economy, 21:127-135, February, 1913.

Educators also were groping to establish appropriate curricula for those early business schools.²⁹ In 1911 the American Association of Schools of Business was established, its object being the "promotion and improvement of collegiate education for business."

Writers in this period were vociferous in their criticism of accounting as an aid in management. The following statement is typical of many: "Accounting records too often do not serve as an aid in administration, but only as a means of providing post-mortem evidence."³⁰ Another writer attacked all conventional methods of charging depreciation because they failed to recognize the fact that "elementary experience teaches that the rate of depreciation must necessarily increase with the age of the plant."³¹

²⁹For the early experiences of first schools of business in this country see: Isaac A. Loss, "The Ann Arbor Conference on the Higher Commercial Education," Journal of Political Economy, 11:457-466, June, 1903; Rosewell C. McCrea, "The Work of the Wharton School of Finance and Commerce," Journal of Political Economy, 21:111-116, February, 1913; Marshall, op. cit., pp. 97-110; H. P. Pearson, "The Amos Tuck School of Dartmouth College," Journal of Political Economy, 21:117-126, February, 1913; Scott, op. cit. pp. 127-135.

³⁰James O. McKinsey, "Accounting as an Administrative Aid," Journal of Political Economy, 27:759-781, November, 1919.

³¹Oliver F. Lyons, "Depreciation: The Surveyor's Versus the Accountant's Standpoint," Economic Journal, 20:469-472, September, 1919.

Niles Carpenter, Jr. of Northwestern University advanced an interesting financial analysis of the reasons for the failure of the Westinghouse Electric and Manufacturing Company in the 1907 depression, one of the more important reasons being the greater use of debt by this company in contrast to its competitor, General Electric Company.³²

IV. Summary

In this chapter the book and periodical literature pertaining to business finance was examined for the period 1895-1919, a period of infancy of the subject. Writers had different backgrounds and wrote mainly for businessmen, lawyers and others interested in the new corporate form of business organization. Their approach to the study of business finance was mainly descriptive and influenced by legal and accounting viewpoints.

The spread of the corporate form of organization necessitated by the rapid stage of industrialization of the United States during this period, the increasing influence of investment bankers on management, the business boom of the First World War, the familiarization of the public with securities markets through the Liberty Loans, and the

³²Niles Carpenter, Jr., "The Westinghouse Electric and Manufacturing Company, The General Electric Company, and the Panic of 1907," Journal of Political Economy, 24:230-253; 382-399, March-April, 1916.

emergence of collegiate business schools are important historical factors that influenced the writers of that period.

CHAPTER IV

CONCEPTUALIZATION

1920-1929

The decade of the 1920's is considered the second period in the development of the literature of business finance in this country. Books and articles in this field which appeared during this time period are reviewed and analyzed. The period opens with the publication of Arthur S. Dewing's The Financial Policy of Corporations and ends with the stock market crash of 1929. It is a period of increased refinements in the literature of finance as compared with that of earlier times; the literature is increasingly directed to the student in the rapidly expanding business schools, and in general reflects the augmented interest of the public in corporations and their financing.

I. The Period

This decade was a return to "normalcy" following the First World War. An initial temporary setback in economic activity was followed by a period favorable to business activity but ended in a stock market crash following intensive stock speculation.

The beginning of this decade is marked by the publication in 1920 of Dewing's The Financial Policy of

Corporations.¹ This great work, both in volume and detailed treatment of the subject, profoundly influenced writers of texts on corporation finance, not only in the 20's, but during the years up to and including the 50's. It is only recently that texts have departed substantially from Dewing's approach. Interestingly, in the twenties there is another significant development, an interest in financial management, or as it was called at the time, "internal finance." For some reason, an explanation of which will be attempted later, these initial contributions to financial management did not germinate, were not followed up in the literature of the next two decades; and it is not until the fifties and sixties that a new wave of interest in internal financial management occurred.

The post-war period of readjustment was followed by a new era in American business. Development of scientific methods of organization and control greatly increased the efficiency of business production and distribution and opened the way to an increase in the size of the average business unit. Management became more specialized and more frequently distinct from ownership.

When the income tax law deprived men of great wealth of some of the benefits they had previously enjoyed in

¹Arthur S. Dewing, Financial Policy of Corporations (New York: The Ronald Press Co., 1920).

holding corporate bonds, the investment houses turned to educating the smaller investor. The public utilities, driven by the need of more funds, approached their own customers as possible buyers of preferred stock. Numerous people who formerly had known savings banks, building and loan associations, life insurance and real estate as the only possible savings media were taught through major campaigns to consider security buying as another savings vehicle. The need of corporations to raise more funds either to expand their operations, or to fund large amounts of liabilities, coupled with the general prosperity of the country and the increased earnings of individuals, resulted in a phenomenally strong market for investment securities.

The list of new books in business finance for the period of 1920-1929 is significantly long. It reflects the increased interest of the people in this country in corporations as an investment and savings medium.

A. Economic activity

A temporary hesitation in the war boom of business activity was experienced with the signing of the Armistice in 1919. This hiatus was followed by soaring prices, sales, and production resulting from credit expansion and speculation in inventories. A sharp deflation resulted after May, 1920 and lasted through 1921 and part of 1922.

From 1922 to 1929, an expansion of the consumer durable goods industry and a boom in construction and real estate sustained a rising tide of prosperity. By 1927, residential construction, automobile output, purchases of consumer durable goods, and new investment in producers' goods had begun to decline. Prosperity continued, however, fed almost entirely by unprecedented securities speculation not reflected in commodity prices. A severe crash of stock prices occurred in the last quarter of 1929.

B. Banking

During the second decade of the century, corporations increasingly used their earnings to satisfy capital needs, while adopting a conservative dividend policy. The growth of the securities market and the rapid growth of investment trusts led to bypassing of established investment bankers. The business practices of reducing accounts receivable, together with the stress on smaller inventories and their rapid turnover, left commercial banks with idle funds.

The volume of loans on security collateral expanded alarmingly, and commercial banks branched into such fields as real estate, time deposit banking and investment banking. This was a period of large banking consolidation and a spread of branch banking as well.

II. Books

The following developments characterize the book literature of the decade 1920-1929:

- (1) Writers were writing mainly for college audiences.
- (2) Business finance was more securely established as a field of study. The major authors of this period presented broader and deeper treatment of the subject.
- (3) The major trend was in the external approach, reflecting the ever-increasing interest of the investing public.

More specifically, the major writers of the period were as follows:

A. Arthur S. Dewing

Arthur S. Dewing, a Ph.D. graduate of Harvard, taught at that institution as Assistant Professor of Philosophy for ten years and as Assistant Professor of Economics and Associate Professor of Finance for about eight years. He then became a public utilities executive and achieved the position of president and chairman of the board of several large companies. He wrote two books on the subject of philosophy and several works on business finance. He is sometimes referred to as the "father of corporate finance."

His five volume work, The Financial Policy of

Corporations,² first appeared in 1920 and enjoyed multiple subsequent editions. Professor Dewing brought to the subject of corporation (or business) finance an intelligent and incisive mind most often found in some of the more liberal and esthetic fields. His knowledge of classical history, philosophy and social theory is manifest in his writings and complements the mass of factual data which he presents.

Dewing, though acknowledging the value of his study to practicing businessmen and bankers, was particularly hopeful that the college students of his day also would find it useful in their studies.³

His five volumes dealt respectively with: the form of the different securities likely to be issued by a corporation; the development of a corporation from its promotion; the various problems arising from the financial administration; the methods which may be pursued in obtaining the money necessary to expand a corporation and the form which this expansion may take; and finally, the reasons for business failures and the various means to be employed to rehabilitate a bankrupt corporation. The subsequent editions of this book retained to a large extent this form of approach to the

²Arthur S. Dewing, Financial Policy of Corporations (New York: Ronald Press Company, 1920).

³Ibid., p. v and vi.

study of business finance and greatly influenced other writers in the field. This approach as we have seen has been called the "traditional approach."⁴

His Volume III, "The Administration of Income," was treated in a descriptive manner in a way similar to the other volumes. Topics such as the significance of accounting theory in finance, theory of compensation for wasting assets, the cost of borrowed capital, the management of surplus, special reserves for business contingencies, the principles governing the distribution of profits to stockholders, the practical expediency of dividend disbursements and the origin and use of the voting trust were included in this volume.

Dewing noted the various meanings accorded to the term "capital" by the various writers so as to make it meaningless outside of its context. Furthermore, he noted the use of retained earnings as a method of financing and said:

If, as with established industrials, little new capital is required for an expanding business, a large proportion of the stockholders' surplus may be distributed as dividends. But if on the other hand, considerable amounts of new capital are required for the ordinary course of the business, a small proportion of the stockholders' surplus should be distributed and a large proportion reinvested in the business.⁵

⁴See also Chapter II, page 18 and Chapter VI, page 132.

⁵Ibid., p. 78.

He also recognized the importance of a stable dividend record and noted:

A dividend record showing large disbursements during years of prosperity and "passed" dividends during the depressions stamps the stock as speculative and investors tend to associate the stock and the bonds together in one category.⁶

He referred to the capital structures as the "financial plan." The factors, conditions and customs controlling the form of the financial plan can be summarized as:

- (1) The value and the cost of the tangible assets to be acquired.
- (2) The traditions and the width of the market in which securities will be sold.
- (3) The certainty and the regularity of the future earnings.
- (4) The attitude of the promoters concerning the concentration of control of the enterprise.

Dewing avoided the term "working capital" and used the term "current capital" when referring to the total of raw materials, finished products on hand, the credits resulting from the sale of these finished products and the money necessary to keep the business running smoothly.

Professor Dewing in addition wrote Problems to

⁶Ibid., p. 85.

Accompany the Financial Policy of Corporations⁷ in 1921 and Corporation Finance,⁸ co-authored by R. R. Dewing, in 1922.

B. Edmond E. Lincoln

Edmond E. Lincoln, a Rhodes scholar, received his M.A. degree from Oxford University, England, and his Ph.D. at Harvard in 1917. He taught at Harvard from 1914 to 1922. His 1921 book, Problems in Business Finance,⁹ contains an excellent and thorough bibliography of books in business finance available at that time. His 1922 book, Applied Business Finance,¹⁰ was subsequently revised four times. Lincoln does not take a narrow view of the subject of business finance, by including only the raising and the distribution of money in a business concern. In his words, "There can be no successful management of any enterprise without the proper co-ordination of all the departments of a business through a central financial control."¹¹ Furthermore, he recognizes what he called "permanent working capital" as that minimum

⁷Arthur S. Dewing, Problems to Accompany the Financial Policy of Corporations (New York: The Ronald Press Company, 1921.)

⁸Arthur S. Dewing and R. R. Dewing, Corporation Finance (New York: The Ronald Press Company, 1922).

⁹Edmond E. Lincoln, Problems in Business Finance (Chicago: A. W. Shaw Company, 1921).

¹⁰Edmond E. Lincoln, Applied Business Finance (Chicago: A. W. Shaw Company, 1922, 1923, 1925).

¹¹Ibid., 1922 edition, p. 42.

amount required at all times.¹² His Applied Business Finance deals with such subjects as commodity loans and their importance, loans secured by bills of lading, warehouse loans, other commodity loans, pledging receivables, security loan, dealer credit, and the special problems of the small borrower. In 1941 he added a chapter on the relationship and differences of public and business finance, the relationship between public debt, public spending, and public lending, and private financial management.

C. James O. McKinsey

McKinsey's formal education included a Ph.B. degree from the State Teachers' College, Warrensburg, Missouri, in 1912, an LL.B. from the University of Arkansas in 1913, a Ph.B. from the University of Chicago in 1916, and an M.A., also from the University of Chicago, in 1919. He also received a CPA in 1919. He taught at the University of Chicago from 1917 to 1935, and wrote his three books while there. McKinsey was somewhat of a pioneer in the field of business finance as his were the first books that used the so-called "internal" approach to finance. His first book, Budgetary Control¹³ (1922), mentions that

¹²Ibid., 1923 edition, p. 181.

¹³James O. McKinsey, Budgetary Control, (New York: The Ronald Press Company, 1922).

the planning which may be done in connection with any particular business may be classified into three broad, overlapping groups.

1. That which deals with the operation of separate departments, such as production, sales, and finance. Such planning has been described loosely in the past as industrial engineering. 2. That which deals with the co-ordination of the operations of the several departments to the end that a well-formulated program may be made, for the business as a whole. Such planning may be termed budgetary control. 3. That which deals with the determination of future conditions as reflected in the business cycle and the shaping of the plans of the business to meet these conditions. Such planning is known as "forecasting" or "business predicting."¹⁴

His first book deals with group number (2). In it he discusses commendably the "financial budget" which is none other than what is today usually known as the "cash budget." He does not mention the "capital budget," but he uses the term "plant and equipment budget."

His second book, Financial Management, also published in 1922,¹⁵ is the first to use the term "Financial Management" as a title. In the preface he states that "It is the purpose of this text to treat the everyday problems of financial management as they logically arise in the normal operations of a going concern." He defines financial management as that dealing with problems of (1) determining the

¹⁴Ibid., p. 3.

¹⁵James O. McKinsey, Financial Management (Chicago: American Technical Society, 1922).

amount of capital required, (2) securing the capital, and (3) controlling the investment and use of capital. He claims that

Most of the texts on finance place emphasis on promotion, syndicates, reorganization, consolidation, mergers, receiverships, etc. These topics make interesting reading and much data can be obtained with reference to them. They are, however, of comparatively little significance to the average financial executive, since the normal business experiences such conditions but rarely, if at all.

and

In the past, writers on finance have regarded methods of securing capital as constituting the principal part of financial management. It is now recognized, however, that the proper use of capital is a feature quite as important as the method by which it is received.¹⁶

His book also includes, "considerable emphasis ... upon budgetary control, upon accounting and statistical methods, for these are considered as the backbone of scientific financial management." He distinguishes between permanent and temporary needs for capital.

McKinsey's third book, co-authored by Stuart P. Meech, Controlling the Finances of a Business,¹⁷ is in a substantial way an enlarged, extended, and improved version of Financial Management. Controlling the Finances of a Business is an

¹⁶Ibid., p. 6.

¹⁷James O. McKinsey and Stuart P. Meech, Controlling the Finances of a Business (New York: The Ronald Press Company, 1923).

impressive work. It contains 638 pages, but more important, its table of contents reads like that of any "modern" book in financial management. The book is divided into eight parts: the background for financial administration, determining capital requirements, sources and devices for securing capital, marketing securities, control of income, and organization for financial administration. Part II, "Determining Capital Requirements," includes chapters on budgetary control as a basis for estimated capital requirements, integration and fixed capital needs, planning for future capital needs, the business cycle and fixed capital needs, conservation of working capital, internal policy and working capital needs, the business cycle and working capital needs, estimating cash requirements, and financial budget and cash programs.

McKinsey gives one of the most explicit justifications for his preference of defining "working capital" as the total of current assets. He points out that due to the need for a safe margin of current assets over current liabilities, the commonly accepted definition of working capital has grown. (This is the definition which states that working capital is the "excess of current assets over liabilities.") But, he argues, "If one accepts this definition, then clearly he cannot say that working capital is secured from banks, or from trade creditors, for when capital is thus secured, current liabilities are increased as much as are the current assets."

In his opinion the old definition of working capital was formed with the accounting definition of proprietorship in mind, whereas the term, "fixed capital" (as it describes fixed assets) is an outgrowth of the economists' definition of the concept "capital" as the "fixed instruments of production."¹⁸

D. Joseph H. Bonneville

Bonneville wrote his first book, Elements of Business Finance,¹⁹ in 1925. A second edition of this book appeared in 1928. This work, improved, augmented and co-authored by Lloyd E. Dewey, was renamed Organizing and Financing Business and was published in 1932.²⁰ Bonneville closely adhered to the content and terminology of the other writers of the period. To him, "private finance," covers activities of promotions, organizations, reorganizations, adjustments, and readjustments of business, financial legislation, banking, securities, and financial management. In his first book in 1925,²¹ Bonneville observes that there are two great functions in a business, those of "producing and marketing." Finance is one of the

¹⁸Ibid., pp. 101-102.

¹⁹Joseph H. Bonneville, Elements of Business Finance (New York: Prentice Hall Inc., 1925).

²⁰Joseph H. Bonneville and Lloyd E. Dewey, Organizing and Financing Business (New York: Prentice Hall Inc., 1932).

²¹Bonneville, op. cit., 1925, p. 5.

assisting functions in business. He also defines "financial plan" as consisting of the scheme embracing the solution of the following three programs: (1) determining as accurately as possible the amount of capital needed, (2) devising the method of raising that capital in the most efficient, economical, and desirable manner, and (3) making plans for the proper management and administration of the capital.²²

E. Cecil E. Fraser

Fraser studied at the University of Illinois and at Harvard University where he received his M.B.A. degree in 1921. He taught at Harvard from 1923 to 1931, and after an eight year absence to work in industry, he returned in 1940 and taught until 1947. Fraser's two works are stamped with the influence of his professor at Harvard, Arthur S. Dewing. Both of his books were published in 1927. Problems in Finance,²³ which was revised in 1930, is a familiar Harvard casebook for finance students. Finance,²⁴ published in the series, "Manuals of Business Management," was intended for men primarily concerned with other fields: "To assist such men in securing a brief summary of the salient points of

²²Bonneville, op. cit., 1925, p. 172

²³Cecil E. Fraser, Problems in Finance (Chicago: A. W. Shaw Company, 1927).

²⁴Cecil E. Fraser, Finance (Chicago: A. W. Shaw Company, 1927).

finance without taking the time to study an exhaustive treatise."

F. Charles L. Jamison

Jamison's 1927 book, Finance, went through but one edition. It is interesting that it met the same fate as McKinsey's works. Both authors' works were directed to a survey of the function of finance from the point of view of the corporation treasurer in a growing concern rather than that of an outsider, as other authors had done up to that time. Jamison had this to say about the nature of the finance function in a business concern:

Finance is a specialized function in industry that calls for specialized skill and training on the part of men who administer it ... Therefore, we find the function of finance carefully differentiated from other administrative functions. It has a distinct plan of organization, with distinct duties and responsibilities for its personnel. The Finance Department can consist of but one man, or it may comprise an extensive organization.²⁵

G. Edward S. Mead

Mead's Corporation Finance experienced its fifth revised edition in 1923. In 1926, Mead was joined by Karl W. H. Scholz in writing another book, Rudiments of Business Finance.²⁶

²⁵Charles L. Jamison, Finance (New York: The Ronald Press Company, 1927).

²⁶Edward S. Mead and Karl W. H. Scholz, Rudiments of Business Finance (New York: D. Appleton and Company, 1926).

Mead gave the following reason for writing this book: "This book is the outgrowth of many suggestions that the principles of corporation finance and the methods employed in the financial operations of corporations could be stated in simpler terms than are found in the various manuals on the subject, particularly in my own Corporation Finance."²⁷ Corporation Finance was revised many times, and its revision eliminated material in corporation law and accounting to make room for expanded treatment of finance instruments and methods of financing. Thus, in this book not only was the subject treated in simpler terms but also additional material was provided by the co-author, especially in Chapter 10 on the business budget and Chapter 11 on the subject of stock dividends. It is worthy to note that Mead, when he refers to working capital (which he interpreted to be the total of the current assets of the business) uses the term "revolving capital."²⁸

H. Other writings

Other significant developments in the literature of business finance in this period were as follows:

A small forty-five page pamphlet entitled Internal Financial Management was written in 1922 by Lucius W.

²⁷Ibid., p. ii.

²⁸Mead seems to be the first American to use this term which closely resembles the French capital de roulement. Gerstenberg used the term "circulating capital."

Guernsey.²⁹ The author³⁰ did not, however, define "internal financial management." He was disturbed by the high incidence of corporate failures at the time. He remarked that a lot of these failures were due to the absence of carefully planned courses of action. Some of the causes of corporate failures discussed were such things as payment of dividends that had not been earned, and the existence of unwieldy fixed charges.

Avard L. Bishop's³¹ Financing of Business Enterprises calls the "financial plan" "financial structure,"³² and includes a good bibliography of books of corporation finance at the time. Sloan's Corporation Profits (1929) was a study of the size, variation, use and distribution of corporation profits in the period of prosperity between 1926 and 1927.³³

Charles W. Gerstenberg, continuing active from the preceding period, recognized in his book Financial Organization and Management³⁴ the idea of a concept of capital

²⁹Lucius W. Guernsey, Internal Financial Management (Boston: American Institute of Finance, 1922).

³⁰Professor of Business Administration, Yale University.

³¹Avard L. Bishop, Financing of Business Enterprises (New York: Harper and Brothers, 1929).

³²Ibid., p. 161.

³³Lawrence H. Sloan, Corporation Profits (New York: Harper and Brothers, 1929).

³⁴Charles W. Gerstenberg, Financial Organization and Management (New York: Prentice Hall Inc., 1924).

cycles, and presented it in a diagram showing the outflow of cash.

Louis F. Musil, Treasurer of Cities Service Company,³⁵ claimed that the finance function is one of the operating functions of the firm along with the production and marketing functions. On the other hand, he believed that accounting was a facilitating function.

The term "capital" was used in a variety of meanings by writers of this period with the total assets concept being the most predominantly used. Writers used the term capitalization when referring to the sources of capital. It was not until the forties that writers began to use the term "capital structure" to refer to the components of the securities of the firm. Even then there was still no agreement among writers in the second decade of the century as to what constituted the capitalization or capital structure of the firm. Arthur Dewing defined capitalization as the sum of the

³⁵Louis F. Musil, Co-ordinating Financial With Accounting, Statistical, Personnel, and Office Management Functions (New York: American Management Association, 1926).

permanent liabilities and the capital stock of the corporation. Only those bonds and notes with maturities over a year were considered by Dewing as part of a firm's capitalization. Lincoln, on the other hand, limited the term capitalization to include the authorized capital stock of a beginning concern only.

In this period the problem of estimating capital requirements were analyzed. Different concepts were developed with asset valuation concept almost always favored. A. S. Dewing favored estimating capital requirements by capitalizing expected returns. He devoted an entire chapter to the explanation of how estimated earning capacity determines capital requirements.

Finance men were by and large influenced by the legal and accounting concepts of surplus. The legal definition of surplus being the excess of assets over the liabilities and capital stock, was used by Gerstenberg³⁶ and McKinsey and Meech,³⁷ among others.

III. Articles

In the period between 1920 and 1929, as was also the case in the preceding period, writers of articles paid a

³⁶Charles W. Gerstenberg, Financial Organization and Management (New York: Prentice Hall Inc., 1924), p. 407.

³⁷James O. McKinsey and Stuart P. Meech, Controlling the Finances of a Business (New York: The Ronald Press Company, 1923), p. 566.

great deal of attention to the problem of the aims of formal business education. In addition, writers of this period were concerned with examining the teaching and practice of corporate finance and other problems of theory.

A. Business education

An excellent article on the early history of the formation of higher commercial education in American universities appeared in 1928.³⁸ The author notes that early in the nineteenth century technical institutions and universities were introduced. Implicit in this introduction is the realization that apprenticeship was no longer a prerequisite for the acquisition of certain technical information. In the field of commercial education there was first the development of the so-called "commercial colleges," which were private institutions established to teach commercial skills such as letter writing, bookkeeping, etc., to young men and women interested in pursuing a business career. Concurrently there was the introduction of commercial courses in public schools for those students who could not attend the private "commercial colleges." The introduction of commercial education in American colleges did not come until later, starting in 1881 with the Wharton

³⁸F. Rume, "The Formative Period of Higher Commercial Education in American Universities," Journal of Business, 1:238-253, April, 1928.

School of Finance and Commerce. The universities were to stress the role of public responsibility and the scientific aspects of business and to provide professional aim.³⁹

Business was increasingly recognized as a profession during this era. Lawrence Lowell explains professionalization as "a case of division of labor among brain workers."⁴⁰ He notes that the turning point in the emergence of the profession occurs when it is realized that professional knowledge and basic principles can be learned much more rapidly and thoroughly by academic study. It is no more justifiable to insist that future businessmen be trained as apprentices in business than it is to insist that aspirants for the bar begin their career by copying letters and other legal documents in legal offices, or for future physicians to roll pills for practicing physicians, as was the practice in earlier times. To give the emerging profession of business a professional status, he believed, was one of the objects of business schools.

As to the relationship between the newly emerging schools of business and economics, one writer asserts that

³⁹Willard E. Hotchkiss, "The Basic Elements and Their Proper Balance in the Curriculum of a Collegiate Business School," Journal of Political Economy, 28:89-112, February, 1920.

⁴⁰Lawrence A. Lowell, "The Profession of Business," Harvard Business Review, 1:129-131, January, 1923.

"economics is no more inclusive of commerce than is mathematics of engineering, or biology of medicine, or ethics of law. The subjects are distinct."⁴¹ Another writer put it this way: "what biology is to medicine, and physics is to engineering, economics is to commerce."⁴²

In 1925, Professor Anderson of Illinois was of the opinion that whereas the early field of business was lacking in literature, magazines, associations, etc., at that time it had trade magazines and scientific papers, excellent textbooks and experienced teachers.⁴³

While the majority of educators thought that business schools could provide their students with a workable knowledge of the basic principles of business practice, one educator went so far as to suggest that business schools could actually develop the so-called "business acumen." He believed that the problem approach, the study of "background courses, the stress on the sources of data (accounting, mathematics, statistics) the cultivation of a critical attitude, all these

⁴¹Eliot G. Mears, "The Teaching of Commerce and Economics," American Economic Review, 13:648-651, December, 1923.

⁴²Ralph E. Hiefman, "The Relationship between Departments of Economics and Collegiate Schools of Business," American Economic Review, 18:73-84, March, 1928.

⁴³James E. Hagerty (chairman), "The Teaching of Business and Economics," American Economic Review, 15:76-80, March, 1925.

(usually taught in business schools) could in effect be said to develop a student's "business acumen."⁴⁴

More specifically, regarding formal education in business finance, two excellent papers were presented at the American Association of Collegiate Schools of Business meeting of May, 1921, by Harold G. Moulton and Charles W. Gerstenberg, respectively.⁴⁵ Moulton notes that a review of finance courses currently offered by business schools revealed that most courses were pursuing fragmentary knowledge, with no regard to sequential considerations, as revealed by the absence of requirements for the study of prerequisite courses. What was needed, in his opinion, was a general survey course in finance, perhaps called "financial organization of society" to show the intermediaries needed to bring savings to industry. He is also critical of the terms "fixed" and "current" capital. And contrary to what was taught in those days, he advances the opinion that commercial banks do indeed provide some of the constant capital of business.

⁴⁴Forrest A. Kingsbury, "Business Judgement and the Business Curriculum," Journal of Political Economy, 30:375-87, June, 1922.

⁴⁵Harold B. Moulton, "Possibilities of a General-Survey Course in Finance" (followed by C. O. Hardy's addendum), Journal of Political Economy, 29:368-399, May, 1921; Charles W. Gerstenberg, "Special Problems of Content and Presentation in Finance Instruction in Large Schools of Commerce" (New York University), Journal of Political Economy, 29:400-409, May, 1921.

Gerstenberg was aware of a problem in the teaching of finance, especially acute, he thought, in large schools. He notes that there are possibly three kinds of teachers in business finance: lawyers, graduates of schools of business administration and economics Ph.D.'s. The lawyer, he claims, tends to be overly involved in law, the business school graduate very often runs amuck of accounts, and the economics Ph.D. usually places too much emphasis on social matters. Gerstenberg thought also that casework and other course work are most important in the teaching of business finance.

W. H. Lough, who reviewed Moulton's and Gerstenberg's articles,⁴⁵ is fundamentally in agreement with them. He suggests that students in business finance be started with the simple, the concrete, the familiar, and therefore more easily comprehended material. He proposes that the basic course in business finance be some kind of credits and collections course whereby the simple problems of collecting money and granting credit will introduce the student to the problems of business finance in general.

B. Other articles

In addition to examining problems connected with the teaching of business, writers of this decade were concerned

⁴⁵W. H. Lough, "Reorganization of Instruction in Finance in University Schools of Business," Journal of Political Economy, 29:645-662, October, 1921.

with examining the current trends and practices of corporation finance, and other more theoretical problems.

Professor Evans⁴⁷ states that in the early days of railroads in this country, preferred stocks were first used when the railroads found themselves in financial difficulties. However, at first it was rarely contemplated that preferred stocks should be used again after the emergency had passed. The dividend rate was higher than that of common stock, and in many instances cumulative, and had the same voting right as common stock.

Samuel W. Anderson⁴⁸ found the typical features of preferred stocks in the second decade of this century to be (1) sinking fund provisions, (2) cumulation of dividends, (3) restrictions on borrowing, (4) restrictions on the paying of dividends on common stocks, and (5) contingency voting.

Albert Keister⁴⁹ observed that between 1916 and 1921 no-par common stock was strongly favored by issuing corporations. So was preferred stock, of which 90 per cent of

⁴⁷George H. Evans, Jr., "The Early History of Preferred Stock in the United States," American Economic Review, 19:43-58, March, 1929.

⁴⁸Samuel W. Anderson, "Provisions of Industrial Preferred Stocks," Harvard Business Review, 6:32-43, October, 1927.

⁴⁹Albert A. Keister, "Recent Tendencies in Corporation Finance," Journal of Political Economy, 30:257-273, April, 1922.

the issues were "callable." He also finds that during the same period, two-thirds of the financing of public utilities was done by borrowing, whereas two-thirds of the security financing of industrial concerns was accomplished by selling stock. Further, he noted that during periods of boom preferred stock was favored, whereas in depressions bond issues were more extensively used. In addition, he noted that public utilities regarded debt to be perpetual, whereas industrial concerns invariably provided sinking funds for their bonds.

C. O. Hardy⁵⁰ finds participating bonds to be rare but mentions different instances of their being used in 1921.

In 1927, Forrest Q. Walker⁵¹ was alarmed by the possibility of compulsory informative publicity by the Federal Trade Commission on corporation accounts, as was being suggested at that time. He thinks this appropriate for banks, investment companies, railroads, and public utilities because of the nature of their business. His main objection is that such publicity is a great threat to competition. He did not, on the other hand, see how the small investor would benefit from such compulsory publicity of corporation accounts since

⁵⁰Charles O. Hardy, "Some Recent Financial Devices," Journal of Political Economy, 29:249-251, March, 1921.

⁵¹Forrest Q. Walker, "Some Practical Objections to Compulsory Publicity of Accounts of Industrial Enterprises," American Economic Review, 17:34-36, March, 1927.

the public, in his mind, has shown "appalling lack of any critical appraisal of value."

George Putnam,⁵² noting an inflation of fifty per cent between 1913 and 1926 which gave a number of concerns substantial paper profits, wonders how many firms had made a reserve for a possible fall in prices.

Morris A. Copeland's article "Seasonal Problems in Financial Administration" (1920)⁵³ was truly a "pioneering" article for its time. Basically, the article explains in detail how to construct and use a cash budget. But Copeland also does an excellent job of isolating what he calls "constant" (permanent) capital and "variable" capital, showing how the different types of capital should be financed and the consequences of not financing them properly. It must be remembered that a formal budgetary plan was not widely used by American business at this time. Copeland tried hard to popularize the use of such a formal plan by arguing all the benefits of using a budget.

James C. Bonbright's "Earning Power as a Basis of Corporate Capitalization"⁵⁴ was also a notable article of

⁵²George E. Putnam, "The Role of Paper Profits in Industry," Harvard Business Review, 4:129-137, January, 1926.

⁵³Morris A. Copeland, "Seasonal Problems in Financial Administration," Journal of Political Economy, 28:793-826, December, 1920.

⁵⁴James C. Bonbright, "Earning Power as a Basis of Corporate Capitalization," Quarterly Journal of Economics, 35:482-490, May, 1921.

this period. He attacks the earning power basis of capitalization so popular with contemporary textbook writers. That capitalization should be based on earning capacity rather than on actual cost, his thought was "... not only unsound in theory but is also vicious in its practical application."⁵⁵ He is of the opinion that promoters and bankers, even when they are honest, are sure to be very optimistic. "The fact is that earning power (i.e., prospective earning power) is largely a matter of conjecture. There can be no adequate objective tests. And to expect a conservative capitalization to be set up in the absence of objective tests is simply utopian."⁵⁶ He asserts that "since capitalization is a measure of liabilities rather than assets, it should equal the principal of the funded debt plus the amount of capital actually subscribed for by shareholders. This is the orthodox theory."⁵⁷

Another writer of that period, Rufus Roum,⁵⁸ was careful to explain the difference between business value and other kinds of value. Business value, or the value of business assets, is derived not from its cost, but only from the income that these assets are expected to produce. In his words, "it is income that sets the value of assets."

⁵⁵Ibid., p. 482.

⁵⁶Ibid., p. 489.

⁵⁷Ibid., p. 485.

⁵⁸Rufus C. Roum, "Business Value," Journal of Business, 2:312-325, July, 1929.

G. V. Cox, in an empirical study, discovers an association between earnings and stock prices, but finds it hard to establish a clear indication of a relationship between the two factors.⁵⁹

Another interesting article is S. E. Howard's "Interest, Rent, and Normal Return on Capital Investment in Their Relation to Manufacturing Costs."⁶⁰ In it he argues against the inclusion of contractual payments of interest in manufacturing costs, and wants interest payments to be kept separate so that "manufacturing costs" can be compared with those of firms that use different methods of financing. Howard mentioned that revenues must be sufficient to pay for all legal costs of the business and also provide a rate of return to equity funds used at least equal to what said funds would earn if employed elsewhere. This means that in effect he gives at this early date (1920) recognition to a cost of equity funds.

IV. Summary

The second decade of the century was a period of prosperity for business. Developments in scientific methods of

⁵⁹Garfield V. Cox, "The Relation of Stock Prices to Earnings," Journal of Business, 2:383-395, October, 1929.

⁶⁰Stanley E. Howard, "Interest, Rent, and Normal Return on Capital Investment in Their Relation to Manufacturing Costs," American Economic Review, 10:546-563, September, 1920.

organization and control greatly increased business efficiency, and a great demand for funds was experienced by business firms. On the other hand, numerous people were taught through efforts by investment bankers to consider security buying as a savings vehicle. The list of new books in business finance for the period 1920-1929 is significantly long and reflects the new interest of Americans in corporations as an investment and savings medium.

Books for the first time are principally aimed to college students of the subject. It reflects, however, the interest of "outsiders" in business finance by the emphasis placed on their viewpoint by the writers. Two notable exceptions to this trend were the writings of James O. McKinsey and Charles L. Jamison which stressed the "insider," administrative viewpoint.

The articles of this period indicate the keen interest of educators and businessmen in the question of proper objectives and content of courses in colleges and universities.

CHAPTER V

DEPRESSION

1930-1939

The decade of the 1930's (the third period in the development of business finance literature in this country) may properly be called the most critical period in the history of the American economic system. Books and articles that are part of this literature and which appeared during this period are reviewed and analyzed in this chapter. While authors confine themselves mainly to reviewing, adding to, and improving the body of knowledge in business finance as it existed prior to this period, the articles reflect to a certain degree the unsettled economic conditions of the day, and the skepticism and doubt that arose about the economic system and the practices of American business at the time.

I. The Period

The period opens with the aftermath of the stock-market crash of late 1929. It later witnesses the economic crisis in early 1933, when the index of industrial production fell to an all-time low, and it includes a long period of slack economic activity which did not come to an end until the beginning of the next period, the 1940's, with the involvement

of the United States of America in World War II. The period also saw the enactment of numerous federal laws that were to change radically the practice of business finance.

A. Economic activity

Following the initial phase of the decline in stock market prices and the leveling off of industrial production, there was a withdrawal from the United States of foreign bank deposits due to European financial stringency. Declines in agricultural prices led to a deterioration of farm mortgages, a rapid increase in the mortality of country banks in 1930, and, finally, the ultimate undermining of the whole rural credit structure between 1931 and 1932. The liquidation of collateral by banks caused a further decline of security values. President Herbert Hoover recommended an economic recovery program based on the assumption that government loans to banks and railroads would check deflation in industry and agriculture and restore purchasing power to its previous level. A measure was passed in 1932 establishing the Reconstruction Finance Corporation which was authorized to provide emergency financing for banks, life insurance companies, building and loan associations, railroads, and farm mortgage associations. However, by March 1933, the nation's banking system was showing signs of alarming weaknesses, and there was widespread hoarding of currency. Unemployment climbed to about fifteen million people; one-third of the nations's

railroad mileage was thrown into bankruptcy; and farm mortgage foreclosures were widespread.

Between 1933 and 1937 New Deal intervention to check the downward spiral took a variety of forms, including deficit financing. Business activity and prices rose by 1937 when a brief recession was experienced in August of that year and was followed in 1938 and 1939 by further recovery. Yet in August 1939, about ten million persons were still unemployed.

B. Financial legislation

Among the numerous laws of the New Deal administration, the following are of particular significance in the field of finance. The Banking Act (Glass-Steagall Act) of June 16, 1933 created the Federal Deposit Insurance Corporation, extended the open market activities of the Federal Reserve Board, permitted limited branch banking, separated the deposit from the investment affiliates of commercial banks, and permitted savings and industrial banks to join the Federal Reserve system.

The Federal Securities Act of May 27, 1933 was designed to compel full disclosure to investors of information relating to new securities issues offered to the public. With certain exceptions it required that all new issues were to be registered with the Federal Trade Commission by the filing of sworn statements placed in public file. In 1934 this function was transferred to the Securities and Exchange Commission.

In 1934, the Securities and Exchange Act provided for federal regulation of the operation of stock exchanges and for correction of certain unfair practices in the securities markets. The act established the Securities and Exchange Commission to administer both the 1933 and the 1934 legislation. It further made trading of securities subject to the regulations of the commission and prohibited price manipulation. It also empowered the Federal Reserve Board to regulate the use of credit in financing, trading in securities, and prescribed regulations concerning margin requirements.

The 1934 Corporate Bankruptcy Act allowed the financial reorganization of corporations, provided that at least two-thirds of the creditors consented, and stipulated that the petition for reorganization might be filed in court by creditor or stockholder if approved by at least one-quarter of other stockholders.

The Revenue Act of 1935 increased the surtax rate on individual incomes over \$50,000. Taxes on personal incomes above one million dollars were graduated steeply to 75 per cent on income in excess of five million dollars. The Revenue Act of 1936 included among its provisions an undistributed profits tax on corporate income that added to the normal corporation income tax a scale of surtaxes ranging from 7 per cent to 27 per cent. This provision was attacked by business groups as penalizing the setting aside of

corporate profits for expansion during slack periods. The Revenue Act of 1938 became law without the signature of President Roosevelt. It repealed the progressive normal tax and undistributed profits tax authorized in 1936 and substituted a tax of 19 per cent on corporations whose income exceeded \$25,000, with the tax being reduced by a flat $2\frac{1}{2}$ per cent of dividends paid out of incomes subject to the tax. (In effect it reduced taxes on large corporations and increased them on smaller ones.)

II. Books

The literature of business finance for the period 1930-1939 is exceedingly rich. As one writer of the period put it:

The economic confusion of the current depression, culminating in the spring of 1933 in an intense storm center in the general area of banking and finance, has produced in the past few months a veritable cloudburst of literature on the subject.¹

Included in the literature of this period were some very sound books on business finance.

A. Henry E. Hoagland

Hoagland's degrees include an A.B. from the University of Illinois (1910), an A.M. from the University of Wisconsin (1911), and a Ph.D. from Columbia University (1917) in

¹Deane W. Malott, "The Recent Literature of Finance," Harvard Business Review, 12:485-490, July, 1934.

economic statistics. He served as instructor at the University of Illinois from 1916 to 1918 and was a statistician and economist for the state industrial commission in New York from 1912 to 1916. Professor Hoagland joined the faculty of the College of Commerce and Administration at Ohio State University in 1920, where he remained until his retirement. In 1933 he wrote the first edition of his book Corporation Finance,² which had a second edition in 1938 and a third edition in 1947. According to the author,

The book has been written in full recognition of the fact that few of its readers will ever become corporate directors and officers and an even smaller number will ever undertake the promotion of business corporations. The author has had before him constantly the probability that most of his readers will, sooner or later, become owners of corporate securities.³

While this statement implies a heavy emphasis on the outside viewpoint, the investor viewpoint, the book concerned also with the problem of successful utilization of capital funds by business management. In the first chapters Hoagland examined the concepts of a corporation, the kinds of securities commonly used to secure capital, the promotion of corporations, and the means used to sell securities to the investing public. He acknowledges the fact that these topics

²Henry E. Hoagland, Corporation Finance (New York: McGraw-Hill Book Company, 1933).

³Ibid., p. ix, 1938 edition.

constituted the principal content of what in the past was considered corporation finance.⁴ A thorough understanding of them he deems essential, whether from the viewpoint of the manager of the corporation or the purchaser of its securities. "But the essence of business success is not in the raising of capital. Rather it lies in the use that is made of it after it has been accumulated,"⁵ Hoagland remarks. He also discusses what he calls "internal financial control," examining the organization financial controls, such as the finance department duties, the finance committee, the controller, budgets, corporate reports, ratios, short-term maintenance policies, determination of profits, surplus and its uses, dividend policies, corporate expansion, etc. Hoagland's book did not provide anything substantially new; nonetheless, it is clearly written and widely read. This writer has found it extensively quoted and referred to in British books on corporation finance.

B. W. Mackenzie Stevens

Financial Organization and Administration⁶ (1934) is a book distinct in this period. Similar to McKinsey and Meech's and Jamison's books of the 1920's, this book broke away from the traditional approach to the treatment of

⁴Ibid., p. 261, 1938 edition.

⁵Ibid., p. 463, 1947 edition.

⁶W. Mackenzie Stevens, Financial Organization and Administration (New York: American Book Company, 1934).

corporation finance. The internal viewpoint is prevalent in this book. Though he starts with typical chapters on types of business organization, capital structure, bonds and stocks, different methods of financing, financial structures, business failures, expansions, combinations, and the stock exchanges, Stevens follows with Part III, which includes chapters on budgetary control; financial control of production, purchases, inventories, expenses, and assets; coordination of financial administration, cash budget and master budgets, ratio analysis, reserves, and others. The emphasis is strongly on a "how to" rather than an analytical basis. Stevens supports his text with numerous charts and examples.

Of importance is Stevens' somewhat crude approach to what would be called an "average weighted cost of capital." When discussing the rate to use in capitalizing future earnings, he suggests that

if money could be secured from a bond issue equal to 40 per cent of the assets of the concern at 5 per cent, from a preferred-stock issue equal to 30 per cent of the assets at 6 per cent, and a balance from a common-stock issue on an average 8 per cent return, the average rate for a company with assets of \$100,000 would be 6.2 per cent.⁷

He then uses this average weighted cost of capital as the minimum acceptable rate of return for any investment project. Until this time, the cost of borrowed money alone had been

⁷Ibid., p. 209.

used by various writers. However, Stevens does not recognize the effect of the corporation income tax. He erroneously compares the rate of interest of bonds, which is tax deductible, to the dividend rate on preferred stock which is an after-tax cost.

Though Stevens is not explicit at this point as to whether he regards the "return" to common stock to be dividends divided by the market price of the stock or earnings divided by the price of the stock, reference to an earlier page strongly suggests he uses the latter concept.⁸ This contribution, however, went unnoticed by the other writers in the field for at least the next ten years. Even Stevens himself in later discussion lapses to the use of the word interest on borrowed capital as what has to be covered by any investment that is to be undertaken.

C. Floyd F. Burtchett

Burtchett wrote his voluminous (1078 pages) book Corporation Finance in 1934⁹ while in the Department of

⁸"If, for example, the common stock in a given line of business is earning 7 per cent on an average, securities issued by a given concern in that line of business such that the new securities may reasonably be expected to earn \$7 per share will sell readily at slightly under \$100 per share." ibid., p. 207.

⁹Floyd F. Burtchett, Corporation Finance (New York: Harper and Brothers, 1934).

Economics of the University of California at Los Angeles.¹⁰

Corporation Finance embodies the author's lectures in finance substantially as they had been given in the preceding seven years, and Burtchett warned that

No volume discussing so complex a field as Corporation Finance can ever be rid of the author's preconceptions, biases and idiosyncracies, for the very selection of the subjects to be included, the data to be employed, and the methods to be applied constitutes a judgment of the first order, the exercise of which involves every frailty of the human intellect.¹¹

However, while the "acme of scholarship - detached observation- is practically impossible of achievement in the realm of economic affairs, it is hoped that a relatively high degree of impartiality has been preserved."¹²

Burtchett's first edition had an excellent introductory chapter on the development of the corporation. In addition to

¹⁰ A second edition of Corporation Finance was co-authored by Clifford M. Hicks in 1948. (Floyd F. Burtchett and Clifford M. Hicks, Corporation Finance rev. ed. New York: Harper and Brothers, 1948). The second edition was significantly more compact; much of the extensive footnote material of the first edition was eliminated. The co-author of the second edition claimed that the photographic illustrations were included in the text for the first time in the history of the field. He also claimed that projects that were included at the end of every chapter constituted a new feature not usually found in the field. These projects called upon the student to use library research, statistical analysis, and report writing as devices for training in business as well as in the subject matter of finance.

¹¹ Ibid., p. viii.

¹² Ibid., p. viii.

the usual discussion of the instruments of corporation finance, the various forms of financial organization, promotion and the sale of corporate securities, growth and expansion, corporate dissolution and financial reconstruction, the book contained two particularly interesting parts. Part V, Financing of Ordinary Operations of the Business, included analytical chapters on accounting, budgets and internal financial controls, analysis of financial statements, working capital, depreciation and wasting assets, management of income, surplus and dividend policies, current borrowing and credit extension, extinction of long-term indebtedness, and financial management and the business cycle. Part VIII, Social Aspects of Corporation Finance, contained chapters on social aspects of corporate financial policy, regulation and control of corporate fiscal policy, the taxation of corporations, and some problems of the future. Burtchett was the first author to treat in a standard text the subject of the social aspect of corporation finance.

In the chapter on budgets the author footnoted that the term budget is derived from the Old French word bougette, meaning a bag or sack. Later the term was applied to the case from which the Chancellor of the Exchequer took his report on government income and expenditures to read before the legislators. Finally, this term was applied to the financial statement itself.

Burtchett made it clear that the discussion of budgeting or of internal financial control occupies really an

intermediate position between finance proper, accounting, and business organization and administration. He referred to what is commonly known today as a "cash budget" as 'cash realization budget', and what would be called today "capital equipment budget" he called "financing budget," which are used, in his words, to "show the type and quantity of financing expected to be done in the next budget period." Later¹³ he talks about the "financial budget" when referring to what is commonly known today as the "cash budget." He noted that the budget as a business device is an invention that has been developed parallel with the growth of the business unit and the extension of absentee management;¹⁴ and he claimed that the greatest impetus in America for the use of budgeting technique was the depression of 1920 when businesses were caught with excess inventories which were blamed as the cause of the depression period. He included a list for those who would be interested in ratios¹⁵ and proposed that C. W. Gerstenberg seems to have been the inventor of the term "circulating capital."¹⁶ Burtchett speaks of poly-corporate expansion,¹⁷ which is an expansion in terms of financial controls rather than operations. Under the

¹³Ibid., p. 535.

¹⁴Ibid., p. 526.

¹⁵Ibid., p. 557.

¹⁶Ibid., p. 574.

¹⁷Ibid., p. 581.

subject of social aspects he points out the defects of the laws prior to the important laws passed in the thirties. Burtchett's account of the historical use and development of profit-sharing securities is most interesting,¹⁸ as is his account of the origin and development of equipment obligations.¹⁹ He also advances an excellent description of forms of business organizations, combinations, and solidifications.²⁰

Burtchett suggests²¹ that the first user of the terms "quantitative" and "qualitative" aspects of capitalization was Reed in 1925.²²

Burtchett wrote in excellent and vivid language; when discussing articles written on holding companies, he referred to some as "ribald in propaganda and utterly senile."²³

D. Elvin F. Donaldson

Professor Donaldson's degrees include a B.Sc. (1925), an M.A. (1927), and a Ph.D. (1933), all from The Ohio State University. He also studied at the University of Chicago in

¹⁸Ibid., p. 219.

¹⁹Ibid., p. 242.

²⁰Ibid., p. 325.

²¹Ibid., p. 362.

²²Harold L. Reed and Allyn A. Young, Principles of Corporation Finance, (New York: John Wiley and Sons, 1925), pp. 59-76.

²³Burtchett, op. cit., p. 325.

1927 and Columbia University in 1930-1931. He has been on the staff of The Ohio State University College of Commerce and Administration from 1925 to date. The author justified the writing of his book, Business Organization and Procedure (1938), in this way:

Most of the large schools of commerce have well-developed courses in corporation finance, business combinations, business law, industrial management, etc., and a number of excellent books are available for use in such courses. In the opinion of the author there exists a need for an additional course dealing, not with the various activities of business organizations, but with the business organizations themselves. It is for such a course that this book has been written.²⁴

This relatively large book (579 pages) consists of three parts. Part 1, Non-Corporate Forms of Business Organizations, includes chapters on common law, individual proprietorship, partnership, joint stock companies and the Massachusetts Trust. Part 2, Corporations, has chapters on the corporation, promotions, stock subscriptions, selection of state for incorporation, corporate name, by-laws, legal nature of preferred stock, etc. Part 3, Combinations, offers chapters on matters such as the combination movement, the trust holding company consolidation, and other topics.²⁵

²⁴Elvin F. Donaldson, Business Organization and Procedure (New York: McGraw-Hill Book Company, 1938), p. vii.

²⁵Donaldson's writing style is clear and precise. He treats admirably the explanation of the minor forms of business organization. A major part of Business Organization and Procedure later found its way, in a shortened form, into Donaldson's later work, Corporate Finance.

E. Hastings W. Lyon²⁶

Corporations and Their Financing (1938)²⁷ is Professor Lyon's third book in the field. The first two books were discussed in Chapter III of this dissertation.

This book is permeated with the author's knowledge of the law. Lyon remarks in the first chapter of his book that the "functions of business are the same whether the form of organization be individual enterprise, partnership, or corporation."²⁸

Though the concept was earlier recognized by other writers, Lyon in his book gives a very lucid explanation of the question of what constitutes permanent and temporary capital.

Some part of the capital, though represented by current assets, remains permanently in the business. This, which we call working capital, is just as permanently in the business as land, buildings, and machinery; and it needs just as permanent financing. The specific items of wealth change; the aggregate of the value does not. We are not concerned with the current credits, but, only with the permanent financing.²⁹

The book was based mainly on his earlier books, containing such topics as the corporation, concept of capital stock, creditor securities, capitalization, marketing securities,

²⁶See also Chapter **III**, page 37 of this dissertation.

²⁷Hastings W. Lyon, Corporations and Their Financing (Sioux City, Iowa: Health Publishing Company, 1938).

²⁸Ibid., p. 3.

²⁹Ibid., p. 307.

internal financing and corporation income, reorganization, capital for corporations, secondary markets and the stock exchange, federal taxation and regulation.

F. Other writers

Arthur H. Winakor's 1934 book³⁰ demonstrated that working capital is increased by the amount of value that is transferred from fixed assets into saleable goods; that is, by the depreciation productively consumed, which is converted into goods sold and then recovered in the sales price.

Milo Kimball's book, Principles of Corporation Finance³¹ (1939), followed the usual approach to the subject. It included the usual list of selected readings as well as voluminous references to supplementary readings in the work of other popular contemporary writers such as Burtchett, Dewing, Gerstenberg, Hoagland, Lyon, Lincoln, and Mead.

Of similar "traditional" nature was Kenneth Field's Corporation Finance (1938).³² Professor Field, together with

³⁰Arthur H. Winakor, "Maintenance of Working Capital of Industrial Corporations by Conversion of Fixed Assets," University of Illinois, Bureau of Business Research, Urbana, 1934.

³¹Milo Kimball, Principles of Corporate Finance (New York: Longmans, Green and Company, 1939).

³²Kenneth Field, Corporation Finance (New York: The Ronald Press Company, 1938).

most other writers of that period (Bonnevillie, Baker and Mallot, and Crumbaker), favored the total asset concept of capital.

Calvin Crumbaker's Organizing and Financing Modern Business (1939)³³ favored the total assets concept of capital and explained that the total amount of goods owned by a corporation could be divided into categories. The first is that part of capital which is fixed or sunk, tied as it were to a specialized function, and the value of which cannot be recovered but by continuous use and final disposal after practical usefulness has disappeared. The other group of capital goods includes those not so completely sunk or fixed and which, therefore, change. Accordingly, they should be described by the prefix "working."³⁴

As we have seen, the increased awareness of the social responsibilities and progress of the corporation occasioned a whole section in a textbook of the period.³⁵ These phenomena were also recognized by Moulton, who claimed that the changes in the thirties were such that his older book had to be rewritten and a new title be given to it.³⁶ Also, the

³³Calvin Crumbaker, Organizing and Financing Modern Business (New York: John Wiley and Sons, 1939).

³⁴Ibid., p. 298.

³⁵Floyd F. Burtchett, Corporation Finance (New York: Harper and Brothers, 1934).

³⁶Harold G. Moulton, Financial Organization and the Economic System (New York: McGraw-Hill Book Company, 1938).

second revised edition of Bonneville's Organizing and Financing Business³⁷ was necessitated, according to the author, because of the legislation in the thirties pertaining to securities.

During this decade, two concepts important to finance appeared in writings by economists. Since these concepts were later adopted by finance writers, they merit a brief examination at this point. Irving Fisher in The Theory of Interest defined "the rate of return over costs" as being the

hypothetical rate of interest which if used in calculating the present worth of the two options would equalize them or their differences (cost and return) may be called the rate of return over cost.³⁸

John Maynard Keynes, in The General Theory of Employment, Interest and Money,³⁹ differentiated the rate of return on investment and the rate of interest, and labeled the first the "marginal efficiency of capital." The marginal efficiency of capital, therefore, is that rate of discount

³⁷Joseph H. Bonneville and Lloyd E. Dewey, Organizing and Financing Business (New York: Prentice-Hall Inc., 1938).

³⁸Irving Fisher, The Theory of Interest (New York: The Macmillan Company, 1930), Chapter VII.

³⁹John Maynard Keynes, The General Theory of Employment, Interest and Money (New York: Harcourt, Brace and Company, Inc., 1935), p. 135.

that equates the present value of future earnings to an investment supply price. The equation for its calculation was offered by Alvin H. Hansen⁴⁰ as being

$$\frac{R_1}{1+r} + \frac{R_2}{(1+r)^2} + \dots + \frac{R_n}{(1+r)^n} \quad \text{where}$$

$R_1 \dots R_n$ is a series of prospective annual returns,

R is the cost of investment,

r is the rate of discount which would make the present value of the annual returns series equal to the replacement costs.

Keynes' concept (the rate of discount which equates the present worth of the receipt stream to the present worth of the cost stream) is commonly referred to today as the "time adjusted rate of return," the "internal rate of return" and other names. Fisher's concept in current literature today is called the "present value method."

III. Articles

The finance articles written during the period 1930 through 1939 fall into two general classes: (1) those dealing with a problem of the financial ownership and management of business corporations; (articles relating to the examination of financial data of the period reflected by the

⁴⁰Alvin H. Hansen, A Guide to Keynes (New York: McGraw-Hill Book Company, 1953), p. 118.

unsettled conditions of the day) and (2) articles further pursuing the development of theory and tools in corporation finance.

A. The separation of ownership
and control of corporations

Awareness of the increasing separation of the ownership and the control of corporations was not new in this particular period. The market crash of 1929 and ensuing depression, however, brought attention to the possible evils of the separation of ownership and control of corporations.

The Modern Corporation and Private Property⁴¹ was the best expression of the period on that subject. Professors Berle and Means examined with alarm the general problem of the evolution of modern corporations. Their book was impressive and provoked a lively discussion in learned articles. In Chapter V of their book they critically analyzed the control of the two hundred largest corporations in the United States. They found that only 11 per cent of these largest corporations were controlled by private ownership and majority ownership combined, while 79 per cent were known, or thought to be, controlled by minority ownership, management,

⁴¹Adolph A. Berle, Jr. and Gardiner C. Means, The Modern Corporation and Private Property (New York: The Macmillan Company, 1933). It is widely held that the Berle and Means book had a profound effect on President F. D. Roosevelt and may have influenced some of the New Deal legislation.

or through some legal device without any important ownership. Among the ideas they discuss is the inability of the shareholders to remove unwanted directors and other forms by which minority interests are able to control corporations in this country.

Two articles by Ben W. Lewis⁴² and W. L. Crum,⁴³ respectively, dealt in a critical manner with Berle and Means' book.

The main thesis of William A. Lough's 1933 article⁴⁴ is that "expansion of giant corporations in recent years has been motivated only in part by the search for profits; more strongly and persistently by an urge to use easily available capital resources to win or hold a dominating possession." According to Lough, corporations were allowed to do this because of the failure of security purchasers to pay adequate attention to corporate profits.

Shaw Livermore⁴⁵ thought that "in the period when the perennial problem of control over corporations has received

⁴²Ben W. Lewis, "Berle and Means on the Modern Corporation," Journal of Political Economy, 43:548-554, August, 1935.

⁴³W. L. Crum, "On the Alleged Concentration of Economic Power," American Economic Review, 43:548-554, March, 1934.

⁴⁴William H. Lough, "Adjusting Corporation Finance to Industrial Growth," Journal of Business, 6:275-292, October, 1933.

⁴⁵Shaw Livermore, "Unlimited Liability in Early, American Corporation," Journal of Political Economy, 43:674-687, October, 1935.

renewed attention, an earlier era of state regulation deserves to be recalled." He noted that in the period between 1800 and 1830, the States of Massachusetts and Connecticut applied discriminatory policies to certain applicants for corporate charters.

It was not against all applicants for charters that the discriminatory policies were aimed. Only those groups, which appeared to be seeking license for operation in fields where private gains seem to outweigh the potential public benefit, were given 'limping' charters and denied the privilege of limited liability.⁴⁶

He believed that the revival of the Massachusetts and Connecticut attitude of 1800-1830 might be a greater social value than a large proportion of the "legislative tinkering" witnessed in recent years.

W. H. S. Stevens' two-part article is an exhaustive, descriptive and analytical examination of the various classes of stockholder participation in use at that period.⁴⁷ A second article dealt with the voting rights of capital stock and shareholders.⁴⁸ Having reviewed the different types of voting arrangements existing at that time, Stevens recommends (1) eliminating all purely non-voting stock issues; (2)

⁴⁶Ibid., p. 686.

⁴⁷W. H. S. Stevens, "Stockholders' Participation in Profits" Parts I-II, Journal of Business, 9:114-132, April, 1936; 9:210-230, July, 1936.

⁴⁸W. H. S. Stevens, "Voting Rights of Capital Stock and Shareholders," Journal of Business, 11:311-348, October, 1938.

developing stronger variable voting controls where there are two or more classes of stock, with such controls becoming effective promptly upon failure either to observe reasonable conservative standards of management or to produce revenues; and (3) extending the system of voting proxies, etc. Stevens found that "concentration of voting controls is not peculiar to corporations with non-voting issues."

Robert A. Gordon's 1939 article⁴⁹ aimed at indicating how and to what extent power of the financial group had been translated into some measure of entrepreneurial control of company activity. He found a decline of such control in the thirties because of the then recently enacted legislation.

B. Developments in theory and application of business finance

Norman S. Buchanan's "Theory and Practice in Dividend Distribution" contains a noteworthy footnote:

The enterprise may be regarded as an endeavor to maximize its present worth, and therefore, the reinvestment of earnings is justified if the reinvestment increases the present worth by more than the amount reinvested, i.e., within the enterprise the capital has a productivity greater than the rate of interest.⁵⁰

⁴⁹Robert A. Gordon, "Financial Control of Large Scale Enterprise," American Economic Review, 29:85-99, March, 1939.

⁵⁰Norman S. Buchanan, "Theory and Practice in Dividend Distribution," Quarterly Journal of Economics, 53:64-85, November, 1938.

In the last sentence Buchanan is in effect using the rate of interest as a minimum "cut-off point" for investment decisions. Buchanan was not the only one to do so, but he recognizes in his formulation the "time value of money" concept. Robert Weidenhammer⁵¹ also defined "faulty investment" as that which yields in the long run less than the return offered in the capital market on risk-free securities. The idea, popular today, of a weighted average cost of capital did not appear until later.⁵²

David L. Rolbein⁵³ made a survey to examine the effect of the Revenue Act of 1936 taxing undistributed profits on corporation dividend policies. He examined the tax status of different forms of dividends to stockholders and observed an increase in cash dividends.

Vernon A. Mund⁵⁴ noted that economic texts speak of the price of a freely reproducible good as tending to

⁵¹Robert Weidenhammer, "Causes and Repercussions of the Faulty Investment of Corporate Savings," American Economic Review, 23:35-41, March, 1933.

⁵²With the exception of W. Mackenzie Stevens, Financial Organization and Administration (New York: American Book Company, 1934). See page 84 of this dissertation.

⁵³David L. Rolbein, "Non-cash Dividends and Stock Rights as Methods of Avoidance of the Undistributed Profits Tax," Journal of Business, 12:221-264, July, 1939.

⁵⁴Vernon A. Mund, "The Financial Adjustment in the Empirical Law of Cost," American Economic Review, 26:74-80, March, 1936.

correspond with its cost of production. In the case of transferable agents, having alternate uses, this comes about through a "technological adjustment;" that is, by the amount of goods produced. In the case of specialized, durable, productive agents with limited if non-existent alternative employment, a "financial adjustment" takes place. This "financial adjustment" brings fixed asset valuation in line with replacement costs, and also readjusts depreciation charges, insurance costs, etc., to bring total per unit costs in line with price. In Mund's opinion, such a financial adjustment was occasioned by the changes in the price levels between 1929 and 1936.

A. C. Littleton⁵⁵ found that one of the reasons for the change from par value to non-par value shares was the desire of corporate managers to avoid having a fluctuating capital stock amount and to eliminate possible liability for payment of dividends out of capital stock. Now, while "no par value stock" is associated with a "stated capital" (and this solves the problem mentioned previously), it does not serve the objective for which the rule for nonpayment of dividends out of capital was first set up, namely that of protecting creditors. As a substitute for stated capital, Littleton proposes an asset-debt ratio. In other words, payments of dividends to stockholders would not be permitted if asset value fell

⁵⁵A. C. Littleton, "A Substitute for Stated Capital," Harvard Business Review, 17:75-84, No. 1., January-February, 1938.

below, say, one and one-half times the amount of debt outstanding.

Harry G. Guthmann⁵⁶ made a statistical study of one hundred and ninety-one leading industrial corporations for the years 1926, 1929, 1930, 1931, 1932. He found only a slight decrease in current assets; however, a decrease in current liabilities was greater, showing an improved current ratio for the depression years. In addition, since the main decrease in current assets was due to a decrease in inventories and receivables, the corporations were more liquid than ever.

W. A. Holt and E. L. Morris⁵⁷ studied eighty cases of reacquiring of stock as reported in Moody's Cumulative Index for 1931 to 1932. They conclude that "excess working capital arising from a reduced volume of business and unusually low security prices, were, no doubt, important factors in stimulating this action."⁵⁸ Reasons for the reacquirement were in some instances to cancel stock because of rigidities in their covenants or possible existence of overcapitalization. Other

⁵⁶Harry G. Guthmann, "Industrial Working Capital During Business Recession," Harvard Business Review, 12:472-477, July, 1934.

⁵⁷Walter A. Holt and Edwin L. Morris, "Some Aspects of Reacquired Stock," Harvard Business Review, 12:505-510, July, 1934.

⁵⁸Ibid., p. 505.

corporations purchased stocks at prices below par value or stated value, another procedure used to improve the appearance of the company's balance sheet.

Some articles explored the problem of depreciation. John B. Canning⁵⁹ in a mathematically oriented article (using such words as "distribuendum," "minuend," and "subtrahend") took exception to the straight-line method of depreciation which makes lean years look "freakishly" bad. He would like to see charging of fixed expenses on a basis of either the mean of production volume or the mean of selling prices. In a footnote, he remarked that "the figure for the net income of an enterprise becomes a probable fact only upon the termination of the enterprise."

P. F. Brundage⁶⁰ clearly differentiates the "phenomenon" of loss due to "wear and tear, decay, inadequacy, and obsolescence" and the loss in value that measures that phenomenon. He explains the different methods of charging depreciation and remarks that in Great Britain for tax purposes "the declining balance" method is acceptable. Preinreich⁶¹

⁵⁹John B. Canning, "A Certain Erratic Tendency in Accountants' Income Procedure," Econometrics, 1:52-62, January, 1933.

⁶⁰Percival F. Brundage, "Depreciation: An Old Subject With a New Importance," Harvard Business Review, 13:334-343, April, 1935.

⁶¹Gabriel A. D. Preinreich, "The Practice of Depreciation," Econometrics, 7:235-265, July, 1939.

also examines (with the help of mathematical notations) various methods of depreciation used in the United States. He finds also that a diminishing balance method is "occasionally practiced" in this country, but mostly in Great Britain. Regarding the sum-of-the-year-digits method he remarks, "I have never seen it applied, but many accounting textbooks mention it!"⁶²

The inadequacy of the financial statements of corporations to the investor in the thirties and earlier was highlighted by the results of a survey by Harold Parker published in 1930.⁶³ Parker discovered that 95 per cent of the corporations surveyed gave no details as to "other" income. He judged the information on "depreciation, depletion, and obsolescence" to be adequate in only 50 per cent of the cases. Operating expense details were lacking in 90 per cent of the cases examined, and only 2 per cent provided information about maintenance expenses.

In much the same vein, L. H. Haney⁶⁴ also makes a plea for better corporation accounting data. Surveying the pub-

⁶²Ibid., p. 249.

⁶³Harold Parker, "Needs of Investors with Respect to Corporation Statistics," Journal of the American Statistical Association, 25:suppl:13-17, March, 1930.

⁶⁴L. H. Haney, "Corporation Accounting Data from the Standpoint of the Investor," Journal of the American Statistical Association, 25:suppl:7-12, March, 1930.

lished corporation accounts of the period, he was forced to make the following statement:

I challenge anyone here to tell me what General Electric earns. What is the true investment of National Biscuit? How are the heavy maintenance charges of American Telephone and Telegraph to be justified? No one knows. No one can find out.⁶⁵

He also offered the following rhetorical question, "If such companies as United States Steel, General Motors, Studebaker and Timken Roller Bearings can report quarterly and show depreciation, why cannot American Brake Shoe and Eastman Kodak?"⁶⁶

In March, 1929, in an American Economic Review article, George Herberton Evans⁶⁷ traced the early beginnings of the use of preferred stocks in the United States. In a later article (1931) Evans accounted for the preferred stocks in the United States from the years 1850 to 1878.⁶⁸ He noted that the use of preferred stock, which had proved its worth before 1850, was more frequent in the next twenty-five years. Nevertheless, this practice was confined almost entirely to

⁶⁵Ibid., p. 10.

⁶⁶Ibid., p. 11.

⁶⁷George Herberton Evans, "The Early History of Preferred Stock in the United States," American Economic Review, 19:43-58, March, 1931.

⁶⁸George Herberton Evans, "Preferred Stock in the United States," American Economic Review, 21:56-62, March, 1931.

the transportation industry. One of the changes in preferred stock usage, however, was that instances of automatic conversion of preferred stock into common stock ceased to appear. Voluntary conversion, not known before 1850, was now frequently used. Also the participation feature became very common. Corporations issued several classes of preferred stock. Redemption and a veto power on the further issuance of preferred stock and bonds were new features, and the cumulation of preferred dividends became more common. Finally, the simple instrument of the earlier days was developing into a stock with many rights and privileges. In a later article,⁶⁹ Evans tried to trace the early history of the use of industrial preferred stocks in this country by giving brief histories of a number of industrial companies in the late 1850's; their experiences foreshadowed the problems of later stocks. These preferred stocks were used by textile manufacturers, utilities suppliers, producers of agricultural implements, and gold and quicksilver mining concerns. They were used by corporations engaged in various lines and in different parts of the country. Their common element was that the preferred stocks were invariably employed when the corporation was in financial distress.

⁶⁹George Herberton Evans, "Early Industrial Preferred Stocks in the United States," Journal of Political Economy, 40:227-243, April, 1932.

IV. Summary

The decade of the 1930's was a critical period in the history of the American economic system. Extensive legislation of economic and business significance was enacted during this time.

Many of the books in this period contain chapters on the social significance of business corporations and discuss the effects of the new legislation on business practice and financial management.

In addition, the book literature of this decade is characterized by further developing and refining concepts and principles promulgated in earlier periods. Most books followed the "traditional approach" to the subject, but one writer used the insider viewpoint in his book.

In embryonic stages are found in this period such concepts as the cost of equity capital, the time adjusted rate of return on invested capital and the "present value" method of evaluating investment proposals.

Articles during this decade dealt with such topics as the separation of ownership and management of corporations, social significance, the shortcomings of accounting practice, the effects of the economic legislation on American business and the developments in methods of financing of business firms.

CHAPTER VI

WAR AND READJUSTMENT

1940-1949

The books and articles of the fourth period, 1940-1949, in the development of contemporary American business financial management literature are examined in this chapter. This is a period that includes a major war and period of readjustment. The war and its aftermath put stresses on the economic system. Rapid changes were required to provide for the conflict and later for the demand for consumer goods that had gone unsatisfied during the war years.

The book literature during this time, especially that of the earlier part of the decade, is preoccupied with and examines the question of the social responsibilities of business, an emphasis necessitated by the economic conditions of the preceding period. Except for this unique feature, books written during the forties follow mainly the path set by earlier authors in the field. The periodical literature, not burdened by a long time lag, is more representative of the events taking place during the decade. Earlier articles dealt with the problems of the possibility of mobilization of funds for war production, and those articles written in the second half of the decade are concerned mainly with the

price inflation experienced then and its effects on the financing of business.

I. The Period

A. Economic activity

A sudden spurt in economic activity followed the outbreak of World War II in Europe. The Index of Industrial Production, standing at 105 (1935-1939=100) in August, 1939, leaped to 125 in December of the same year. By 1940 the effects of the United States military program was manifested in government expenditures, industrial output, and national income. The entry of the United States into the war brought a large scale mobilization of manpower and resources, and economic activity made giant progress. By 1944, the Index of Industrial Production reached 235. In spite of war-time price and wage controls, wholesale prices rose from 78.6 in 1940 to 105.8 in 1945. From 1946 the inflationary upturn was accelerated by the removal of government economic controls, postponed consumer demand, and financing for defense and foreign expenditures. (There was a minor recession in 1949).

B. Investment markets

The period between 1940 and 1945 witnessed the enormous expansion of the government's role as supplier of

capital funds. In 1940 the Reconstruction Finance Corporation was authorized to advance loans for the acquisition, production, or stock-piling of strategic raw materials and the reconstruction, expansion, and operation of plants needed for the war effort. Similarly, under an executive order, in 1942 the government began to guarantee or participate in loans made by banks to finance war production. The Smaller War Plants Corporation was set up by the government to provide funds for small businesses with war contracts, and its functions were assumed by the Reconstruction Finance Corporation in 1945. In addition, as a result of the government's desire to issue its securities at a low rate of interest, the Federal Reserve Board acted to support the federal bond market and therefore temporarily abdicated its normal control over the money market.

After the war, life insurance companies began to purchase entire issues of securities directly from the issuing corporations. Corporations, due to high personal taxes, proceeded to finance themselves out of profits in lieu of increasing dividends.

II. Books

Almost all of the books published in this period either contain chapters on, or otherwise treat, the subject of the social aspects of corporation finance. In addition,

for the first time, the present value method of evaluating investment proposals was mentioned by a textbook author.

A. Norman S. Buchanan

Professor Buchanan was born in Canada and received his Bachelor's degree from the University of Toronto in 1927. He received his Master's and Doctorate degrees at Cornell in 1929 and 1931 respectively. He taught at Colgate University, the University of California, and has been associated with the Rockefeller Foundation for a number of years. In the preface of his 1940 work, The Economics of Corporate Enterprise,¹ Buchanan emphasizes the word economics in the title. He stated that recently a group of writers had developed the economic theory of the single enterprise to a refined level heretofore unknown. Since, in his opinion, there had been no thoroughgoing attempts to apply the principles of economic theory to the corporation, he undertook to do so in his book:

Descriptive material of how corporations are organized, how they raise funds by the sale of security contracts, the provisions of such contracts, corporate expansion, reorganization, etc., are all very well. But unless such descriptions are built over a firm theoretical skeleton so that they form a recognizable and logical body of thought they are likely to remain unassorted and unrelated piles of gaudy and drab materials.²

¹Norman S. Buchanan, The Economics of Corporate Enterprise (New York: Henry Holt and Co., Inc., 1940).

²Ibid., p. v.

He presented the classical variables in the literature and the propositions based on them which had been developed as guides for the use of income by the corporation, and rejected them all. The proposition that "cash considerations prevent corporations from paying dividends permitted by earnings" was rejected because, as he said, if these earnings are invested in liquid items, there is only a temporary lag between the determination of earnings and the payment of dividends in cash.

Similarly, Buchanan dismissed the proposition that "corporations are frequently conservative in their dividends because they distrust the earning statements and fear an illegal declaration of dividends." He claimed that under modern corporate laws the likelihood of successful lawsuits in this respect is very small. He also rejected the proposition that "corporations accumulate the surplus credit against which undetermined losses of subsequent periods may be debited without impairing the original paid-in capital." He argued that unless the surplus is actually reduced by losses and needs to be built up again, there is no reason to suppose that surplus accumulation from earnings should go on indefinitely unless additional capital can be made to earn as much within the corporation as elsewhere. After rejecting these and other propositions, Buchanan presented

his own, based on certain assumptions, and came to the following conclusion: "no portion of the earnings ought to be reinvested unless the return upon the increment of capital employed promises to be at least as large as could be earned upon the same capital employed elsewhere, i.e., outside the enterprise." thus indicating that he favors a marginal approach.³ It is significant that Buchanan was among the earliest writers to challenge the accounting practice of reporting asset values without regard to the changing value of money and to stress the importance of adjusting figures to account for changes in price levels.⁴

Buchanan's treatment of the subject of investment decisions is noteworthy. Specifically, he held that where management is faced with two investment proposals yielding two different streams of earnings, the investment that yields the larger present worth of future earnings discounted at the same rate of interest should be undertaken.

Those ways of using the assets which give small returns in the near future must yield considerably larger returns in the more remote future in order to be superior to alternative methods which yield immediate though smaller returns almost at once.⁵

³Ibid., p. 234.

⁴Ibid., p. 231.

⁵Ibid., pp. 182-183.

Though he used the term "interest" as the discount rate to be used in calculation of the present worth of future earnings, it seems that Buchanan had in mind the rate which represents what the money earned in other enterprises and did not consider anything such as cost of capital, which was later used as the discount rate by other writers.

B. H. G. Guthmann and H. E. Dougall

Professors Guthmann and Dougall's Corporate Financial Policy⁶ first appeared in 1940. It enjoyed subsequent editions and was one of the most widely used books at the time. Professor Dougall received his B.A. from the University of Toronto in 1925 and his M.B.A. and Ph.D. degrees from Northwestern University in 1926 and 1930 respectively. He taught at Northwestern from 1929 to 1946, and then went to Stanford University where he has taught since 1946. Professor Guthmann received his A.B. from Syracuse University in 1917, his M.B.A. at New York University in 1921, and his Ph.D. in economics from the University of Chicago in 1929. Professor Guthmann has taught at Syracuse University and the University of Texas. He has been associated with Northwestern University from 1927 to date. These two authors were both on the faculty of Northwestern University when their first edition of Corporate Financial Policy was written. The work is readable

⁶H. G. Guthmann and H. E. Dougall, Corporate Financial Policy (New York: Prentice Hall Inc., 1940).

and contains an excellent reference bibliography keyed to each chapter, but mainly it follows the "traditional" form of content. The authors explain in the preface, however, that the book is aimed directly at the solution of problems of financial policy, that the emphasis is upon a management point of view, and that the material of current practices included in the book were correlated at each point with underlying principles:

Only by understanding the reasons that lie behind practice can management decide upon the correct course of action under varying conditions of business.⁷

The major part of the book, despite the claims of the authors that it is a substantially different book from its contemporaries in the field of corporate finance, follows a conventional layout in treating the subject. There are chapters on the legal forms of business organization, corporation stocks and bonds, promotion, capitalization, investment banking, organized security exchanges, short-term financing, expansion, combination, and the like.

In their last chapter on the social aspects of corporation finance, the relationship of finance to economics, the social problems of voting and control, the need for risk capital, the financial advantages of size, and dangers of debt were discussed. Of special interest is the selected

⁷Ibid., p. vii.

reference list where cross-references to other contemporary books and articles are given, chapter by chapter.

C. W. Bayard Taylor

Professor Taylor received an A.B. from Beloit College in 1918, an A.M. and a Ph.D. from the University of Minnesota in 1923 and 1928 respectively. He taught at the University of Kansas from 1928 to 1930, at Western Reserve from 1930 to 1931, the University of Wisconsin from 1931 to 1936, and at Claremont Men's College and Graduate School from 1948 to 1961 when he received an L.L.D. degree from that college. He wrote a book entitled Financial Policies of Business Enterprise⁸ while he was professor of finance at the University of Wisconsin. This is a well-written lengthy book (867 pages). Throughout this work the writer undertook to explain as well as to describe. There is a stress on principles and not too great a use of examples. In the words of the author, "the choice has been deliberately made to study financial hygiene instead of financial pathology."⁹ Nonetheless, the table of contents reads like that of any of the contemporary books on corporation finance.

⁸W. Bayard Taylor, Financial Policies of Business Enterprise (New York: Appleton-Century, 1942).

⁹Ibid., p. vi.

Taylor's Financial Principles and Policy (1941) was privately printed.¹⁰ The following quotation from this book is interesting because it is representative of the finance writers' idea of the relationship between accounting and finance.

Accounting is related to finance by a process of infiltration and ingratiation. When, in very early times, it accepted the assignment to provide management with a record of business transactions its work was quantitative primarily and analytical secondarily. Now it seeks the role of counselor. As management was compelled by the march of economic events to specialize and departmentalize, the mere problem of reporting and classifying the transactions and results of business enterprise became more and more complex. New devices of control based upon delegated authority and reports of the performance of those to whom such delegation had been made, were demanded and created. New systems of accounting, new accounts, and new classifications, all directed to special services, situations and problems which an expanded management required to have treated were evolved by the accountants and offered to that management as aids to planning and policy formulation. And naturally, when an accountant undertook the construction of a new system he prepared himself for such construction by seeking to understand the purpose to which the system was to be applied. The specifications were contained in the objective. Knowing the objective, the accountant knew the process or procedure; knowing the process he was able to interpret the results of the pursuit of that process as his system recorded the results thereof. Where the record revealed results short of the management's objective he made bold to explain and even advise.

¹⁰W. Bayard Taylor, Financial Principles and Policy (private printing, 1941).

Therefore, accounting journals and treatises contain many titles that treat financial practice and policy.¹¹

D. William H. Husband and James C. Dockeray

Professor Husband received an A.B. degree in 1922 from the University of Michigan and A.M. and Ph.D. degrees from The Ohio State University in 1924 and 1928 respectively. He taught at Ohio Wesleyan University from 1922 to 1936. Professor Dockeray obtained an A.B. from Ohio Wesleyan University in 1929 and an A.M. (1931) and Ph.D. (1936) from The Ohio State University. He has taught at Iowa State Teacher's College (1935-1936), Millikin University (1936-1942), the University of Maryland (1942-1946), George Washington University from 1946 to the present where he became Professor of Finance and Chairman of the Department of Public Administration in 1955.

When they were writing Modern Corporation Finance,¹² (1942), Husband was with the Federal Home Loan Bank Board and Dockeray was Associate Professor of Business Administration in the James M. Millikin University.

The distinguished characteristic of this book is its emphasis on the social aspects of corporations. The usual

¹¹Ibid., p. 2.

¹²William H. Husband and James C. Dockeray, Modern Corporation Finance (Chicago: Richard D. Irwin, 1942).

material, such as bonds, stocks, legal forms of business organization, reorganization and the like are covered in a manner similar to other contemporary books; however, the events that preceded this book made the authors assign a major part of their quite long book to a discussion of the public responsibilities of business enterprise and all the related social questions.

Prior to the 1930's, private business was called upon to assume a minimum of responsibility. The operations of private enterprise were assumed to be both automatic and beneficial to society at large. Under the circumstances, there developed a philosophy which seemed to place an obligation upon society in favor of business . . . difficulties did appear in the form of recurring depressions, but ensuing periods of recovery and prosperity always seemed to take up the slack and to point the way to further progress. It is not surprising that immediately following the crash of 1929, improvement was thought to be inevitable and that full recovery was believed to be just around the corner. When the rising sun of recovery failed to appear after long years of unemployment and various forms of economic distress, there was no longer escape from widespread public inquiry as to the effectiveness of the private system.¹³

Therefore, the authors, in addition to recognizing the basic position of the corporation in their book, gave adequate consideration to the interests of the public as a whole and to the rights of investors as part of the public whose interests in the corporation are more intimate.

¹³Ibid., p. 5.

In their words, "this social emphasis constitutes an entirely practical and necessary approach; this is a day of social awakening when business policies must be considered in the light of their effect upon the public-at-large."¹⁴

It is a point of interest that present-day writers on corporation finance and financial management have reverted to the custom of giving the social aspects of business financial practice little or no attention.

E. Carl A. Dauten

Professor Dauten obtained an A.B. degree in 1936, an A.M. in 1939 and a Ph.D. in 1944, all from Washington University in St. Louis. He was Associate Professor of Finance at Washington University when he wrote Business Finance.¹⁵ Professor Dauten's book is distinct insofar as it breaks away from the pattern followed by other books of the subject, leaving out the "big business" approach and concentrating on the problems of small business. Therefore, such topics as investment banking, operation of security markets, and holding companies are not included.

¹⁴Ibid., p. 7.

¹⁵Carl A. Dauten, Business Finance (New York: Prentice Hall Inc., 1948, 1956).

F. Hiram L. Jome

Professor Jome received an A.B. degree in 1918 from St. Olaf and an A.M. and a Ph.D. in Economics from the University of Wisconsin in 1920 and 1925 respectively. He taught at the University of Wisconsin (1920-1923), Denison University (1923-1931), and at DePauw University from 1931 to 1958 when he died. He was at DePauw University when he wrote his book, Corporation Finance (1948).¹⁶ He wrote primarily for students in corporation finance who had had only a beginning course in economics and wished to acquire a foundation in corporation finance. Therefore, the book is written in clear, simple language but covers the usual subject matter. A chapter on social aspects of corporations is included.

G. Other writings

Other writings of interest during this period included Case Problems in Finance (1949),¹⁷ which was a very interesting selection of problems covering such areas as financing current operations, financing long-run needs, reserve and dividend policies, promotion, expansion and combination.

A number of studies in business financing undertaken by the National Bureau of Economic Research were published

¹⁶Hiram L. Jome, Corporation Finance (New York: Henry Holt and Company, 1948).

¹⁷Pearson Hunt and Charles M. Williams, Case Problems in Finance (Chicago: Richard D. Irwin, Inc., 1949).

during this period. The objective of this series of studies was to ascertain and present to the public important economic facts and their interpretation in a scientific and impartial manner. Such studies as Neil Jacoby and Raymond J. Saulnier's Financing Equipment for Commercial and Industrial Enterprises¹⁸ described the use and development of this method of financing. Also by the same authors was Term Lending to Business.¹⁹ Other books of this series included Financing Small Corporations in Five Manufacturing Industries 1926-1936²⁰ by Charles L. Merwin and The Pattern of Corporate Financial Structure²¹ by Walter C. Chudson.

III. Articles

The periodical literature in the forties is concerned mainly with the problems of financing American industry after the war. Earlier articles, written during the war, concentrated upon the availability of funds for American business

¹⁸ Neil Jacoby and Raymond J. Saulnier, Financing Equipment for Commercial and Industrial Enterprises (New York: National Bureau of Economic Research, 1944).

¹⁹ Neil Jacoby and Raymond J. Saulnier, Term Lending to Business (New York: National Bureau of Economic Research, 1942).

²⁰ Charles L. Merwin, Financing Small Corporations in Five Manufacturing Industries 1926-1936 (New York: National Bureau of Economic Research, 1942).

²¹ Walter C. Chudson, The Pattern of Corporate Financial Structure (New York: National Bureau of Economic Research, 1945).

after the war; those written in the latter part of the decade reflected the concern with the inflation experienced at the time and its effects on the financing of business. More specifically, the accounting treatment of depreciation, long a hotly contested point in the field of business finance because of its effects on the level of reported income, comes under greater attack in 1947 and thereafter as writers questioned the adequacy of standard practices of depreciation in times of inflation.

A. Early articles

Frederick C. Dirks²² points out in an article in 1944 that the post-war liquidity position of American business was not going to be uniform. He remarks that trading companies would come out of the war with relatively large amounts of excess cash because once they had sold their inventories during the war, the induced restrictions of the war effort would prevent them from replacing these inventories. On the other hand, manufacturing companies during the war had indeed placed much of their funds into productive assets, and their cash position after the war would not be such as to enable them to finance their new working capital needs. An article

²²Frederick C. Dirks, "The Rising Liquidity of Manufacturing Companies and its Implication for Financing Postwar Conversion," Journal of the American Statistical Association, 39:207-217, June, 1944.

by C. C. Abbott²³ echoes much the same thought. Abbott feared what he considered undue government intervention into the business sector in response to the post-war financial predicament of American business. He said,

Many firms will have to finance the liquidation of one type of business at the same time that they are financing the development of another type of undertaking, and in some cases the new undertaking would be radically different from the one which is being liquidated. Under these circumstances the establishment of cash requirements, financial needs, and credit standards will inevitably be difficult. The fact that so many companies are already making arrangements aimed at surmounting these difficulties indicates that business men recognize that the only kind of planning or preparation is that which they do themselves. It may be hoped, therefore, that the residuum of problems necessarily left to governmental action will not prove insoluble.²⁴

Marshall D. Ketchum's 1944 article²⁵ on the financial problems of small businesses provides an excellent economic analysis of small businesses, their position and their problems. He discusses their war problems and then recommends certain post-war institutional arrangements to solve the alleged difficulties of small businesses in acquiring capital. A few years later a good many of his proposals are mirrored in the Small Business Administration.

²³C. C. Abbott, "Working Capital During the Transition," Harvard Business Review, 22:No. 3:291-298, May-June, 1944.

²⁴Ibid., p. 298.

²⁵Marshall D. Ketchum, "The Financial Problem of Small Business," Journal of Business, 17:67-90, July, 1944.

The 1942 article by Smith and Mace²⁶ is a precursor of the number of articles to be written in later years investigating the influence of taxes on managerial decisions. They noted that because of the normal Federal tax, the surtax and excess profit tax applicable at that time, a high degree of indeterminance surrounded the problem of ascertaining the best form new securities should take.

B. Later writings

The adequacy of accounting practices in periods of rising prices was questioned first in articles in the late 1940's and was to reach its peak in the fifties. There were articles advocating some change in accounting practice, and there were those defending the standard methods. Professor Dan T. Smith²⁷ was apprehensive of President Truman's claim that business profits were too high during that period. He observed that in periods of rising prices there is the problem, under conventional accounting practice, of inventory profits (for those firms not using a LIFO method of inventory valuation) and of increased cost of equipment. He noticed the proportion of profits to national income to be falling and

²⁶Dan Throop Smith and Myles Mace, "Tax Uncertainties in Corporate Financing," Harvard Business Review, 20:315-326, May-June, 1942.

²⁷Dan Throop Smith, "Business Profits During Inflation," Harvard Business Review, 26:216-219, March, 1948.

suggested that unless adequate profits are allowed to occur as return for the assumption of risk, future financing would be stifled.

L. K. Brandt²⁸ reported the results of a questionnaire sent to 107 corporations asking them if they were planning to expand plant facilities in 1948 and how they intended to finance the expansion. The responding firms planned to use internal sources of financing for 64 per cent of their anticipated capital requirements, up to then, an unusual proportion.

George D. Bailey²⁹ thought current arguments on behalf of economic concepts of income to be expedient and pragmatic. If businessmen are willing to say that orthodox methods of accounting determination of earnings are wrong, then he is sure accountants could develop theories and methods with some assurance of practical applications. However, he thinks that accounting concepts are attacked only during periods of fluctuation in the price level. He thought that there were too many hazy concepts at the time as well as an emphasis in accounting on the balance sheet and not on earnings. He believed that the reason why corporations were clamoring for new accounting

²⁸L. K. Brandt, "Sources of Funds for Corporate Plant Expansion," Southern Economic Journal, 15:279-288, January, 1949.

²⁹George D. Bailey, "Concepts of Income," Harvard Business Review, 26:680-692, November, 1948.

methods of ascertaining income was that they made unusually large profits after the war.

The uncertainty brought about by reporting of income in periods of rising prices and the potential danger of adopting dividend policies that may be in violation of existing statutory provisions prompted Harvey M. Spear³⁰ to examine the statutes of different states pertaining to limitations on the dividend policies of corporations. He found these limitations worded differently in the different statutes. For example, one type used in New York and Pennsylvania, prohibits "capital impairment" which is understood to be the payment of dividends if they would reduce the assets below the par value of the capital stock. A second type is that of the "balance sheet excess," where dividends are permitted only when assets are more than liabilities plus capital. A third type is where dividends are permitted to be paid only out of "net profits." In most states where this test is used, it is usually combined with either the "capital impairment" or the "balance sheet excess" test. Statutes limiting the payment of dividends to profits without any other stated limitation is the oldest limitation, both in this country and in England. A fourth formulation, that of

³⁰Harvey M. Spear, "Dividend Policies Under Changing Price Levels," Harvard Business Review, 27:612-621, September, 1949.

"insolvency," which follows the "conveyance theory," prohibits the payment of dividends when the corporation does not meet its debts. Again, this test is frequently combined with either the "capital impairment" test or with the "balance sheet excess" test.

Stanley L. Miller³¹ was not alarmed by the talk in some investment circles that the dearth of venture capital could lead to too much borrowing. He finds that the relatively low level of stock fluctuation after the war was counterbalanced by the reduction of the level of pay-out ratios. Whereas, in previous times the pay-out ratios were as high as two-thirds to three-fourths of reported income, during the post-war period they had been reduced to as little as one-half. He explained the low figure in this way: low pay-out ratios exist because under rising prices more than the depreciation on original cost must be set aside for replacement assets of appreciated value.

An interesting article was Thomas H. Sanders' in the Harvard Business Review in 1949.³² Though he argues for the soundness of the "orthodox" accounting process of depreciating assets on the basis of "original cost," nonetheless, he takes

³¹Stanley L. Miller, "The Equity Capital Problem," Harvard Business Review, 26:671-679, November, 1948.

³²Thomas H. Sanders, "Two Concepts of Accounting," Harvard Business Review, 27:505-520, July, 1949.

exception when the Federal Trade Commission and other regulatory bodies make use of this sort of depreciation amount for rate setting.

I accept depreciation on original cost only so long as the companies are free to follow financial policies by which they may make appropriate provisions for the maintenance and expansion of their plants . . . In this provision I include intelligently considerate tax treatment which will not deplete working capital to a damaging extent.³³

C. Financial tools

Joel Dean³⁴ in an article in the American Economic Review (May, 1948) contended that the break-even chart is of short-term and static nature and therefore not reliable for forecasting of future profits. The basic premise that profit is a single-valued function of output is wrong, he argued, especially with today's relative changing prices when both expenditures and income prices may be changing.

The relatively recent phenomenon of using sinking funds in preferred stock issues was pointed out by Wilsey in 1947.³⁵ He noted that of preferred stocks initially offered during the six year period immediately before 1947

³³Ibid., p. 519.

³⁴Joel Dean, "Cost Structures of Enterprises and Break-even Charts," American Economic Review, 38:153-164, May, 1948.

³⁵Lawrence H. Wilsey, "The Use of Sinking Funds in Preferred Stock Issues," Journal of Finance, 2:No. 2:31-42, October, 1947.

over 50 per cent contained a provision for redemption. This he attributes to the desire of the corporation to use preferred stock rather than bonds when it is less costly to do so. Such a practice also allows them to replace later the preferred with internally generated equity funds.

A perceptive article by Professor Guthmann³⁶ explores the possibilities by which the financial manager may improve the income and appreciation of the common stock by financial operating efficiency. Market value of a new issue may be improved (despite the depressant effect of large supply of new stock and pricing of new issues below current market price) if: (a) one buys with the new funds properties of other businesses at "bargain" terms (i.e. at less than asset value); and (b) by proper timing of the new issue (i.e. the assets worth \$10, market price \$30, offer the stock at \$20). Earning power may be improved if: (1) the business is young and has not achieved optimum size; (2) property with low earning is bought which promises to return higher earnings after amalgamation.

³⁶H. G. Guthmann, "Dilution and Common Stock Financing," Harvard Business Review, 23:No. 2:246-252, March, 1945.

Herbert R. Silverman's article³⁷ examines the history, trend, and current position of old-line factor houses and the law on factoring in different states. Interestingly, he shows the development of a factor from a trading and a financial nature to a purely financial concern, and notes the word "factor" comes from the Latin "facere," which is translated as "he who gets things done." This phrase applied to the mercantile functions of an intermediate when the factor was such and was earning a del credere commission.

William L. Cary's³⁸ investigation into the short-comings of the sale and lease-back method of financing assets is one of the most comprehensive articles on sale and lease-back.

D. Articles on education

Pearson Hunt's 1943 article³⁹ is somewhat of a classic in the literature of the teaching of corporation finance. This article is fundamentally a review of the fourth edition of Dewing's monumental work, The Financial Policy of

³⁷Herbert R. Silverman, "Factoring as a Financing Device," Harvard Business Review, 27:594-611, September, 1949.

³⁸William L. Cary, "Sale and Lease-back of Corporate Property," Harvard Business Review, 27:151-164, March, 1949.

³⁹Pearson Hunt, "The Financial Policy of Corporations," Quarterly Journal of Economics, 57:303-313, February, 1943.

Corporations.⁴⁰ Hunt took this occasion to question the trend and nature of the books of corporation finance and the teaching of corporation finance in the nation's colleges and universities. He is the first to use the term "traditional" to apply to this earlier body of knowledge produced by Dewing and the other writers of major books, with the exception of McKinsey, Meech, and Jamison. He asked for examination of other areas. Hunt called the period following World War II the "heyday of financial capitalism," when everybody seemed to be interested in the capital market.

In such an environment it was only to be expected that the subject matter of studies in corporation finance should emphasize the matters of greatest interest to investment bankers, rather than to the treasurers of operating companies or to an observer in some ivory tower. Thus, the traditional approach to the subject matter took up the topics of the forms of corporate securities, of promotion in the financial plan, of valuation, of expansion with special reference to the holding company, of the determination and administration of income, and of failure and reorganization, in the field.⁴¹

It should be noted, however, that Hunt himself did not explicitly and directly provide a definition of the field. Rather, he defined corporation finance as the field of knowledge bounded on one side by private law, especially that covering agency contracts and property; on a second side by

⁴⁰Dewing, loc. cit.

⁴¹Hunt, op. cit., p. 305.

those business customs and practices which are not covered by the simple formula of "the profit motive;" on a third side by "the public interest," enforced by courts, and administrative bodies; and finally, by general economic theory, especially as it relates the single firm to the structure of the whole economy. Hunt further indicated his preference for the term "private finance" for this area, since many matters not closely related to an individual corporation should be included in the scope of studies so as to cover all the field as carefully as that part related to private law and business custom. In addition, Hunt thought that such subjects as the effect of government action upon private financial decision, the question of the bounds of appropriate financing, and the question of control inherent in a system of widespread ownership should be included in the study. He believed that not only must the student in private finance know the theories of employment, but the person whose chief concern is employment must know the economics of the individual firm. He also suggested that writers in the field can develop new material of real significance only by observing the problems of a firm as a treasurer would. He concluded with his main contention that the authors of standard corporation finance books were too narrow in their approach to a subject that would better be named private finance and that accordingly, their work had lost some of its significance.

Francis J. Calkins⁴² published in 1949 the results of a catalog survey of course offerings for the year 1947-1948 by the fifty-eight members of the American Association of Collegiate Schools of Business. He provided tables of credit hours given in such areas as money and monetary theory, bank management, business cycles and forecasting, public finance, personal finance and investments. He discussed the dilemma of the college schools of business which are asked to meet the demands of business, both for specialists and "broad-gauge" executive talent.

IV. Summary

The fourth period in the development of business finance literature (1940-1949) is initially one of war effort and later, one of readjustment after the war. Early articles dealt with the problems of financing for the war effort and the problems of conversion to peace-time production after the war. Later in the decade, article writers gave their attention to the effect of the post-war inflation on financing and they questioned the adequacy of the standard accounting methods to deal with the problem. Similarly, the context of books and collegiate courses in business finance were challenged.

Almost all the books of this period discussed the social aspects of business. This social emphasis was brought about

⁴²Francis J. Calkins, "University Courses in Finance," Journal of Finance, 4:244-265, September, 1949.

by the widespread public inquiry into the adequacy of the private enterprise system following the long years of unemployment and other forms of economic sickness in the previous decade.

The use of the present value method for the evaluation of investment proposals is promulgated for the first time in a popular textbook in the field.

The seeds for the great changes to come are sown in Professor Buchanan's 1940 book and Professor Hunt's 1943 article.

CHAPTER VII

NEW DIRECTION

1950-1960

The decade from 1950 to 1960 is the last period in the development of business finance literature examined in this study. A few important books published in the early sixties are considered in this chapter. As the literature is continuously being expanded, it is hoped that some other student of the subject will continue the literature study where this dissertation leaves off.

Marked at its beginning by the Korean conflict and by three recessions, the period of the fifties and early sixties is nevertheless one of post-war economic expansion. This is the era of the cold war, the race to the moon, the electronic computer, synthetic and polyester fibers, and tranquilizers, to name but a few of its characteristics. The business finance literature of this period is plentiful. Not only are past concepts and ideas further developed and refined, but new problems attract the attention of scholars. Rapidly changing environmental and institutional conditions led to the development of rigorous theoretical and conceptual frameworks and de-emphasizing takes place in the routine and

descriptive method. The development of mathematical theoretical models in finance is facilitated by advances in high speed computers which make empirical verification of a hypothesis more readily available. Numerous articles appear during these years, dealing with developments in techniques of financial administration, reporting results of empirical investigations aimed at verifying or disproving theoretical principles, and, in general, concerned with the corporate investment decision problem. The book literature is characterized by an emphasis on the managerial, "insider" viewpoint, a departure from the "traditional" outsider approach that had dominated in textbooks during the previous forty years.

I. The Period

A. Industrial production

The years from 1950 to 1960 are marked by three recessions in economic activity; that of 1953-1954 was principally caused by inventory liquidation and a decline in the defense expenditures of the Federal Government. Gross national product declined from \$364.9 billion in 1953, to \$356 billion in 1954 with 3.7 million people being unemployed in the Spring of 1954.

The 1957-1958 setback in economic activity was caused

by an over expansion of plant capacity and a drop in exports. Output of durable goods was particularly hard hit. A rapid recovery followed until the steel strike of January, 1959. In 1960, the last of the declines was marked by a decline in the demand for steel, autos, and appliances and led to a contraseasonal rise of four million unemployed in November of that year.

The index of industrial production (1957 = 100) rose from 75 in 1950 to 110 in 1960. This is a 1.4 per cent annual increase in gross national product per capita in constant 1954 dollars, a rate well below that of the countries of Western Europe and the USSR. The Consumer Price Index (1947-1949 = 100) rose to 114.4 in 1953 and to 127.4 in 1960, with especially sharp increases in housing, apparel, transportation and medical care.

B. Industry trends

The period is characterized by the widespread adoption of automation and the use of high speed computers; the increase in production of synthetic acrylic and polyester fibers; and the rapid expansion in defense and "space age" industries, geared to military technology such as spacecraft, electronics and production of high energy fuels. Finally, the compact automobile is introduced in this country and reaches 30 per cent of the total United States passenger car production by 1960.

C. Money and capital market

In this period, the number of individuals participating in the ownership of domestic industry increased greatly. This was done mainly through the expansion of investment companies which by 1960 had 2.5 million shareholders. Savings-bank deposits rose from 63.2 billion dollars in 1952 to 100 billion dollars in 1959. Life insurance in force in January of 1960 was 542 billion dollars in contrast to 276 billion dollars in 1953. In 1951, the Federal Reserve Board raised bank reserve requirements to check the great expansion of credit and bank loans that began in the fall of 1950. United States Government bonds sold below par for the first time in more than a decade, with long term interest rates showing a tendency to rise. As an anti-inflationary step, bank rates on loans rose gradually. Short term business loan rates increased from an average of 2.7 per cent in 1950 to 5 per cent in 1959, a level that had not been reached in the last twenty years.

II. Books

The distinguishing characteristic of the textbooks published in the fifth decade of this century and the first year of the 1960's is the emphasis on the managerial, "insider" viewpoint. While some books remained "traditional" in their approach, the majority adopted new and often novel

arrangements of chapters, and in general, emphasized the analysis rather than the description of subject matter.

A. Bion B. Howard and Miller Upton

Introduction to Business Finance (1953)¹ by

Professors Howard and Upton may safely be considered the first of many books breaking away from the "traditional" approach to the subject of business finance. At the time of writing this book, Bion B. Howard was Professor of Finance at Northwestern University. He received a Bachelor's degree at the University of Chicago in 1933, and from Northwestern University the M.B.A. in 1940 and Ph.D. in 1950.

Miller Upton at the time was President of Beloit College. In the preface of their book, the authors mention the increasing interest among academicians and practitioners in the "new approach" to business finance; away from the descriptive, the episodic, pertaining mainly to the business corporation, and towards the administrative viewpoint. In addition, the authors criticized two of the tendencies in the books of the post-war period, that of treating the corporation as a social institution and secondly approaching business finance from the standpoint of small businesses.

¹Bion B. Howard and Miller Upton, Introduction to Business Finance (New York: McGraw-Hill Book Co., Inc., 1953).

The texts that have appeared in recent years have not fully satisfied the need for material consistent with this approach. One tangent of such finance books has been in the direction of developing the corporation as a social institution, an approach even further away from the internal management approach. These books are more socio-economic than administrative in nature and therefore necessarily assume substantial prior knowledge on the part of the student as to the operation of the individual firm. Another tangent has been toward developing the special financial operations and problems of small business. By thus concentrating on only one type of business organization these texts are subject to one of the major criticisms of the traditional corporation finance texts--too limited in application. Where concern for the small business has been centered around the managerial approach, the results are satisfactory, but too often the books have merely followed the traditional pattern, while using the small business situation as the point of reference.²

Accordingly, the authors arranged the contents of their book into six parts. Part I, Financial Organization contains two chapters; one on the meaning and scope of business finance; the other on organization of business to share risk, income and control. Part II, Administrative Tools of Finance: Financial Analysis, contains chapters on the balance sheet and the profit and loss statement, flow of funds analysis, analysis for judging financial condition and analysis for judging profitability. Part III, Administrative Tools of Finance: Budgets and Financial Planning, contains chapters on the nature and purpose of budgets and budgeting, planning to maintain solvency, budgeting to further

²Ibid., pp. vii-viii.

profitability, the development of a detailed budget, and promotional expansion. Part IV, Short-Term Financing of Asset Requirements, includes chapters on principles of short-term financing, trade credit, commercial bank and other forms of unsecured credit and secured short-term credits. In Part V, Intermediate and Long-Term Financing of Asset Requirements, the authors discuss such topics as term loans and equipment financing, borrowing on the basis of long-term credits, and raising owner's funds for the business. Part VI, Non-Recurring Financial Problems of the Business Unit, discusses such topics as financial considerations in exchange or sale of business properties and remedial action for financial strain.

Such staple items in traditional textbooks as investment banking, description of the different forms of business organization, or description of the more exotic kinds of securities are either altogether eliminated or discussed very briefly. In contrast, having stressed the fact that management is concerned with future rather than with past operations, the authors devote four chapters to developing and discussing the usefulness, techniques, importance and application of budgeting and budgets.

However, conspicuously missing from this book is a treatment of the investment decision at a level of sophistication which is today universally found in basic books of

finance. It is of great interest to note the similarities in the outline and approach taken by these authors with that taken by two other writers exactly thirty years previously.³

B. Charles L. Prather

Professor C. L. Prather's formal education includes a Master's degree in 1923 and a Doctorate in Economics in 1927, both from the University of Illinois. He has taught in the University of Illinois, the University of Pittsburgh, and the University of Syracuse and has been on the faculty of the University of Texas as Professor of Finance from 1946 to date. Professor Prather's Financing Business Firms first appeared in 1955 and a revision was issued in 1961.⁴ It is difficult to classify as either a "traditional" or a "new approach" book. On the one hand it contains the traditional textbook's detailed description of financial instruments and institutions with abundant examples, footnotes, and references, yet, at the same time, it stresses the "why" and discusses "newer" topics such as the present value of future earnings method in capital budgeting. An example of his

³See Chapter IV, page 66 of this dissertation. James O. McKinsey and Stuart P. Meech, Controlling the Finances of a Business (New York: The Ronald Press Company, 1923).

⁴Charles L. Prather, Financing Business Firms (Homewood, Ill.: Richard D. Irwin, Inc., 1955, 1961).

awareness of the significance of proper analysis rather than description, is the following quotation which appears in the discussion of the use of ratios in business finance:

However, ratio analysis does not show the existence of lines of credit and loan commitments that business firms may have with their banks, and this ability to borrow may mean that a business firm is considerably stronger than ratio analysis would suggest.⁵

Whereas the book incorporates some of the advantages of both the older type of books and the new type of books, it also contains the drawbacks of books attempting to accomplish everything. Such drawbacks include the absence of discussion of the time adjusted rate of return on investment and the omission of any reference to the concept of a "weighted cost of capital" to the firm. He describes the nature and use of bonds and stocks late in the book, a practice which the writer of this dissertation finds awkward in teaching the subject with the use of this text. The inclusion of outstanding summaries for every chapter and the excellent questions and problems offered, make this one of the most significant books of this period.

C. W. Bayard Taylor

Financial Policies of Business Enterprise (1956) second edition⁶ by Professor Taylor was written in collabora-

⁵Ibid., p. 118; 1961 ed.

⁶W. Bayard Taylor, Financial Policies of Business Enterprise (second edition, New York: Appleton-Century-Crofts, Inc., 1956).

tion with Professor Frank M. Graner of the University of Wisconsin. This book is as elegantly written as the first edition which was published in 1942. The comments and criticisms of students and teachers who had used the first edition served as a basis of improving and updating the second edition.

The authors indicated they have "faith in the principles approach," but did not want to discount the value of texts that prefer the "problems approach." Part I, The Evolution of the Business Unit, contains detailed treatment of the proprietorship, partnership, the corporation, and the trust holding company as well as a whole chapter on the finance of co-operatives.

D. E. F. Donaldson

Professor Donaldson's Corporate Finance⁷ was published in 1957. This painstakingly exhaustive book was offered by its author as a "complete survey of the principles underlying the financial practices and the financial management of the modern business corporation."⁸ Particularly emphasized is

⁷E. F. Donaldson, Corporate Finance (New York: Ronald Press Company, 1957).

⁸Ibid., p. v.

the important area of taxation and its impact on the corporation and its owners. This book follows a "traditional" approach to the subject matter. Parts are included on the Forms of Business Organizations; Corporate Securities; Promotion and Financing Through Securities; Working Capital; Administration of Income; Expansion and Combination; Re-adjustment; Reorganization, Receivership and Dissolution. Authoritative detail is found throughout the book and its 876 pages make it one of the longest and most comprehensive books in the field. In the treatment of the subject of the different forms of business organizations, the author draws substantially from his expertise as witnessed by his book Business Organization and Procedure (1938).⁹

A second edition of Corporate Finance co-authored by Professor John K. Pfahl, also of The Ohio State University, appeared in 1963.¹⁰ In this edition, the detailed treatment of the subject was retained and brought up to date, and a new part on Financial Management was added. The latter part includes discussions on the weighted cost of capital and the present value method.

⁹Elvin F. Donaldson, Business Organization and Procedure (New York: McGraw-Hill Book Company, 1938).

¹⁰Elvin F. Donaldson and John K. Pfahl, Corporate Finance (second edition; New York: The Ronald Press Company, 1963).

E. Pearson Hunt, Charles M. Williams and Gordon Donaldson

Basic Business Finance by Hunt, Williams, and Donaldson, all on the faculty of the Graduate School of Business of Harvard University, first appeared in 1958.¹¹ A revised edition was published in 1961.

Basic Business Finance has been a very popular textbook. Though it was intended for use in a basic course at the graduate level, this book is known to be used in junior level, first courses in Finance. Though intended for courses which use the case approach, and it contains thirty-six cases, this book is not lacking in textual material. In the second edition, a full 632 pages are devoted to the latter. The treatment of the subject in the text is at a more advanced level than in the other books which have been discussed previously.

In the words of the authors, "this book is written from the point of view of the chief financial officer in an operating business, a man with responsibilities for getting a job done well."¹² The book neglects, however, to provide many of the basic details that would make it useful to those charged with managing finance functions. The outline of the text material follows that of the "new approach." Part I,

¹¹Pearson Hunt, Charles M. Williams, and Gordon Donaldson, Basic Business Finance (Homewood, Ill.: Richard D. Irwin, Inc., 1958).

¹²Ibid., p. 6; 1961 ed.

Introduction, deals with the nature of the finance function in business and the place of the corporation in the United States. Part II, The Management of Assets and the Need for Funds, deals with such topics as inventory, receivables and cash management, and investment in fixed assets. Part III, The Analysis of Past Financing and Future Fund Needs, is devoted to a discussion of the interpretation of financial statements and the problem of forecasting future needs for funds. Part IV, Short- and Intermediate-Term Sources of Funds, deals with the effective use of bank credit, the non-bank sources of short-term credit, and the term loan. Part V, The Long-Term Capital Structure, includes a discussion of the basic types of securities, their use in allocating income risk and control, and dividend policy and retention of earnings. Part VI, The Details of Specific Long-Term Financial Contracts, deals with the topics of the use of assets without obtaining ownership, and the cost of capital. Part VII, The Sources of Long-Term Corporate Capital, includes chapters on the sources of long-term capital, and the nature and effects of government regulation on long-term financing. In Part VIII, Financing Growth and Development, the subjects of financing small enterprises, the financial aspects of business mergers, the problems of refunding and recapitalization, and the problems of business failure are treated. Part IX, The Analysis of Long-Term Investment Opportunities, includes two chapters, the first, on time adjustment, presents the principles

of compounding, discounting, finding the rate of return, annuities, and amortization of loans. The other chapter relates to the appraisal of capital investment opportunities in which the criteria for the selection of investment proposals, the amount of investment required, the times at which the benefits are to be received and the costs are to be paid off, the anticipated length of life, the presentation of funds flows over time, the application of criteria, and the choice of a cut-off rate are all discussed.

In the chapter, Spontaneous Sources of Credit, the authors show that in the normal operations of a business certain funds are forthcoming without any conscientious effort by the managers in negotiating the availability of these funds. They call these the spontaneous sources of funds which includes normal trade credit, accrued expenses and accrued income taxes.

The treatment, in this text, of the cost of capital to the firm is the most up-to-date and extensive in the textbook literature. The determination of the cost of bonds, preferred stock, and equity capital is first presented and then integrated into a concept of the weighted cost of capital. Chapter 30, The Appraisal of Capital Investment Opportunities, follows a chapter on the explanation of the nature and significance of time adjustment to the value of the dollar. In Chapter 30, the average rate of return method, the pay-back

period method, and the time adjusted rate of return on investment method are all developed. Of primary interest is their discussion of the problem of selection of a cut-off rate for accepting investment proposals.¹³

F. Robert W. Johnson

Professor Johnson received his M.B.A. from Harvard University in 1946 and a Ph.D. in Finance from Northwestern University in 1952. He taught in the University of Buffalo from 1950-1959 and it was there that he wrote his book Financial Management. After 1959 he taught at Michigan State University and now teaches at Purdue University.

Though Howard's and Upton's Introduction to Business Finance is the first post-war book with a marked managerial emphasis, Robert W. Johnson's 1959 book,¹⁴ Financial Management is the first of the modern textbooks to use the term

¹³In the treatment of the investment decision, the writer of this dissertation has found a fundamental confusion. Many authors imply that the cutoff point for accepting an investment proposal has to be the cost of capital. This does not have to be so as Hunt et al. have pointed out. If the company is faced with several alternatives promising a higher return than the cost of capital, then management should not accept any proposal promising a rate equal to or greater than the cost of capital rate but less than the rate of available alternatives. The use of the average weighted cost of capital as a cutoff point may be used only as the minimum acceptable rate.

¹⁴Robert W. Johnson, Financial Management (Boston: Allyn and Bacon, Inc., 1959). A revised edition was published in 1964.

financial management in its title. In this book, according to the author,

the financial manager occupies the center of the stage. He is the decision making unit. This is not an abstract recital of the habits and practices peculiar to the world of finance, but an attempt to involve the reader in the fundamental decisions and compromises made by a financial manager as he faces this complex and dynamic economy.¹⁵

The book opens with a discussion of the role of finance in the economy, the functions of financial management in business and the different forms of organization for financial management. This is followed by an examination of the dilemma of liquidity versus profitability. Part II, Financial Planning, includes chapters on financial analysis, planning short-term needs of funds, planning for profits, and capital budgeting. Part III, Acquisition of Funds, discusses the operations of money and capital markets, financing theory of trade credit, commercial bank credit and other forms of credit. In addition, intermediate term financing and long term financing (both in the form of debt and equity) are examined. Part IV includes two chapters, one on the management of cash and accounts receivable, and the other on the management of inventory and fixed assets. Finally, Part V, Evaluation of Business Enterprises,

¹⁵Ibid., p. vi.

examines the principles of valuation of a new company, and of companies at times of business combinations and reorganizations. In the chapter on capital budgeting, the author discusses the pay-back method, the average rate of return method, and the time adjusted rate of return method in measuring the attractiveness of an investment proposal. In the same chapter, the weighted average cost of capital and its role in the investment decision is presented. The present value method is not discussed.

At the end of the book, a selected bibliography by chapter is provided.

G. Richard C. Osborn

Professor R. C. Osborn holds a Bachelor's degree from Stanford University, a Master's degree from the University of Southern California, and a Ph.D. degree from the University of Illinois. He taught in various colleges and universities until he joined the staff of the University of Illinois in 1947.

His book, Corporation Finance (1959)¹⁶ is an extremely well written book that bespeaks of the influence of long years of teaching experience. However, this is a textbook of business finance that is entirely "traditional" in its

¹⁶Richard C. Osborn, Corporation Finance (New York: Harper and Brothers, 1959). A revised edition was published in 1965.

treatment of the subject. The book deals with such topics as different forms of business organization, a description of the nature of capital stock, bonds, short-term sources of funds, investment banking, organized security exchanges, legal regulation of securities markets and other such staple items of the traditional approach.

Professor Osborn joins other contemporary writers in disliking the emphasis that earlier writers had placed in their books on long-term sources of funds to the exclusion of short-term borrowing. Professor Osborn suggests that short-term borrowing be added to bonds, preferred stock and common stock in the concept of "capital structure."

In analyzing the capital structure of an enterprise, short-term debt is often excluded from consideration. Such exclusion is less significant for the railroads and public utilities, which have relatively few current liabilities. For industrials, however, a considerable proportion of the capital is furnished on a short-term basis, with new debt being incurred constantly as old obligations come due and are paid off. Small firms, especially, have extensive current borrowing. Consequently, both in comparisons among firms and between industries, the elimination of short-term debt as a source of funds can give a distorted picture.¹⁷

Corporation Finance contains a chapter, Special Problems of Small Business, as well as a final chapter called Macroeconomic Aspects of Corporation Finance. In this latter chapter, such subjects as the changing role of the

¹⁷Ibid., p. 140.

individual; the world-wide emphasis on collectivism; the aggregative approach to economic stability; the significance of inflation; the responsibilities of the Federal Government's economic affairs; the regulation of corporate profits; and the influence of government action on business finance are discussed.

H. Raymond P. Kent

Professor Kent earned a Bachelor's degree in 1931, a Master's degree in 1934, and a Ph.D. in economics in 1938, all at the University of Pittsburgh. He has been on the faculty of the University of Notre Dame since 1938. His Corporate Financial Management (1960)¹⁸ was revised in 1964.

Professor Kent is the first writer to discover a fundamental dichotomy in the finance function in the firm. He classifies the finance activities in the firm as either executive finance functions or incidental finance functions. Executive finance functions are (1) establishing asset-management policies; (2) determining the allocation of net profits; (3) estimating cash-flows and requirements; (4) controlling the flow of cash; (5) deciding upon needs and sources of new outside financing; (6) carrying on negotiations for new outside financing; and (7) checking upon

¹⁸Raymond P. Kent, Corporate Financial Management
(Homewood, Illinois: Richard D. Irwin, Inc., 1960).

financial performance. The incidental finance functions are (1) supervision of cash receipts and disbursements, and the safeguarding of cash balances; (2) custody and safeguarding of securities, insurance policies, and other valuable papers; (3) taking care of the mechanical details of new outside financing; and (4) record keeping and reporting.¹⁹

The "financial structure" of the firm, according to Professor Kent, is the sum of all the different sources of funds (including short-term sources) which would be the concept identified by Professor Osborn as "capital structure."

The book abounds with discussions of techniques, with detailed descriptions of principles, institutions, instruments, and procedures. Curiously enough, two topics that had been discussed in the professional journals and which had been treated in virtually all of the contemporary textbooks are given very scanty treatment by Professor Kent. These topics are the estimation of the desirability of investment proposals and collateral to this, the problem of ascertaining the weighted cost of capital to the firm. The author mentions a "rough method" of estimating the rate of return to capital which is what is commonly known as the average rate of return on investment. He then devotes about two pages to the description of the time-adjusted rate of return

¹⁹Ibid., Chapter 4.

method, which the author titles the "exact method" of estimation. There is no discussion of the method commonly called the present value method in which future earnings are discounted back to the present at a rate which the company would like to earn on its project in view of the alternatives available to them.²⁰ Though some authors have claimed that this method and the rate of discount method (which is the rate that will give a present value of future earnings equal to the present value of the outlay) are really different ways of looking at the same thing, it is not so. It has been -- shown that in the case of mutually exclusive investment proposals (where the company has to choose the one that is more desirable) the present value method is more reliable than the time adjusted rate of return on investment method.²¹ Professor Kent makes the point that the expectations of businessmen relating to the prospects of success of different proposals will differ at different times mainly on the basis of optimism or pessimism on their part.

I. Ernest W. Walker and William H. Baughn

Ernest W. Walker, Professor and Chairman of the

²⁰Ibid., pp. 198-199; 1964 ed.

²¹Cf. Ezra Solomon, "The Arithmetic of Capital Budgeting Decisions," Journal of Business, 29:124-129, April, 1956.

Department of Finance, University of Texas, received his B.B.A. and M.B.A. from the University of Mississippi, did postgraduate work at Duke University and received his D.B.A. from Indiana University. Before going to the University of Texas, he taught at Drake University. William H. Baughn, Professor of Finance and Associate Dean of the College of Business Administration at the University of Texas, received his B.S., M.A. and Ph.D. degrees from the University of Virginia where he taught for several years. He also taught at Louisiana State University. Professor Walker and Baughn's book, Financial Planning and Policy was published in 1961.²²

The authors, like many others in business finance, claim that their book takes an internal viewpoint of the subject.

In the past many business finance courses have treated the subject from the standpoint of the public policy aspects of corporate finance. The external, or "outsiders" point of view has often overshadowed the fundamentals of internal financial management....This book attempts to provide an orderly framework for analyzing the major financial problems of a business firm by emphasizing the separate steps, planning, implementing, and controlling the various functions of a financial manager.²³

But while many authors have made these same claims for their books, the book written by Professors Walker and Baughn

²²Ernest W. Walker and William H. Baughn, Financial Planning and Policy (New York: Harper and Brothers, 1961).

²³Ibid., p. xiii.

has indeed thoroughly treated the problems that confront the financial manager of a business.

Part I of this book, Organization for Financial Management, contains two chapters, Scope and Objectives of Financial Planning and Organization for the Finance Function. These two chapters combined devote forty-seven pages to explaining the nature and significance of the finance function and the concept of the finance function in the firm. This is by far the longest and most detailed presentation of the subject in any book to date.

The headings of the remaining parts give a good indication of the nature of the treatment of the subject: Part II, Analysis of Procedures Necessary for Financial Management; Part III, Determination of Financial Requirements; Part IV, Policies Covering Internal Sources of Funds; Part V, Securing Necessary Funds; and Part VI, Other Aspects of Financial Management.

The authors are careful to define the terms they use. "Capital" is defined as the "total funds committed to the business, that is, total assets..." "Capital structure is synonymous with total capital, except that this term refers to the make-up of the credit side of the balance sheet, or a division of trends among trade creditors, bank creditors, bondholders, stockholders, etc." "Capital structure" is used to refer to what Professor Kent prefers to call the

financial structure of a firm. In a similar vein, Professors Walker and Baughn use the term "capitalization" to refer not only to the sum of long-term debt and capital stock but also include the short-term creditors whom they recognize as constituting suppliers of capital.²⁴ Working capital is defined as the total of current assets, and net working capital is the difference between current assets and current liabilities. However, later in the text they refer to the current assets concept of working capital as gross working capital.²⁵

The authors are careful to explain that "like many other widely used terms, income has no precise meaning even within one discipline."²⁶ Furthermore, they point out that "contrary to what may be implied from the exact dollars and cents figures on profit and loss statement, there is seldom a true income figure."²⁷

The topics of capital budgeting, cash budgets, ratio analysis of financial statements, and other such tools as used by the financial manager are discussed very extensively. The authors use footnotes liberally to refer to the contributions of other authorities in the field of finance.

²⁴Ibid., p. 97.

²⁵Ibid., p. 151.

²⁶Ibid., p. 213.

²⁷Ibid., p. 211.

J. J. Fred Weston

Author of numerous articles and monographs in the field, Professor Weston published his Managerial Finance²⁸ in 1962. This book stresses heavily the decision making aspects in the field of business. The point is made that decisions in research, engineering, production, and marketing are influenced by financial considerations and hence the emphasis in the book is on finance as it relates to the other management functions. Practical financial management has undergone a revolution that the textbook literature should recognize.

The traditional emphasis on raising funds must be placed in the broader perspective of planning and control activities. These functions must be carried out efficiently to achieve successful interaction with the firm's external environment and to make an appropriate contribution to the operation of the economy.²⁹

The book opens with a discussion of the nature of the economic, legal, and tax environment in which the firm operates. The tools of financial analysis and control then are discussed. This is followed by a section on financial planning which includes forecasting, budgets, profit planning, and planning the financial strategy. The author claims to

²⁸J. Fred Weston, Managerial Finance (New York: Holt, Rinehart and Winston, Inc., 1962).

²⁹Ibid., p. vii.

have been influenced in the writing of this book by his experience in presenting the material in executive development programs as well as in undergraduate courses. Brief summaries contain the highlights of each chapter. In addition, selected bibliographies and problems and questions are available at the end of every chapter. There are also appendices to certain chapters. For example, the appendix to Chapter XII deals with the Modigliani and Miller theory on the cost of capital and the Alchian-Kessel net monetary debtor-creditor theories. Weston does not favor the Modigliani-Miller theory of a constant cost of capital to the firm but prefers the orthodox theory of a U-shaped cost of capital curve over different degrees of financial leverage in the firm.

K. Robert Lindsay and Arnold W. Sametz

Robert Lindsay is a Senior Economist of the Federal Reserve Bank of New York, and Arnold W. Sametz is Professor of Finance, Graduate School of Business Administration, New York University.

Financial Management: An Analytical Approach³⁰ uses a unique approach to the subject of business finance and is aimed at two groups of readers: (1) students of finance in

³⁰Robert Lindsay and Arnold W. Sametz, Financial Management: An Analytical Approach (Homewood, Ill.: Richard D. Irwin, Inc., 1963).

business schools and (2) liberal arts students with an interest in finance and economics. The contents of the book have been built around the flow of funds in the business. In Part I, a chapter on the financial flow and the pool of funds is found. The balance sheet at different years, the income statement, and the statement of the sources and uses of funds are explained in this chapter. Part I also considers the theory of financial control of the firm and covers such diverse topics as the economic theory of the firm, a theory of optimum assets and their financing, and others. Part II, Uses of Funds, includes a chapter on the expected return from investment and also covers the subject of the expected rate of return, discounting for security, and discounting for uncertainty. In Part III, the comparative costs of capital, internal sources of funds, depreciation, and retained earnings are discussed. Part IV, Short Term Sources and Uses, considers the financing of working capital. Part V deals with capital structure analysis and trends in principles and practices in capital structures. Part VI, Long Term External Sources, deals with the issuance of corporate bonds, preferred stocks, common stock, the rights and interests of common stockholders, the marketing of corporate securities, investment banking, and the increased importance of financial institutions.

On the whole, this book stresses the functional, analytical approach to business finance, and it is predicted that more books in the future will follow this approach.

L. William Beranek

A novel and interesting book is William Beranek's Analysis for Financial Decisions (1963).³¹

This book, one of the Irwin Series in Quantitative Analysis for Business, is distinct as it approaches the subject with a decisively analytical viewpoint without the requirement of advanced mathematical knowledge on the part of the reader.

In the preface, the author explains the orientation of the book in these words

The need for (1) developing a host of useful analytic concepts, (2) explaining the central issues involved in each problem area, and (3) setting forth insights for reaching decisions has, of necessity, shouldered descriptions of institutions, of the laws of the various states regulating aspects of the corporate form, of the varied features which stocks, bonds, and other claims to a corporation may take, into the background.³²

While the author states that the book has been used successfully in a course in which neither an accounting background nor a basic course in finance was required, it is

³¹William Beranek, Analysis for Financial Decisions (Homewood, Ill.: Richard D. Irwin, Inc., 1963).

³²Ibid., p. viii.

suggested that most instructors at the undergraduate level "would probably be best advised to employ the text for a second course in business finance or as a supplementary text for courses in either managerial economics or business policy."³³

A rather detailed presentation of the contents of this book is deemed almost a necessity to provide a picture of what this unusual book seeks to accomplish. Following two chapters treating such subjects as the elements of financial analysis, the setting of goals, special problems in goal setting, and model testing, Chapter 3 takes up the problem of rationing of resources of single-period, single-product projects and a single model is designed. In Chapters 4 and 5 the assumptions of single-period, single-product are dropped and a more complex model is the result. Introducing the factors of risk and uncertainty in Chapter 6 makes the model more realistic and by necessity even more complex. In Chapter 7, the nature of the supply functions of resources and their significance to financial administration is discussed. In Chapter 8, advanced models of financing are developed, while Chapter 9 considers the relationship of capital structures and the element of risk. Chapter 10 considers the management of receivables and credit policy. Chapter 11 considers the problem of the determination of an "optimum" cash balance. In Chapter 12,

³³Ibid., p. x.

the reader is introduced to model simulation. In Chapter 13 the Simplex method of linear programming is developed and, finally, in Chapter 14 elements of vector and matrix algebra are explained.

Each chapter begins with a simple analysis which becomes progressively more complex. Review questions, problems, and suggested readings are included at the end of each chapter. This is indeed a novel approach, and the influence of this book on the body of financial management literature at the time of the writing of this dissertation is not known. One can, however, speculate that in the future, texts for the basic course in business finance (which the Beranek book certainly is not) will contain, in addition to the conventional material, quantitative expression as an addition to, rather than a substitute for, the former.

M. Joseph E. Bradley

Joseph E. Bradley received his B.A. degree in 1939 and his M.A. in 1940 from Pennsylvania State College; and a Ph.D. from the University of Pittsburgh in 1948. He has taught at West Liberty Teachers College, the University of Pittsburgh, and has been at Pennsylvania State University from 1950 to date, where he is now Professor of Finance.

Professor Bradley contributed two books to the field during this period, Fundamentals of Corporation Finance³⁴ in 1953 which was revised in 1959, and Administrative Financial Management³⁵ published in 1964. The first book followed, by and large, the traditional form. Administrative Financial Management, however, is quite unique both in format and content and warrants closer examination. The form of the books used in first courses in Finance in the future will most probably resemble that of Administrative Financial Management.

Professor Bradley states that

The purpose of this book is to present a new approach to the basic financial management course. An attempt is made to broaden the area of business finance and to integrate it with the over-all administration of the firm. This approach alters the traditional approach to finance which was to analyze it solely as a functional area.³⁶

The book is divided into five parts. Part I contains chapters on the scope of administrative financial management, a review of the nature and significance of financial statements and a discussion on promotion and the different forms of business organization. Part II, Managing the Capital, includes such topics as the concept of capitalization of

³⁴Joseph E. Bradley, Fundamentals of Corporation Finance (New York: Rinehart and Company, Inc., 1953).

³⁵Joseph E. Bradley, Administrative Financial Management (New York: Holt, Rinehart and Winston, Inc., 1964).

³⁶Ibid., p. vii

income; the importance of planning and the tools used in the planning process; policies governing the administration of cash, receivables and inventories; ratio analysis used to evaluate management's performance in using capital; and finally, a discussion of remedial actions to be taken in the event that management's performance in the administration of capital is found to be inadequate.

Part III, Planning for Expansion, is a very clear discussion of the topics of evaluating and ranking investment projects in order of their relative desirability, estimating the percentage cost of capital, and arriving at an optimum mixture of sources of capital. Parts IV and V discuss the process of satisfying a company's quest for capital, evaluation of sources of capital, and methods of financing.

Of particular interest is Professor Bradley's point that "all assets are part of capital but not all capital is necessarily an asset of the businessman who uses it." The significance of this statement is illustrated in the case of the firm which operates in rented space and uses leased office equipment.

In his final chapter, Professor Bradley foresees the following challenges facing the field: to improve the planning process; to sharpen the concept of the percentage

cost of capital;³⁷ to place more emphasis on an interdisciplinary approach to finance (to draw into the administrative process the areas of economics, statistics, sociology and organization theory); to integrate more fully the finance function with other areas of business such as marketing and production; and to use computers to improve the administrative process.

III. Articles

The periodical literature in Business Finance is particularly rich in this period, 1950-1959. Articles on developments in techniques and improvements of the tools of financial administration, articles reporting results of empirical research aimed at verifying theoretical principles, and finally, articles dealing with the investment decision in the firm appear in number.

A. Articles on the investment decision

A significant development in the periodical literature of the fifties is the emphasis on the topic of investment decision by a number of able writers. The appearance of

³⁷"A more refined concept of cost of capital will improve the decision-making process in seeking the optimum combination of assets, in seeking the optimum size of the firm and in seeking the optimum source of capital mixture." ibid., p. 591.

Joel Dean's Capital Budgeting³⁸ in 1951 focused the interest of financial writers on this subject. In this book, Dean puts forth the discounted cash-flow method as a tool in measuring the worth of a new investment.³⁹

In a key article in the Journal of Finance of May, 1953,⁴⁰ Joel Dean suggests three areas of capital management: (1) measuring the worth of individual investment proposals; (2) setting up standards for screening proposals; and (3) projecting the firm's demand for and supply of capital funds. He evaluates postponability, payback, and rate of return, the three basic methods of measuring the worth of investments.

In a later article⁴¹ Joel Dean offers what he considers the ten components of a complete management program for capital expenditures, discusses "ten common fallacies" in making investment decisions, and gives the advantages and disadvantages of using the "accounting method" over the

³⁸Joel Dean, Capital Budgeting (New York: Columbia University Press, 1951).

³⁹For earlier contributions by economists on this topic, see pages 95 and 96, Chapter V of this dissertation for the work of Irving Fisher and John Maynard Keynes.

⁴⁰Joel Dean, "Better Management of Capital Expenditures Through Research," Journal of Finance, 8: 119-128, May, 1953.

⁴¹Joel Dean, "Measuring the Productivity of Capital," Harvard Business Review, 32:120-130, January-February, 1954.

"discounted cash-flow method" in calculating the rate of return on investment. In an article appearing in the Controller in 1958 Dean deals similarly with the problem of profitability of different investment proposals.⁴²

Myron J. Gordon in 1955⁴³ also compared and contrasted different methods of calculating investment attractiveness. He explains that when a proposal's life is greater than the pay-off period, the reciprocal of the pay-off period provides the best short-cut estimate of its rate of profit; and when the life is less, the average investment formula is best. The present value formula, however, gives the "true" rate of return. Although the MAPI formula does provide an index of the profitability of an investment, Gordon is of the opinion that this formula has serious limitations.

In 1956 Ezra Solomon⁴⁴ suggested that after one has established, through engineer's valuation and market forecasting, the outlays required and future cash earnings promised, and one has also estimated through financial analysis the availability and cost of capital, then logic and

⁴²Joel Dean, "Profitability Indexes for Capital: Rationing Funds for Largest Return," The Controller, 26:64-67, February, 1958.

⁴³Myron J. Gordon, "The Payoff Period and the Rate of Profit," Journal of Business, 28:253-260, October, 1955.

⁴⁴Ezra Solomon, "The Arithmetic of Capital Budgeting Decisions," Journal of Business, 29:124-129, April, 1956.

arithmetic is all that is needed to select amongst investment alternatives. However, he made a very important point -- the present value of future earnings method and the rate of return method may give conflicting answers. The methods will always give identical results in "accept or reject" situations.

Of great interest is Armen Alchian's article "The Rate of Interest, Fisher's Rate of Return Over Costs and Keynes' Internal Rate of Return,"⁴⁵ (1955). Alchian points out the difference between Keynes' "marginal efficiency of capital" and Fisher's "rate of return over cost." He explained Keynes' concept as that rate of discount which equates the present worth of the receipt stream to the present worth of the expenses stream. Fisher's concept was developed in order to rank investment alternatives by the criterion of maximum present value. However, if (1) the net receipt stream generated by the non-constant, non-perpetual investment option can immediately upon its generation be reinvested with the same Keynesian internal rate of return, and (2) this reinvestment can be continued, then the ranking made using Keynes' method and Fisher's method will agree.

⁴⁵Armen Alchian, "The Rate of Interest, Fisher's Rate of Return Over Costs and Keynes' Internal Rate of Return," American Economic Review, 45:936-942, December, 1955.

A noteworthy article giving answers to the following questions was written by Lorie and Savage in 1955.⁴⁶ The questions were: (1) Given the cost of capital, what group of investments should be selected? (2) Given a fixed sum for capital investment, what group of investment proposals should be undertaken? (3) How do you select the best among mutually exclusive alternatives? In summary, it was proposed in answer to question (1) that "proposals should be selected that have positive present values when discounted at the firm's cost of capital;"⁴⁷ (2) select those that collectively will maximize net present value to the firm; (3) the best alternative is the one with the greatest present value at the firm's cost of capital.

Very informative is Professor Solomon's 1955 article, "Measuring a Company's Cost of Capital."⁴⁸ In this article Solomon discusses four different concepts of the cost of common stock to the corporation. He prefers the concept "earnings if new investment is not undertaken" divided by the "current market price" as theoretically the more correct. In addition, he explains why retained earnings and common stock have the same cost. In the case of financing by both debt and equity,

⁴⁶J. H. Lorie and L. J. Savage, "Three Problems in Rationing Capital," Journal of Business, 28:229-239, October, 1955.

⁴⁷Ibid., pp. 230-231.

⁴⁸Ezra Solomon, "Measuring a Company's Cost of Capital," Journal of Business, 28:240-252, October, 1955.

Solomon prefers the average weighted cost concept as promulgated by Joel Dean in Managerial Economics.⁴⁹

Joel Dean and Winfield Smith in an article in 1955⁵⁰ attacked George Terborgh's MAPI formula as having no place in a "comprehensive system of capital controls" because it is not universally applicable. Furthermore, the formula does not provide a means of ranking proposals as contrasted to the "discounted-cash-flow" method. This elicited a reply from George Terborgh,⁵¹ who stated that "universality" was never claimed for the MAPI formula. However, the formula provides "next year gain for replacement" which is stated in each case as a percentage of the new investment, and which enables the ranking of investment proposals.

Gordon Shillinglaw pointed out in 1955⁵² that the value of an investment at its completion (residual value) should be assigned its rightful place in investment analysis. These values originate from many sources and may even be negative. While in some cases residual values have such a

⁴⁹Joel Dean, Managerial Economics (Englewood Cliffs, N.J.: Prentice Hall Inc., 1951), Chapter 10.

⁵⁰Joel Dean and Winfield Smith, "Has MAPI a Place in a Comprehensive System of Capital Controls," Journal of Business, 28:261-274, October, 1955.

⁵¹George Terborgh, "Some Comments on the Dean-Smith Article on the MAPI Formula," Journal of Business, 29:138-140, April, 1956.

⁵²Gordon Shillinglaw, "Residual Values in Investment Analysis," Journal of Business, 30:17-29, October, 1955.

small effect that they may safely be ignored, in others, as in the case of land which is not depreciated, it is imperative that residual values are counted in. He provides an illustration which shows the effect of usual residual values in calculating the return on investment.

In a later article Shillinglaw⁵³ turned his attention to abandonment decision problems. He argues that to abandon an activity as no longer sufficiently profitable to justify expenditure of time, energy, and funds, is important enough in most companies to require top management action; and yet methods to generate the information on which the decision is to be based, are not fully adapted to this task. He shows the advantages of using the discounted cash return method in such situations.

Of practical significance to executives is John McLean's article in 1958 in the Harvard Business Review.⁵⁴ He explains the superiority of the rate on investment method over the year's-to-pay-out method and analyzes the reasons why, out of the various possible methods for calculating return on investment, the discounted-cash-flow procedure is

⁵³Gordon Shillinglaw, "Profit Analysis for Abandonment Decisions," Journal of Business, 30:17-29, January, 1957.

⁵⁴John G. McLean, "How to Evaluate New Capital Investments," Harvard Business Review, 36:59-69, December, 1958.

likely to yield the best results. He outlines clearly the techniques and assumptions needed to make practical use of the discounted-cash-flow method. His article abounds with helpful charts and examples.

An article by Frank E. Norton and one by Horace G. Hill, Jr. in 1955 dealt with questions of administrative organization for capital budgeting and practical aspects of capital budgeting management. Norton's article⁵⁵ deals with the widely scattered literature that is available pertaining to administrative organization and procedures in connection with capital budgeting. Hill's article⁵⁶ describes the life history of an investment proposal: the stages through which an investment proposal passes, such as conception, formalization, coordination, evaluation, capital budget request and approval, project justification, and others.

A notable article in the area of capital budgeting was published in 1958 in the American Economic Review by Franco Modigliani and Merton H. Miller.⁵⁷ This article stirred up a great controversy in finance circles and is

⁵⁵Frank E. Norton, "Administrative Organization in Capital Budgeting," Journal of Business, 28:291-295, October, 1955.

⁵⁶Horace G. Hill, "Capital Expenditure Management," Journal of Business, 28:285-290, October, 1955.

⁵⁷Franco Modigliani and Merton H. Miller, "Cost of Capital, Corporation Finance and the Theory of Investment," American Economic Review, 58:261-297, June, 1958.

still widely debated. It is an attempt to build a theoretical model of stock valuation. Three propositions are examined. Proposition one: the market value of any firm is independent of its capital structure and is capitalized at a capitalization rate of a pure equity stream. Proposition two: the expected yield of a share of stock is equal to the appropriate capitalization rate for a pure equity stream, plus a premium related to financial risk equal to the debt-to-equity ratio times the spread between the rate for a pure equity stream and the interest rate. Proposition three: the cut-off point for investment in the firm will in all cases be the rate used in the equity stream and will be completely unaffected by the type of security used to finance the investment. The Modigliani and Miller thesis that the amount of leverage existing in a capital structure does not influence the market value of the firm breaks with orthodox valuation theory. That is why it has created a controversy. A number of supporting or dissenting articles have since appeared in the literature.

Diran Bodenhorn's 1959 article⁵⁸ examined the four earning streams that had been used by other writers to determine which is appropriate to the capital budgeting

⁵⁸Diran Bodenhorn, "On the Problem of Capital Budgeting," Journal of Finance, 14:473-492, December, 1959.

problem. The first approach is the net cash flow, which is the difference between the expected cash earnings for the year if the project is accepted and the expected cash earnings if the project is rejected. Dean, Lorie and Savage have used this approach in their articles. The other three approaches fall under the general heading of "wealth maximization," that is, maximizing the price of the stock. The second approach, the net income approach, assumes that the price of stock depends primarily on net income, and is used by Ezra Solomon and David Durand. Modigliani and Miller use the net operating income approach, which is income after tax plus interest payments.

Gordon and Shapiro,⁵⁹ in contrast to previously mentioned approaches, developed a theory of stock prices based, not on income, but on dividend payments.

B. Theory and teaching of business finance

A significant development in the periodical literature of finance in this period is the renewed examination of the problem of the adequacy and efficiency of teaching business finance in the nation's colleges and universities. Discussions early in the period were exploratory in nature; the

⁵⁹Gordon, Myron J. and Eli Shapiro, "Capital Equipment Analysis: The Required Rate of Profit," Management Science, 3:102-110, October, 1956.

discussion became more refined by the end of the decade. This is a decade which saw business education in colleges and universities come under the scrutiny of two learned studies, the Pierson and the Gordon-Howell reports.⁶⁰

An anthology of contributions on "materials and methods of teaching business finance" was published in the September, 1950 issue of the Journal of Finance. These were originally delivered in a session of the American Finance Association Annual meetings in New York in December of 1949, and include addresses by Professors Donald M. Halley of Tulane University, Francis J. Calkins of Marquette University, Pearson Hunt of Harvard University, Chelcie C. Bosland of Brown University, and Miller Upton.

In addressing himself to the problem of the content and methods of teaching the first or basic business finance course in a university, Professor Halley⁶¹ mentioned that at Tulane the practice was to first teach a course in personal finance followed by a course in business finance. This procedure shows the similarities of the principles used in personal finance with those in business finance. He argues that specific objectives and the content of courses in

⁶⁰See Chapter I, page 5 of this dissertation.

⁶¹Donald M. Halley, "Materials and Methods of Teaching Business Finance," Journal of Finance, 5:270-274, September, 1950.

business or corporation finance are necessarily shaped by the different circumstances at various institutions. However, the objective of a beginning course should be a knowledge of the following: sources of financial information and their use; financial terminology; capital structures; financial instruments and institutions; the development of the student's ability to analyze financial problems; and, finally, for the student to recognize the business and social significance of the methods used in meeting financial problems.

Dr. Halley, when referring to the "internal administration versus traditional material" problem, notes that "internal administration" may be conceived of either narrowly or broadly. A narrow interpretation of "internal administration" would be concerned with the day-to-day financial problems. Budgets, credits and collections, raising currently needed funds, relationships with banks, paying dividends and refunding of bond issues would be examples of such activities. A broader interpretation of "internal administration" would include, in addition to the above, the management of the business through financial controls. In this broad meaning, "internal administration" includes most, if not all, of the material covered in texts of the "traditional approach," but has a different viewpoint than that of the manager of the business.⁶²

⁶²This is of interest in light of the claim made earlier in this dissertation (Chapter II, p. 19) that a confusion seems to exist among authors on the exact meaning of financial management (financial administration).

Professor Calkins analyzed the problems of teaching a first course in business finance. "It is my impression that in many of our current courses and textbooks, we have become too complex, too encyclopedic, too demanding of memory at the expense of intellect."⁶³ His approach in this first course of business finance would be to teach what could be considered the cycle of creation, development, and dissolution of a small business firm. A fundamental reason for the complexity of most books in business finance is their emphasis on the complicated financing of big corporations or specialized institutions, such as railroads. That is why one should stress the simple problems of the small corporation first, so that the basic principles become more apparent to the student and are not hidden under a mass of complicated arrangements and information.

Professor Pearson Hunt⁶⁴ contended that a basic undergraduate course in business finance could be tailored to suit two different objectives. The course could be part of a "general education" curriculum, or, on the other hand, be part of an "administrative program." A course in business

⁶³Francis J. Calkins, "Materials and Methods of Teaching Business Finance II," Journal of Finance, 5:275-279, September, 1950.

⁶⁴Pearson Hunt, "Materials and Methods of Teaching Business Finance," Journal of Finance, 5:280-284, September, 1950.

finance in a general education program should inform the students of (1) the institutions and practices of the economy; (2) the policies, and the effect of such policies, of public agencies such as the Securities and Exchange Commission; (3) attempt to justify the social philosophy of the "rightness" of present institutions and practices. The course should show that the aggregates of economic significance are equivalent to the sums of individual decisions.

A business finance course which is part of an "administrative program" would include information on financial institutions, and their practices and influence. The course should cover also the use by the financial manager of techniques of accounting, financial analysis, statistics and economic theory. In addition, it would show the students the interaction of theory and institutional fact and should make the student aware that there are issues of social consequence present in many financial programs.

Professor Upton⁶⁵ attempted a synthesis of the preceding papers, and though he admitted that general agreement is virtually impossible in this field, he nonetheless was encouraged to find that the previous discussion developed three areas of more or less general agreement.

⁶⁵Miller Upton, "Materials and Methods of Teaching Business Finance: a Synthesis," Journal of Finance, 5:289-292, September, 1950.

These are (1) the need for reconciling the administrative and social approaches; (2) the desirability of increasing the attention given to the internal operation of a business, particularly the problems of current financing; and, finally, (3) the need for increasing the extent to which cases and problems are used in supplementing the text used in a basic course of business finance.

The National Industrial Conference Board study on The Duties of Financial Executives⁶⁶ (1952) presented a survey of the financial practices of major American companies. The report stressed that the results obtained related to the actual practices of the time; not those of the past; not those of the future, not what the duties of financial executives should be. The report found that

In general, most companies' concepts of the treasurer's job involve financial planning, cash management, banking relations, handling credit and collections and the custody of company assets. The controllership function encompasses accounting, control, auditing, tax management and financial interpretation. And where there is a vice-president of finance or a finance committee, they are usually responsible for financial planning, the establishment of financial policy, the assignments of functions to the financial staff and overall control.⁶⁷

⁶⁶The Duties of Financial Executives, Studies in Business Policy No. 56, National Industrial Conference Board Inc., 1952.

⁶⁷Ibid., p. 5.

An important article throwing light on the practical duties of the finance man in business and at the same time challenging the adequacy of the teaching of business finance in colleges appeared in the September, 1954 issue of the Journal of Finance.⁶⁸ Its author, Professor Fred Weston, reported the results of a survey made to ascertain the place and importance of the finance function in a number of non-financial firms. In regard to the adequacy of the teaching of business finance in colleges, Weston made the following comments: The heavy emphasis on the "outsider" point of view in the literature since the early thirties is due to the growth in stock ownership in that early period. That is why the "insider" viewpoints of the books by McKinsey and Meech⁶⁹ and Jamison⁷⁰ in the twenties never enjoyed multiple editions nor was their lead followed by writers in the next twenty years or so. He considered that few of the writers of books in business finance in the past possessed intimate

⁶⁸J. Fred Weston, "The Finance Function," Journal of Finance, 9:265-282, September, 1954.

⁶⁹James O. McKinsey and Stuart P. Meech, Controlling the Finance of a Business (New York: The Ronald Press Co., 1923).

⁷⁰Charles L. Jamison, Finance (New York: The Ronald Press Co., 1927).

knowledge of internal financial details, that their data were mainly derived from external observation and from the study of unclassified details made public in newspapers and other such media of mass communication. Weston expressed the hope that Hunt's challenge, in the early forties, to the so-called "traditional" approach and his appeal for an emphasis in day to day finance activities would not lead to a vocational character in the teaching of business finance in colleges and universities.

Three important articles appeared in the May, 1955 issue of the Journal of Finance. These papers were presented at a meeting of the American Finance Association on December 30, 1954, in Detroit. The respective writers, Professors Dauten, Weston and Sagan, expressed their thoughts on fundamental issues of finance theory.

Professor Dauten⁷¹ discussed some of the problems in developing "a theory of business finance." He proposes that the basic ingredients of a theory in business finance be the economics of both the individual firm and of the economy. All factors are to be balanced in the light of forecasts to achieve optimum balance between the objectives of both the firm and the economy.

⁷¹Carl A. Dauten, "The Necessary Ingredients of a Theory of Business Finance," Journal of Finance, 10:107-120, May, 1955.

Dauten discussed Weston's and the National Industrial Conference Board's study⁷² and differentiates between finance at the top management level and at the operating level. In the past, what was advanced as "theory" was usually nothing more than generalizations based on empirical studies, and that is why anyone now reading such works as McKinsey and Meech's book of 1923 would smile at the author's oversimplified view of the business cycle.

Weston explains that multiple solutions to business finance problems exist because the values of factual variables for the future cannot be known with a certainty: "Because they differ in their judgments of the future values of variables and in their reactions to uncertainty, decision-makers take a different course of action when confronted with 'similar situations'." He also claims that "despite the wide disavowal of the existence of generalization in business finance, textbooks contain descriptions of techniques, explanations, and lists of advantages and disadvantages which rest upon a substantial framework of theoretical materials."⁷³

The test for a proposition or theory is its ability to yield predictions. He gives examples of propositions in business finance that do enable prediction. For instance the

⁷²See Chapter VII, page 183 of this dissertation.

⁷³J. Fred Weston, "Toward Theories of Financial Policy," Journal of Finance, 10:130-143, May, 1955.

propositions, (1) "trading on the equity magnifies gains and losses," and (2) "during inflation, firms that are net monetary debtors gain and those that are net monetary creditors lose; during depression firms that are net monetary creditors gain and those who are net monetary debtors lose" can be both tested empirically and developed logically. Examples of propositions that should be tested for empirical validity are: (1) "The stage in the life cycle of the firm will influence its financing policies;" (2) "Profitability influences the asset structure. A more profitable firm is likely to be more liquid. Similarly, a more profitable firm has greater access to external financing."

Sagan,⁷⁴ while acknowledging the usefulness of working capital ratios to the financial manager, maintained that the latter should be possessed with additional gifts

Working capital ratios are useful tools in appraising the financial strength and immediate solvency of a company. The financial analyst must rely on these ratios. From an operational point of view, however, the money-manager's primary concern is with the current cash-flows and those flows expected in the near future. He can take little comfort in a satisfactory working capital ratio when he doesn't have funds to meet an immediately due payment....The money manager should be a combination of a credit analyst, a commodity specialist, a money market expert, a bit of a horse trader (a trade useful in dealing with security dealers) and a banker. As such he requires a

⁷⁴John Sagan, "Toward a Theory of Working Capital Management," Journal of Finance, 10:121-129, May, 1955.

proper balance of art, science and diplomacy. If he possesses these, together with an ability to read the future, his will be a successful career.

A discussion followed the presentation of these three papers and the following comments were made: Professor Paul Van Arsdell⁷⁵ stated that there is no universal understanding of the word "theory;" Dauten likens it to managerial financial policy, whereas Weston identifies it with scientific quantitation of propositions. Similarly, Professor Bion B. Howard⁷⁶ raised the point as to whether Weston's "generalizations" are in fact "theories."

In an article in 1954, Professor Weston⁷⁷ attacked the traditional finance standards based on balance sheet data for ascertaining optimum levels of debt in the corporate capital structure. While it is true that a rule of thumb "times interest earned" takes income data into consideration, it's nonetheless insignificant. What is necessary is an analysis of the standards for ascertaining expected cash flows. Standards for ascertaining movements in the levels of debt

⁷⁵Paul Van Arsdell, "Toward a Theory of Business Finance: Discussion," Journal of Finance, 10:144-151, May, 1955.

⁷⁶Bion B. Howard, "Toward a Theory of Business Finance: Discussion," Journal of Finance, 10:144-151, May, 1955.

⁷⁷J. Fred Weston, "Norms for Debt Levels," Journal of Finance, 9:124-135, May, 1954.

rather than the absolute levels are more useful to the financial manager.

F. W. Mueller, Jr.,⁷⁸ in an article on corporation liquidity, argues that working capital equals current assets, or better, it should be "revolving capital." The ease of conversion of an asset into cash is a test of its saleability and not its liquidity. He asserted that in accounting terminology "capital" means property and "working capital" as accountants define it is not property.

James E. Walters⁷⁹ also was concerned with technical solvency. He states that traditionally the availability of current assets to discharge current liabilities is taken as an indication of technical solvency. However, cash inflows and cash resources and their availability to cover cash outflows by a sufficient margin is a more important concept of solvency. He built a theoretical model based on this concept.

In a 1953 article, Ronald P. Soule⁸⁰ accounted for the

⁷⁸F. W. Mueller, Jr., "Corporate Working Capital and Liquidity," Journal of Business, 26:157-172, July, 1953.

⁷⁹James E. Walters, "Determination of Technical Solvency," Journal of Business, 30:30-43, January, 1957.

⁸⁰Ronald P. Soule, "Trends in the Cost of Capital," Harvard Business Review, 31:33-47, March-April, 1953.

changes in the relation of different forms of long term financing. He found the pretax cost of debt to an average good-grade industrial company to have gone down from 3.6 per cent in 1937 to 2.9 per cent in 1951. During the same period, the pretax cost of preferred stocks and common stocks had risen; in the case of common stock, from 8 per cent to 20 per cent.

Robbins and Foster's interesting article⁸¹ deals with the relationship of profit planning to the finance function. They note that "traditional" finance dealt with major decision making, whereas in the "new approach" because of modern techniques of analysis, the profit-planning function is stressed. The new approach focuses on differential cost rather than full production costs and uses such tools as direct costing, incremental statements, and flexible budgets. Today, in practice, however, it is the controller rather than the treasurer who is more involved with the question of profit planning.

Professor Johnson⁸² wrote in 1955 an authoritative article explaining the nature and use of subordinated debentures by American business. He documented the use of this

⁸¹Sidney Robbins and Edwin Foster, Jr., "Profit-Planning and the Finance Function," Journal of Finance, 12:451-467, December, 1957.

⁸²Robert W. Johnson, "Subordinated Debentures: Debt that Serves as Equity," Journal of Finance, 10:1-16, March, 1955.

kind of security in 1936 for the first time and explained the post-World War II popularity for subordinated debentures.

Joseph C. Bothwell⁸³ in a 1950 article gave reasons for the increasing use of periodic stock dividends in the post-war years. These were rising price levels, an unprecedented need for working capital, depressed equity markets, and the demand of stockholders for dividends.

E. Raymond Corey's article⁸⁴ on the development of direct placement of securities is an exhaustive study of that subject. The principal appeal for this method of underwriting, according to Corey, does not lie with the Securities and Exchange Commission's requirements applicable to a public issue, but rather, it is the desire of the security issuer to have a firm commitment, not to have to worry about the vicissitudes of the market. On the same subject, George T. Conklin,⁸⁵ considers that the greatest contribution of direct placement of securities is that it opened a needed avenue to long term financing for small but well established firms.

⁸³Joseph C. Bothwell, Jr., "Periodic Stock Dividends," Harvard Business Review, 28:No. 1:89-100, January, 1950.

⁸⁴E. Raymond Corey, "Corporate Financing by Direct Placement," Harvard Business Review, 28:No. 6:67-76, November, 1950.

⁸⁵George T. Conklin, "Direct Placements," Journal of Finance, 6:85-118, June, 1951.

Of special interest is Henderson and Schlaifer's article which appeared in 1954.⁸⁶ It is divided into three parts; part one is addressed to top executives and explains to them the advantages of using mathematical programming in their business; the second part is addressed to specialists and provides them with some examples of mathematical programming; the third part shows how to use mathematical programming as a planning tool. An appendix provides instructions for using the most common quick procedures for solving different classes of business problems.

Theodore H. Silbert's article on "Financing and Factoring of Accounts Receivable"⁸⁷ provides a detailed list of benefits for the user of these methods of financing. Benefits described include the following: (1) providing liquid working capital in place of frozen assets of receivables; (2) earning cash discount on accounts payable and maintaining a high credit rating; (3) enabling the client to make special cash purchases of scarce materials or bargain offers; (4) enabling the client to expand operations and earn extra

⁸⁶ Alexander Henderson and Robert Schlaifer, "Mathematical Programming: Better Information for Better Decision-Making," Harvard Business Review, 32:No. 3:73-100, May-June, 1954.

⁸⁷ Theodore H. Silbert, "Financing and Factoring Accounts Receivable," Harvard Business Review, 30:No. 1:39-54, January-February, 1952.

in excess of financing costs; (5) reducing credit risks through the use of the finance company's highly developed credit information facilities; (6) offering flexibility of operations, adapted to the special requirements of the individual concern; (7) eliminating or reducing the need to attract outside capital, which could dilute the owner's equity, profits and control; and finally, (8) in the case of factoring, eliminating all bookkeeping activities.

C. Accounting procedures and financial management

Similar to the trend in the forties, there appeared once more a substantial number of articles questioning the adequacy of orthodox accounting methods in providing information used for making sound financial management decisions.

Paul Van Lierd⁸⁸ in 1954 goes so far as to suggest a new accounting system that would take into consideration changes in general price levels. A corporation has two kinds of liabilities, "money liabilities" provided by creditors and "value liabilities" provided by the shareholders. Similarly, the assets of a corporation may be classified as "money assets" or "value assets." He asks for the adoption of an accounting system based on what he calls a "historical approach." By this, he means, a system that would use an

⁸⁸Paul Van Lierde, "Price-Level Changes and Capital Consumption Allowances," Journal of Business, 32:370-382, October, 1959.

index of prices to adjust the value of assets up or down whatever the case might be. In this way, at times of general upward price movements the value of the firm's assets would be increased. Depreciation charges would also be increased. This would decrease net profits and provide a larger, and more realistic cash flow during times of inflation.

Professor Moonitz⁸⁹ believes that conventional accounting practice gives a distorted picture of capital and profits even at times when general price movements go neither up nor down. In his words, "the inability of modern accounting procedures to provide a satisfactory measure of either business capital or business income is notorious." He argues in the following manner: (1) Costs assigned to investment and fixed assets are likely to be understated because a restricted definition of cost is employed. Thus profits will be understated when investments are made and net profits will be exaggerated when understated assets are converted into receipts. (2) Certain costs are classed as expenses (advertising, brand names, research and development are not usually capitalized) therefore assets of the firm are understated. (3) Understating of recorded capital also exists from failure to include future receipts (as for example in the

⁸⁹ Maurice Moonitz, "The Valuation of Business Capital: An Accounting Analysis," American Economic Review, 41:157-165, May, 1951.

case of enforceable contracts), and by carrying items at acquisition or fabrication cost until sold. This is especially distorting when the rate of turnover of assets is low. He further claims that in periods of rising prices reported profit is higher than "actual" profit. Similarly, in periods of falling prices reported profit is lower than "actual" profit and reported losses are greater than "actual" losses. Furthermore, in the case of strong or successful concerns, recorded capital is understated whereas recorded capital of unsuccessful firms is overstated.

Arguments were made in articles for the use of accelerated methods of depreciation and their recognition for income tax purposes; and section 167 of the Internal Revenue Code of 1954 provided explicit recognition of the following in addition to the straight line method: (a) the "declining balance" method at a rate up to twice the straight line rate, and (b) the "sum of the years" digits method.

In 1952 Sidney M. Robbins wrote:

The treatment of depreciation in the books of a company is one of the most hotly contested points in the field of business finance. This controversy has magnified the problems of security analysis. Inasmuch as depreciation is a charge of earnings, variations in handling this charge could affect materially the level of reported income.⁹⁰

⁹⁰ Sidney M. Robbins, "Investor Guideposts in Comparing Income Statements," Journal of Finance, 7:47-65, March, 1952.

On the same subject, George O. May wrote in 1954⁹¹
"In 1947 the adequacy of standard practice of depreciation in times of inflation was called into question partly as a result of events in other countries and partly by actions of a limited number of important companies typified by United States Steel, Chrysler and Dupont."

Robert N. Anthony⁹² in 1955 argued that the principal reason for the adoption of "new" methods of depreciation is that the faster write-off permitted by these methods would stimulate businessmen to purchase new equipment. He maintained that "what the new methods do accomplish is to shift the timings of the deduction." He then proceeds to give an example which shows the advantage of the deferment of the tax liability by using the present value concept of the deduction.

Other articles arguing the merits and disadvantages of the various methods of charging depreciation have been

⁹¹George O. May, "Concepts of Business Income and Their Implementation," Quarterly Journal of Economics, 68:1-18, February, 1954.

⁹²Robert N. Anthony, "Re: Depreciation in Investment Decisions," Harvard Business Review, 33:No. 1:75-76, January-February, 1955.

written by Robert Eisner,⁹³ Evsey D. Domar,⁹⁴ and Erich Schiff.⁹⁵

D. Stock splits, and dividends

Austin C. Barker's three articles⁹⁶ address themselves to the subject of stock splits and dividends. Essentially Barker's empirical investigations show that, contrary to the commonly held opinion, stock splits and stock dividends do not automatically bring about a lasting increase in market price. The presence or absence of an increase in the cash dividend rate is the crucial factor.

On the question of corporate growth, Professor Dobrovolsky⁹⁷ notes that a firm is better off to retain earnings for expansion rather than to pay them out and then

⁹³Robert Eisner, "Accelerated Amortization, Growth, and Net Profits," Quarterly Journal of Economics, 66:533-544, November, 1952; "Depreciation Allowances, Replacement Requirements and Growth," American Economic Review, 42:820-831, December, 1952.

⁹⁴Evsey D. Domar, "Depreciation, Replacement, and Growth," Economic Journal, 63:1-32, March, 1953; "The Case for Accelerated Depreciation," Quarterly Journal of Economics, 67:493-519, November, 1953.

⁹⁵Erich Schiff, "A Note on Depreciation, Replacement and Growth," Review of Economics and Statistics, 36:47-56, February, 1954.

⁹⁶Austin C. Barker, "Effective Stock Splits," Harvard Business Review, 34:No. 1:101-106, January-February, 1956; "Stock Splits in a Bull Market," Harvard Business Review, 35:No. 3:72-79, May-June, 1957; "Evaluation of Stock Dividends," Harvard Business Review, 36:No. 4:99-114, July-August, 1958.

⁹⁷S. P. Dobrovolsky, "Economics of Corporate Internal and External Financing," Journal of Finance, 13:35-47, March, 1958.

ask them back from the stockholders by issuing a new stock because of leakage in the flow of the personal tax payment of the stockholder. Professor Weston⁹⁸ states that if growth is of a permanent nature then the new working capital needed should be financed by permanent sources of capital.

Professors John Lintner⁹⁹ and Paul Darling¹⁰⁰ were concerned also with the question of dividend policy. Both writers conducted investigations in an effort to ascertain the role various factors play in the formulation of dividend policies. Darling, for example, advanced the hypothesis for which he claims to have found empirical support, that, for the universe of large industrial corporations, aggregate dividends will tend to vary directly with current profits; with past profits; with the rate of amortization recoveries; with shifts in anticipations of future earnings; and, will tend to vary inversely with persistent changes in the level of sales.

⁹⁸J. Fred Weston, "Financial Implications of Growth," Controller, 26:118, March, 1958.

⁹⁹John Lintner, "Distribution of Incomes of Corporations Among Dividends, Retained Earnings, and Taxes," American Economic Review, 46:97-113, May, 1956.

¹⁰⁰Paul Darling, "The Influence of Expectations and Liquidity on Dividend Policy," Journal of Political Economy, 65:209-224, June, 1957.

IV. Summary

In this chapter the finance literature of the years 1950-1959, as it appeared in periodical articles, is examined and analyzed. Books published in the same period and a few books appearing early in the sixties are similarly treated.

This period is one of continued post-war economic expansion, though marred by three recessions. It is a time of rapid technological changes, most important of which (with regard to influence on management practice) is the rapid development of electronic computer systems and their widespread adoption by industry.

The article literature of the fifties dealt mainly with the area of the investment decision. Developments in techniques and concepts in this and other topics of financial management were reported in numbers.

For the first time in thirty years a textbook appeared with "financial management" in its title. It was followed by other books with similar words in their titles. Even books with more traditional titles now include extended treatment of the topics of importance to financial managers. The "new approach" is prevalent in books of the early sixties and seems to be the trend of the coming years.

CHAPTER VIII

SUMMARY

The study of business was first undertaken on a thorough basis in the United States of America. The industrial nations of Western Europe, for various reasons, were slow in accepting education in business in their universities. In this country, however, university education in business was begun more than sixty years ago. To the aid of the businessman came the scholar with his objective and methodical inquiry, and better business management resulted. The involvement and contributions of the specialist scholars in business practice is expected to increase in the future.

A scant fifty years ago the writers of articles and textbooks in the field of business finance were men trained in other fields such as economics, accounting, or law. Soon, though, the students of these men came to consider themselves finance men by training. Thousands of undergraduate and graduate students study today in the nation's colleges and universities finance courses and many of them "major" in the subject. These students study the business finance literature which contains, usually, the most recent thought in the field. The older scholars in the discipline, have, in their lifetime, witnessed the developments in the subject first hand. The

younger men, desirous to know of the historical development of business finance thought, do not have a way of finding out this information unless they individually delve into the original publications, a process not only painstaking and time consuming but often impossible, as few libraries have complete collections of business finance literature. Studies on the development of the thought of the disciplines of production and marketing are available, but not so in the field of business finance.¹

All books published in this country from 1895 to 1963 that bear in their titles such words as business finance, corporation finance, financial management, administrative finance, or other such expressions have been examined and

¹John F. Mee, "A History of Twentieth Century Management Thought" (unpublished Ph.D. dissertation, Dept. of Business Organization, The Ohio State University, 1959); Robert Bartels, "Marketing Literature - Development and Appraisal" (unpublished Ph.D. dissertation, Dept. of Business Organization, The Ohio State University, 1941). Dr. Ebied's doctoral dissertation [Atef M. Ebied, "An Inquiry into the Development of Theory on Corporation Construct, the Conceptual and Propositional Framework" (unpublished Ph.D. dissertation, Dept. of Economics, University of Illinois, 1962)] was similar in part to the Mee and Bartels studies. He examined the business finance literature seeking the development of different concepts in the field of finance of the time. The present dissertation, however, examines the literature of different time periods and tries to seek the connection of the development of the literature with the social, economic, and political conditions prevailing during the different time periods.

the more representative ones have been discussed in this dissertation. Similarly treated are journal articles for the years up to 1960 only. The Bibliography of books selected according to the criteria mentioned above is relatively exhaustive. The same cannot be claimed for the Bibliography of articles. The books and articles actually reviewed in the dissertation are listed in the Appendix in chronological order. Presented in an alphabetical order in the Bibliography is the body of literature that has been examined by the writer regardless of whether or not it has been discussed in the text.

Chapter I of this dissertation discusses the justification, scope, and methodology of this study. The expressions of authorities in business education on the need for a study of this sort are presented. The older scholars in the field, who had first hand experience with the development of business finance thought, are rapidly retiring and the opportunity of younger scholars to get the account orally diminishes. This increases the need for a written "narrative" of the developments. In Chapter II, some terms of interest are explored. The very areas of business finance and financial management, whose literature is explored in this dissertation, are delimited carefully.

Chapters III through VII take up the literature from 1895 to 1960, though a few books appearing as late as 1964

are examined on the assumption that their writing was completed years before the publication date and therefore represent the thought of an earlier period. The years between 1895 and 1960 are broken down into five periods and covered in five chapters (Chapters III through VII).

Chapter III covers the years through 1919. During this time most of the writers in the field were men trained in other disciplines and were pioneers in establishing a distinct field of business finance.

Chapter IV covers "the period of conceptualization," which is the decade of the twenties and which begins with Arthur Dewing's The Financial Policy of Corporations, and ends with the stockmarket crash of 1929.

Chapter V deals with the decade of the thirties whose literature is permeated with the depressed conditions of that era. Chapter VI covers the literature of the fourth decade of the century, which is influenced initially by the war effort and later by the post-war problem of adjustments in American business.

The period after 1950, examined in Chapter VII, is a period of new directions and conceptualization in the field; a turning point in the literature away from the outsider viewpoint toward the new insider managerial viewpoint.

I. Chapter III - The Beginnings 1895-1919

Business activity has taken place for many hundreds of years. Business implies exchange and whether such exchange is made by means of bartering or specie or paper money or credit, problems of "financing" this activity always exist. The increasing attention of writers to the problem of business finance, however, parallels the growth of the modern corporation as a method of business organization. Corporations in this country dominated first in fields vested with a public interest (banks, insurance companies, and common carriers) or those involving large aggregate fixed capital (railroads and mines); later they became important in fields involving little public interest and those requiring little fixed capital. It is in the last part of the nineteenth century and early twentieth century that corporations became sufficiently important in this country, to draw significant attention to their operations and consequently their methods of financing and financial administration.

The earliest book treated in this dissertation is Edward Carroll's Principles and Practice of Finance (1895), in which the author devotes an entire chapter to the treatment of various instruments of corporation finance while noting that these are "a rather recent development of finance." In addition, the books of Thomas Greene, Frederick A. Cleveland, Harry C. Bentley, Edward S. Mead, Hastings W.

Lyon, Charles W. Gerstenberg, Hugh R. Conyngton and William H. Lough were examined in this chapter. In general, the book literature of the period 1895-1919 may be characterized in this way: (1) the qualifications and background of the authors were varied, (2) the books were intended mainly for practitioners of finance, and (3) the approach to the subject was basically descriptive and was influenced by legal and accounting viewpoints. The main contribution of the authors of this period is that they broke away from other disciplines and recognized a new field, that of business finance. The majority of the relevant articles appearing in the learned journals of that period dealt with the question of business education in colleges and universities. This is a topic that was constantly discussed throughout the period covered by this dissertation but which was of particular interest in the first twenty years of this century when the school of business movement was in its infancy.

II. Chapter IV - Conceptualization 1920-1929

The decade of the twenties is distinguished by a return to "normalcy" after the First World War. It witnesses the tremendous expansion of the school of business movement. It is the period which has been called "the decade of overconfidence."²

²Thomas C. Cochran, The American Business System (Cambridge, Mass.: Harvard University Press, 1957).

The books of Arthur S. Dewing, E. E. Lincoln, James O. McKinsey, Joseph H. Bonneville, Cecil E. Fraser, Charles L. Jamison, Lucius W. Guernsey, Avarad L. Bishop, Lawrence H. Sloan, and Louis F. Musil are examined. The major characteristics of the book literature of the second decade of the century were these: (1) writing is directed to college students, (2) business finance is more securely established as a field of study and the major authors of the period present broader and deeper treatment of the subject, and (3) the authors use mainly an external approach which reflects the interest of investors in corporations, though McKinsey and Jamison use the "insider" viewpoint in their books.

The articles of F. Rume, William E. Hotchkiss, Lawrence A. Lowell, Eliot G. Mears, Ralph E. Hiefman, and Forrest A. Kingsbury dealt with the nature of the instruction of business subjects in the nation's colleges and universities. They sought mostly to present a philosophical and pragmatical justification for the inclusion of business education at the college level. Articles by Harold B. Moulton, Charles W. Gerstenberg, and W. H. Lough dealt with the problems of collegiate instruction of finance with Lough proposing that the first course in finance should be some kind of simple "credit and collections" course which would serve to introduce the student to the more complex financial problems of the corporation.

Also reviewed were articles by George H. Evans, Samuelson W. Anderson, Albert A. Keister, Charles O. Hardy, Forrest Q. Walker, George E. Putnam, Morris A. Copeland, James C. Bonbright, Rufus C. Roum, Fairfield V. Cox, and Stanley E. Howard. Professor Evans's article traced the history of the use of preferred stock in this country. Copeland's article explained how to construct and use a cash budget, and since formal budgetary plans were not widely used at that time, Copeland made a plea for their wider adoption. S. E. Howard mentioned in his article (1923) that revenues from operations must be sufficient to pay for all legal costs of the business and also provide a rate of return to equity funds at least equal to what these funds would earn if employed elsewhere.

III. Chapter V - Depression 1930-1939

The decade of the 1930's was a critical period in the history of the American economic system. Following the stock market crash of 1929 and the collapse of the economic activity which followed, the old beliefs in the self-regulating character of the economy and the corollary of limited government action were questioned. Extensive legislation of economic, business, and social significance was enacted during this time. Many of the books published in this period contained chapters on the social importance

and responsibility of business corporations and discussed the effect of the new legislation on business practice and financial management. Similarly, many articles of this decade dealt with the topic of the separation of ownership and management of corporations and its social significance.

The books of the following authors written in this decade were analyzed in this chapter: Henry E. Hoagland, W. Mackenzie Stevens, Floyd F. Burtchett, E. F. Donaldson, Hastings W. Lyon, Arthur H. Winakor, Milo Kimball, Kenneth Field, and Calvin Crumbaker. All books followed the traditional approach to the subject with the exception of the one by W. Mackenzie Stevens which followed an internal viewpoint and which included chapters on budgetary control, financial control of production, coordination of financial administration, cash and master budgets, ratio analysis and others. Significantly, Stevens first uses a crude average weighted cost of capital in the investment decision.³ Furthermore, though not explicitly, he used as a measurement of the cost of equity funds the concept "earnings divided by market price" of the stock.⁴

Awareness of the problems of the separation of ownership and control of corporations was not confined to the

³W. Mackenzie Stevens, Financial Organization and Administration (New York: American Book Company, 1934), p. 209.

⁴Ibid., p. 207.

period of the 1930's. However, the stock market crash of 1929 and ensuing depression focussed attention on the possible evils of the separation of ownership and control. Articles addressed to this problem and reviewed in this chapter were written by Ben W. Lewis, W. L. Crum, William A. Lough, Shaw Livermore, W. H. S. Stevens, and Robert A. Gordon. Articles by Norman S. Buchanan, Robert Weidenhammer, David L. Rolbein, Vernon A. Mund, A. C. Littleton, Harry G. Guthmann, John B. Canning, Percival F. Brundage, Gabriel A. D. Preinreich, Harold Parker, L. H. Haney and G. H. Evans also were reviewed. These articles dealt with such topics as the shortcomings of accounting practice, the effects of the economic legislation on American business, and developments in methods of financing of business firms.

IV. Chapter VI - War and Readjustment 1940-1945

The decade of the 1940's included both a major war and a period of adjustment in the economy after the war. These two events greatly influenced the writers of articles in business finance of the time. Authors of books in this period also were under the influence of the events of the preceding decade. The inability of the private system to lift itself out of the depression of the early 1930's led to a widespread inquiry as to its effectiveness. Drs. Husband and Dockeray, in their book, adopted an emphasis on

the social aspects of corporation finance and justified it by claiming that "this is a day of social awakening when business policies must be considered in the light of their effect upon the public-at-large."⁵ Almost all of the other books in the field, published during this time, contained chapters on the social aspects of business finance.

The books of this decade reviewed in this chapter were written by the following: Norman S. Buchanan, H. G. Guthmann and H. E. Dougall, W. Bayard Taylor, W. H. Husband and James C. Dockeray, Carl A. Dauten, Hiram L. Jome, Pearson Hunt and Charles M. Williams, Neil Jacoby and Raymond J. Saulnier, Charles L. Merwin and Walter C. Chudson.

For the first time the suggestion is made in a book in the field that when management is faced with two investment proposals yielding two different streams of earnings, it should choose the investment that yields the larger present worth of future earnings discounted at the same rate of "interest."⁶

Early articles of the decade dealt with the financial problems facing American business in the war and the

⁵William H. Husband and James C. Dockeray, Modern Corporation Finance (Chicago: Richard D. Irwin, 1942), p. 7.

⁶Norman S. Buchanan, The Economics of Corporate Enterprise (New York: Henry Holt and Co., Inc., 1940).

problems expected to arise out of the post-war conversion to a peace economy. Some of the writers were: Frederick C. Dirks, C. C. Abbott, Marshal D. Ketchum, Dan T. Smith, and Myles Mace.

Dealing with the post-war problems of inflation and the alleged inadequacy of standard accounting practice to deal with changes in the price level were articles by Dan T. Smith, L. K. Brandt, George D. Bailey, Harvey M. Spear, Stanley L. Miller, and Thomas H. Sanders.

Articles on the historical development and current use of some instruments and tools in business financing were written by Joel Dean, Lawrence H. Wilsey, H. G. Guthmann, Herbert R. Silverman, and William L. Cary. In 1943, Professor Pearson Hunt in a review of the fourth edition of Arthur S. Dewing's The Financial Policy of Corporations took the occasion to challenge the nature of the book literature in business finance of the day. He called the approach then prevalent in the texts, the "traditional approach." Though he appreciated the reasons for which early books had an "outsider" orientation, he claimed that the need was now for books written with an "insider" viewpoint, employing tools and principles developed by economists.⁷

⁷Pearson Hunt, "The Financial Policy of Corporations," Quarterly Journal of Economics, 57:303-313, February, 1943.

V. Chapter VII - New
Direction 1950-1960

This chapter treats the article literature for the decade of the 1950's and the books published in the period 1950 to 1964. The decision to include books published in the early 1960's was made on the argument that these books belong in the thought of the decade of the fifties but some time was needed to prepare them for publication.

The time after 1950 was mainly one of developments in business and technology under predominantly peaceful conditions. This was a period of rapid technological advancements, the more important of which, as regards business practice and theory, was the development of high speed electronic computers. The shift to the internal managerial emphasis in the literature may be due to a great degree to such factors as rigid government legislation, rigorous competitiveness, and in national and international markets, high cost of labor, all of which put a premium on a high degree of rationalization in the management process. The distinguishing characteristic of the textbooks published in this period was their emphasis on the managerial, "insider" viewpoint. These books were written mainly from the point of view of the chief financial officer and his responsibility as a decision maker. While a few books early in the period persisted in giving abstract recitals of practices and habits

in the field of finance, the majority of them adopted a managerial, "insider," approach to the subject matter. Books by the following authors were discussed in this chapter:

Bion B. Howard and Miller Upton, Charles L. Prather, W. Bayard Taylor and Frank M. Graner, E. F. Donaldson and John K. Pfahl, Pearson Hunt, Charles M. Williams and Gordon Donaldson, Robert W. Johnson, Richard C. Osborn, Raymond P. Kent, Ernest W. Walker and William H. Baughn, J. Fred Weston, Robert Lindsay and Arnold W. Sametz, William Beranek, and Joseph E. Bradley.

The Howard and Upton book in 1953 is considered the first book in twenty years to have a managerial orientation. R. W. Johnson's book in 1959 was the first modern book with "financial management" explicitly stated in its title. The major developments in the textbook literature in the field were in the treatment of the investment decision in the firm to a level of sophistication heretofore unknown.

Articles appearing in the years 1950 through 1959 and the topics that are covered therein are varied. Some articles discussed developments in techniques and improvements of the tools of financial administration, some reported results of empirical research aimed at verifying theoretical principles, and some dealt with the topic of the investment decision in the firm.

Articles on the investment decision were written by Joel Dean, Myron J. Gordon, Ezra Solomon, George Terborgh, Gordon Shillinglaw, John McLean, Frank E. Norton, Horace G. Hill, Franco Modigliani and Merton H. Miller, Diran Bodenhorn and David Durand.

Articles on the problem of the adequacy and efficiency of collegiate instruction in business finance were written by Donald M. Halley, Francis J. Calkins, Pearson Hunt, and Miller Upton. Study in Business Policy No. 56 of the National Industrial Conference Board (1952) and a 1954 article by J. Fred Weston examined the place of the finance function in business and the duties of the financial officers. Articles on the development of "theory" of business finance were written by Carl A. Dauten, J. Fred Weston, John Sagan, Paul Van Arsdell, and Bion B. Howard, all in 1955. Articles on the theory of corporate liquidity were written by J. Fred Weston (1954), F. W. Mueller (1953), and James E. Walters (1957).

Other articles appearing during this period and reviewed in this chapter were written by Ronald P. Soule, Sidney M. Robbins, Edwin Foster, Robert W. Johnson, Joseph C. Bothwell, E. Raymond Corey, George T. Conklin, Alexander Henderson and Robert Schlaifer, Theodore H. Silbert, Paul Van Lierde, Maurice Moonitz, George O. May, Robert N. Anthony,

Austin C. Baker, S. P. Dobrovolsky, J. Fred Weston, John Lintner, and Paul Darling.

VI. Conclusion

The present is a time of fundamental changes in the character of American business. The rate of growth in the size of firms, the separation of ownership and management, and the scientific and technological change have intensified the need for college educated personnel in the "management sciences."

Students of business, however, will derive from a study of the literature of past years an appreciation of the historical development of present theory and practice. Ideas are not born full grown, but are gradually and painstakingly developed over a period of time. A study of the past may prevent one from repeating the mistakes of others. It is no wonder that business history is currently in the favor of scholars.⁸

It is hoped that this dissertation will aid the student of business in gaining an appreciation of the

⁸"History of business, as is now widely held, not only embraces company history and entrepreneurial biography but also many other topics such as the history of business instruments, of business education, of business literature, of business thinking including business ethics and of business behavior." Fritz Redlich, "Approaches to Business History," Business History Review, pp. 61-70, Spring, 1962.

historical development of business finance literature in this country. It is intended to show how the literature is greatly influenced by the environmental conditions of the different eras and how the seeds of important concepts and theories are often to be found sown by someone in the past.

APPENDIX

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AUTOBIOGRAPHY

I, Constantine Danellis, was born in Athens, Greece in 1936. My early schooling was in Greek, and later in English, schools. In 1954, I entered the Polytechnic, Regent Street, London where in 1956 I was awarded a diploma in Business Administration. I spent the next year at the Polytechnic, studying as an external student for the B.Sc. (Economics) degree of the University of London.

From February, 1958 to February, 1959, I studied in the Department of Political Economy, Johns Hopkins University, Baltimore, Maryland. I attended the School of Commerce, The Ohio State University, from March to December, 1959, and was awarded the Bachelor of Science in Business Administration degree. From September, 1960 to December, 1963, I pursued graduate studies full time at The Ohio State University. In December, 1962 I was awarded the Master of Business Administration degree. The topic of my Master's thesis was "An Approach to Determining Optimum Opening Hours for the Savings and Checking Activities of a Commercial Bank and a Case Application of the Approach."

I taught at The Ohio State University from September, 1961 to August, 1964 with the successive ranks of Assistant, Assistant Instructor, and Instructor. From September, 1964 to the present I have held the position of Assistant Professor of Finance in the Division of Business Administration, Sacramento State College, Sacramento, California.