

**The Equity Market and Industry Development: New
Companies on the SSX, 1920-50.**

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Introduction

In Australia, as in most other western economies, the development of arm's length equity markets was a necessary complement to the emergence of large managerial firms. Indeed, it assumed even greater importance in Australia than in most other countries because of the delay in the development of the corporate debt market. There is general agreement that 1920s was the period when a broad-based public market in investment grade equities developed in Australia. It continued to provide the primary source of new external finance for industry until the 1950s when a debt market developed alongside new financial institutions and instruments in the 1950s and 1960s. We focus on the development of the NSW equity market over the period from 1919 to 1949 when it provided the dominant source of new corporate finance¹ We draw on data on new companies listed on the Sydney Stock Exchange (SSX) to explore the nature of the NSW equity market, and its impact on economic development.

Corporate finance

In principle, companies have a range of sources of finance, with retained earnings being the most attractive but most companies also need external sources of finance to fund larger projects. New ventures in industries with high initial capital requirements also normally need additional external finance to supplement the founder or promoters capital. Until the early twentieth century, only banking, insurance, stock and station agencies and a handful of other, mostly rural-related companies had needed to raise large scale external finance. But as the economy's reliance on the rural sector diminished, manufacturing and services began to assume greater importance. Opportunities emerged to build large scale operations in a wider range of industries, and more companies needed external finance. Short term debt in the form of trade credit and short term trading bank loans provided a substantial part of their needs, but they also needed long term finance to fund expansion. To the 1950s, the underdeveloped debt market meant they had limited long term debt financing options. Insurance companies and other institutions did provide loans secured by mortgage in the interwar period, but most industrial companies did not have enough assets securable by mortgage for this to provide a major source of finance. Debentures were also an established financial instrument by the 1920s and were used by many of the English registered companies listed on Australian exchanges, but few Australian registered companies aside from utility companies issued debentures prior to the 1950s. In part, this may be because most lacked the strong and steady cash flow necessary to convince lenders that they could service debentures, but it also likely reflected the absence of regulation governing trust deeds. In addition, there was a paucity of institutions willing or able to organise and underwrite debenture issues in NSW at least until the late 1940s.²

Equity and the SSX

With limited access to long term debt from the 1920s through to 1950, Australian companies relied almost exclusively on the equity market for additional long term funds to supplement retained earnings.³ For new companies, without retained earnings and with limited access to trade credit or trading bank loans, equity capital assumed even greater importance. Stock exchanges were integral to the provision of arm's length equity in Australia as elsewhere. Stock exchange listing provided arm's length investors with a market price and a means by which they could readily sell their securities. Thus listing essentially converted a long term ownership right into a liquid asset, increasing the appeal of equity to arm's length investors. It meant

original owners of established companies could more readily reduce their shareholdings, to allow successful businesses to continue beyond the working life of their founders.⁴ Listing also enhanced the ability of established companies to raise additional equity to take advantage of new opportunities. And new companies needing arm's length equity through an IPO were more attractive to investors if they indicated that were seeking stock exchange listing.

The Sydney Stock Exchange (SSX), like the other Australian exchanges, began as a market for speculative mining shares and government bonds. Investment grade mining companies and an increasing array of industrial companies sought listing in the late nineteenth century, but the real growth in the industrial markets began in the 1920s. Some accounts of the development the major Australian exchanges focus on the increased demand by firms for arm's length finance and the increased supply of investment funds. Ken Loughheed's account of the development of Brisbane stock exchange, for instance, is very much in this mould. He analyses the development of the economy, and the growth in opportunities facing business on the one hand, and the increased wealth of individuals and more recently institutional investors on the other.⁵ However as Salsbury and Sweeney recognise, there were also substantial imperfections which impeded the functioning of the early equity markets, particularly in NSW. These imperfections took two forms. First, the institutional infrastructure was underdeveloped and ill-equipped for the task of facilitating the flow of funds to industry. There were no merchant or investment banks or specialist underwriters. Firms seeking to raise new equity had to rely on stockbrokers. The SSX and its broker members did not really begin to rise to the challenge of facilitating the flow of new finance for industry until the 1950s, 25 years behind their Victorian counterparts.⁶ The second impediment to the flow of funds to equity investments was the highly imperfect public information on individual equities. Disclosure requirements in the early years of the development of equity markets were substantially less onerous than they are today.⁷ Information on many of the fundamentals was not available and much of the information that was disclosed was of dubious value, complicating the formation of expectations about the risk and return of individual equities. Our focus in this paper is on the implications of these imperfections in the Sydney equity market in the period 1919 to 1949.

In the first section we briefly outline our data and discuss the growth in the NSW equity market. In the second section, we examine the imperfections impeding the functioning of this market and then consider ways in which these imperfections were ameliorated. In the third section we explore the effect of these imperfections on the financing of the NSW corporate sector.

I

In the period 1919 to 1949, Australian companies listed on a home exchange – usually the one in the state in which they were registered - but even in 1919, some companies listed on other exchanges drawing on a national market. Notwithstanding this, the market remained more regional than national to 1949, and the regions were each served by their own stock brokers. We restrict our analysis to the Sydney equity market, but we make no pretence that it is representative of other regional markets. On the contrary, the Australian regional markets were clearly differentiated by size, with the NSW and Victorian industrial sector being much larger than those in other

states. And even these two larger markets were very different, with Victoria emerging as home to more of the large national companies prior to 1939 and with a more dynamic financial market infrastructure, including the early entry of prominent stock brokers into underwriting, merchant banking and investment trusts.⁸ Corporate regulation was also the domain of individual colonies and, from 1901, the states and NSW also had weaker disclosure requirements than Victoria from 1896.

Growth in the SSX

Our data on the Sydney equity market are derived from snapshots of the Sydney Stock Exchange (SSX) at ten yearly intervals from December 1919 to December 1949.⁹ We have identified which companies were listed at each snapshot date, their place and date of registration, their industry and, where appropriate, the date and reason for de-listing and other data. We do not capture those companies that listed and de-listed within the decade, so our data provides a lower bound of SSX equity market entry and exit. We are able to track the providence of all companies through to the present day, through name changes, mergers and de-listings. Companies can and do retain their home exchange listing while moving in and out of a second exchange list, depending on their immediate need for funds. We have restricted our analysis here to those companies registered in NSW, since they are likely to have made the SSX their home exchange.¹⁰ We also placed restrictions on the type of company included here. The SSX divided its list into ‘Investment’ and ‘Mining’. The latter contained the more speculative no liability mining companies but it also included a number of investment grade mining companies, while the former included coal mining companies. We have restricted our analysis to limited liability companies – both ‘investment’ and mining – omitting only the no liability mining companies.

The number of new listings at ten yearly intervals confirms the importance of the 1920s as the period when the development of the investment grade equity market accelerated. In 1919, there were only 163 NSW registered, limited companies listed, many of whom would have joined the list in the preceding decade. In the 1920s, almost as many again were listed with 155 new listings. The numbers were smaller in the 1930s and 1940s, with 125 new listings in the 1930s and 144 in the 1940s but these numbers must be viewed as quite substantial, given the economic and political circumstances in these decades. However, as Table 1 below demonstrates, there was also a high exit rate despite the absence of a hostile takeover market – an inevitable consequence of the limited scope for due diligence, and perhaps the prevailing culture. Thus net growth in the SSX list was lower than the entry rate would suggest, although it still represented substantial growth in the number of NSW companies drawing on the public equity market. When coupled with new equity issues by listed companies, the increased number of listings indicates an increased flow of arm’s length equity finance to the NSW corporate sector.

Table 1: SSX NSW Ltd. Companies – Listing Turnover and Growth

Decade	1920-9	1930-9	1940-9
New listings as % of start number	90%	47%	44%
Exits as % of start number	35%	24%	15%
Net Growth	54%	23%	29%

Source: Compiled from *Sydney Stock and Share List*, December 1919, 1929, 1939 and 1949

II

The NSW equity market clearly did grow during the critical period of structural change from 1920 to 1950. However, this occurred against a backdrop of imperfections that were substantial by contrast with those prevailing in the current market and had the potential to constitute a serious impediment to the operation of the equity market. The first of those imperfections discussed below is the highly imperfect information available to investors in seasoned equities. Rational investment decisions are based on an evaluation of the expected risk and return of the investment. But a company's prospects and the quality of its management is internal information. As such it is asymmetric information, or information not available to the investing public. Investors must rely on other methods to reach their valuation of corporate equities. We do not know the exact method by which investors today make their valuations of equities, but it is commonly accepted that financial statement information provides the foundation for their equity valuations.¹¹ Investors in the 1920s and 1930s were also advised to look, *inter alia*, at companies' financial statements but these were far less informative than those available to investors today¹².

Statutory Disclosure

The conduct of public companies, including their disclosure obligations to owners is governed by companies acts, which were the domain of the colonies and then the states in Australia until 1961. NSW passed its first Companies Act in 1874, broadly modeled on the English joint stock acts, which regulated the incorporation of limited liability companies.¹³ These English acts provided model articles of association, which included the requirements that the company keep true accounts, that it table an income and expenditure statement and a balance sheet at the annual meeting, and that the balance sheet be audited and be circulated to all members. However NSW, like other Australian colonies, departed from the English model by not compelling the accounting and auditing requirements, allowing registered in NSW to adopt modified articles with substantially less and unaudited disclosure.¹⁴ NSW did not impose compulsion until its more stringent 1936 Companies Act.¹⁵

The 1936 NSW Act made circulation of the balance sheet compulsory and provided detailed requirements on the form of the balance sheet. These requirements included provision of information on authorized and issued capital, liabilities (with those secured on assets specified separately) and assets (to be divided into floating and fixed with bases for valuation stated and with intangible assets separately detailed). Holding companies were required to show separately their investments in subsidiaries and the amounts due to and from subsidiaries, but (unlike Victorian companies from 1938) they were not required to produce consolidated financial statements or separate statements for each subsidiary until the 1960-61 Uniform Companies Acts. Nor was there any requirement to disclose more information about associate companies, despite their increased importance in the corporate sector. The Act did require companies to disclose the amount of depreciation and transfers from reserves in their director's report. It also required companies to circulate a profit and loss statement but it did not specify the form of that statement other than that it must reveal how profit from subsidiaries was treated and show the directors remuneration. The 1936 NSW Companies Act thus continued to make the balance sheet the primary source of information to shareholders.¹⁶

The requirements of the 1936 NSW Companies Act were thus minimal by comparison with those of today, and certainly lagged behind the adoption of new organizational forms such as the holding company. But the Act's requirements were well in advance of some contemporary companies' disclosure practices and had the potential to increase the balance sheet information available to investors. However, there were serious compliance deficiencies. Most coal miners, for example, produced highly aggregated balance sheets with essentially all operating assets shown as a single item in the late 1930s, although most did separate out debtors and stocks. Mort's Dock and Engineering was not so informative. It disclosed only two substantive assets: 'Property, Plant and Machinery', and 'Stocks, Works in Progress, Debtors & Depositors'.¹⁷ Practices such as these, in violation of the 1936 Act, add to the broader picture of compliance deficiencies documented by Gibson and others in NSW and elsewhere prior to 1961.¹⁸

SSX Listing Requirements

The absence of compulsory statutory disclosure requirements to 1936 and the limitations, omissions and compliance deficiencies thereafter placed a particular onus on the SSX to regulate disclosure by listed companies in NSW through its listing requirements. Salsbury and Sweeney argue that the Sydney Stock Exchange introduced more stringent listing requirements than its Victorian counterpart in the early twentieth century. But the initial requirements were aimed more at ensuring a fair market by regulating the spread, volume and issuing conditions of companies' shares, rather than at ensuring that the market was well informed. The SSX's subsequent regulation of the conduct of its members and the process of market exchange was also intended to create a fair market. In 1925, the SSX did attempt to strengthen disclosure by requiring companies to provide a balance sheet and profit and loss statement for each of their subsidiaries, but three years later this requirement was downgraded, with the suggestion that holding companies 'may' submit aggregate statements of the company and subsidiaries.¹⁹ Only in 1941 did the SSX make provision of a consolidated profit and loss statement and balance sheet for subsidiaries a listing requirement. Gibson argues that, with group statements a notable omission from the new NSW statutory requirements, the new SSX listing requirements did play an important role in increasing the level of disclosure in NSW. But he also found that the stock exchanges, like governments, had difficulty ensuring compliance with their requirements.²⁰ Retrospectivity was an issue, with those companies listed prior to the introduction of new requirements arguing that they were not subject to the changes. The stock exchanges could only threaten to de-list non-compliant companies. This appears to have been effective with newly listed companies but the examples of listed companies cited above reinforces the general view that the SSX made little headway in improving disclosure by the larger, more well established companies prior to the 1960s.

The compliance problems faced by both the government and the SSX reflected the divergent views in the Australian business community on the value of and need for disclosure. Some believed that fuller disclosure could place a company at a competitive disadvantage.²¹ Others argued fuller disclosure would not aid investors until the accounting profession had developed complimentary accounting standards.²² The slow development of compulsory disclosure requirements and complementary accounting and auditing standards meant that, in the early stages of the development of the NSW industrial equity market from to 1936, investors had no statutory entitlement to financial information for limited liability companies. The level of

disclosure did increase after 1936 but the discretion companies were allowed in constructing their profit and loss statement rendered it of little value to investors. Even the balance sheet could obscure rather than enlighten investors, with many companies continuing to provide highly aggregated information. And of course the provision of any meaningful information on holding companies was dependent on the threat of stock exchange delisting. The absence of accounting and auditing standards also made it difficult for investors to interpret the information that was provided.

Imperfect Information and Investment Advice

Unlike today where institutions with in-house research capabilities dominate the equity market, the majority of equity investment prior to the 1950s was made by individuals. And unlike today, they received little by way of written analyses from their stock brokers to help them interpret individual financial statements. However, investors could draw on three national investment journals: *Jobson's Investment Digest*, which was first published in 1920; *The Wild Cat Monthly*, which began in 1923 by reproducing *The Bulletin's* investment reports but had expanded its services substantially by 1928; and *Rydges Business Journal*, which was first published in 1928. The first two of these journals reproduced companies' financial statements and provided a comment on them. Neither shirked from pointing out to investors the inadequacies of both the NSW companies law and the level of disclosure by individual NSW companies. *The Wild Cat Monthly* was normally the more acerbic of the two in pointing out the obviously creative cases. Yet even *Jobson's* made its point. For instance, after commenting on Excelsior Collieries and Coke's treatment of goodwill and depreciation, *Jobson's* concluded that the net asset backing shown by its balance sheet was 'nominal'. Time after time, both journals essentially argued that investors should not draw any conclusions from the financial statements provided by some companies.

IPOs

The highly imperfect nature of information available to investors clearly impeded the functioning of the secondary equity market. This also had implications for the new issue market, since in principle the advantage of listing is that it allows the investor to sell the securities readily at a later date. If imperfections deter investors in the secondary market, then there are flow on effects to new issue market. However, there were even greater impediments to investors in IPOs for whom the prospectus provided the only source of public information on which to base an investment decision. The provisions of the NSW companies act governing the prospectus were especially deficient, requiring only that the prospectus provide notice of any contracts material to the flotation, but there was no obligation to reveal the details of these contracts.²³ Potential investors had no way of knowing, for instance, what floatation and start up costs the new venture would face. Of course the prospectus made statements about profit potential but, without knowing how these were derived, they had little credibility.²⁴

Only promoters or original owners knew a new company's position and could evaluate its prospects with any degree of confidence. The unscrupulous could attempt to exploit this information asymmetry, selling shares in companies in which only they stood to gain. There appears to have been relatively widespread recognition that this did occur especially prior to the mid 1930s.²⁵ But this was *ex post* information. The problem for investors was to try to identify the genuine ventures. And from the genuine ventures they had to try to identify those with good prospects. The success

rate among new ventures was clearly poor across the nation. In 1927, *The Wild Cat* argued that 'in every four [new ventures] there are three that can't make enough to warrant payment of a dividend.'²⁶ In the early 1930s, Rydge was more pessimistic, arguing that 'well over ninety out of every hundred new companies...never reach the dividend paying stage'.²⁷

The underdeveloped financial market infrastructure, and especially the shortage of underwriting facilities also hampered the efforts of genuine ventures to raise equity. There were no specialist underwriters based in Sydney prior to 1950.²⁸ Company promoters, vendors and directors and other institutions often provided a service that was termed underwriting but in fact was a commission selling agency. These agents made a commitment 'to 'use their best endeavours' to sell the securities at a specified rate of commission. They did not provide a commitment to supply the funds by taking any unsubscribed securities on their own account and placing them at a later date. Indeed most could not provide this type of service, because they did not have the capital to make credible commitments for full funding, nor the contacts or reputation to make private placements. Brokers were in a somewhat better position to provide true underwriting and some Sydney brokers gradually began to do so on a small scale from the late 1920s, in response to competitive pressure from Melbourne firms.²⁹ However, as Salsbury and Sweeney's account of the SSX makes clear, Sydney brokers were constrained by their small size and the SSX restrictions on their activities, such as the prohibition on advertising, including the prohibition against circulating letters promoting new issues. The SSX also frowned on its member brokers approaching organizations needing to raise capital, arguing that such behaviour was 'undignified and contrary to Stock Exchange etiquette.'³⁰ Since the SSX was a self-governing body, these restrictions were of the members own making. Salsbury and Sweeney certainly portray the SSX and the member brokers as conservative, insular and clubbish in the 1920s, a situation that did not change greatly until the 1950s.³¹ The consequence was that NSW registered companies were not likely to be approached Sydney brokers, and if they sought out a broker the best they were likely to gain was a commission selling agreement.

The use of commission selling of new issues was made especially problematic in NSW because the company law that did not specify a minimum subscription to trigger allotment. When a commission agent was used for an IPO, even a subscription for a single security virtually forced the company to go to allotment to gain the funds pay the commission. Thus some companies were floated with grossly inadequate capital, dooming them from the outset. Even those with a successful issue could be in a tenuous position if they had adopted the normal procedure for IPOs of issuing partly paid shares. Since the commission was paid on the full par value of the shares, it could eat up a substantial portion of the new venture's initial capital.

In commenting on individual IPOs, the investment journals highlighted the risk to investors. They warned investors to steer clear of some IPOs, at least until the new company proved it could pay a dividend. With others the journals were more lukewarm but seldom were the shares of new companies actually endorsed or recommended. More normally, investors were advised to gain further information before committing themselves. For instance, in 1923 that *The Wild Cat Monthly* concluded in respect of one IPO that 'the information contained in the prospectus was not sufficiently full to warrant shares being recommended without full enquiry into the proposition'.³² In short, on this as on other occasions, the best advice that the

investment journals could offer was that investors make their own enquiries before investing in new companies. Rydge was even more circumspect in the 1930s, advising investors that it was better to buy at premium once the successful ten per cent had proven themselves rather than risk the capital loss of investing in any of the ninety per cent doomed to fail. If highly imperfect information made investing in seasoned equity a high risk proposition prior to the 1950s, investing in new equities was doubly risky.

Investors

The impact of these equity market imperfections, and in particular the extent to which they meant genuine ventures could not raise the necessary capital, depended on the risk and return preferences of potential investors. The investment journals recognized that there were several categories of potential investors with different risk preferences, some of whom were willing and able to accept high risks for the chance of high returns. For instance in its investment advice columns of the later 1920s, *The Wild Cat Monthly* repeatedly distinguished between the ‘man of means’ who could afford to make high risk investments in new companies, and the ‘widow’ with more limited capital who needed a steady return. It also cautioned the ‘man’ of limited means who might be attracted by the prospect of high returns that these investments also carried high risk. Rydge in his investment advice book of the 1930s distinguished between the speculator, whom he thought accounted for ‘a tremendous volume of business’ on the exchanges in the 1930s, and the investor who judiciously outlaid funds in the expectation of long term returns. The initial investors in NSW industrial equities may have included many accustomed to the more speculative mining securities, and so willing to bear high risks, but growth in the market and the economy depended on attracting additional investors. This was especially true once the gold boom of the 1930s competed for the more high risk funds.

Preference shares

The use of preference shares rather than ordinary shares may have encouraged investors to buy equities by disguising the risk involved. Preference shares offer investors additional ‘security’ through preferential rights to dividends and capital return. Baskin and Miranti argue that debt-like instruments such as preference shares were important in attracting investors to the market in the US because they had the appearance of providing an assured income stream.³³ They conclude that these securities helped accustom investors to the risk of investment grade equities, as a precursor to the development of the US market for ordinary equities in the 1920s.

The type of capital issued by companies on the SSX investment board (including coal mining but excluding other limited liability mining companies) is provided in Table 2. This table shows that relatively few of the industrial companies listed by 1919 had issued preference shares. Only in the 1920s did preference shares become common in the Sydney industrial equity market. However, in the 1920s the vast majority of new listings issued preference shares, as did many of those companies who had listed earlier. Thereafter, the use of preference shares declined markedly, with less than half the new listings in the 1930s issuing preference shares. While the proportion increased a little among the new listings of the 1940s, preference shares still did not regain the popularity they had enjoyed in the 1920s.

Table 2: SSX NSW Industrial Listings – Capital Structure

Capital	Listed by 1919	New by 1929	New by 1939	New by 1949
Ordinary shares only	99	43	45	64
Preference Shares	27	71	32	63

Source: Compiled from *Sydney Stock and Share List*, December 1919, 1929, 1939 and 1949

The popularity of preference shares in the 1920s indicates that preference shares may well have played the role of attracting new investors, contributing to the long term growth in the equity market in NSW. However, by 1927 *The Wild Cat Monthly* was advising investors to be cautious about preference shares, arguing that preference could be ‘a delusion and a snare’ if the company had little ordinary capital and large liabilities which ranked ahead of the preference shareholders. The downturn of the late 1920s reinforced the message that preference shares were not like government bonds. Almost half the companies that had issued preference shares by 1919 were de-listed by 1930, including a number of smaller companies that disappeared without trace, and others who were taken over. Others that issued preference shares during the 1920s failed or were taken over. And some of those that did survive could not pay their preference dividends. For instance Calendonian Collieries did not make a preference share dividend payment from to 1940. It was not alone. The manufacturer and retailer Bebarfalds did not pay a preference dividend until 1938, and even then it could only pay a dividend on the “A” preference shares. “B” preference shares, issued in 1928, still had not received a dividend by 1940. The accumulating value of the arrears owing was no consolation to the “B” preference shareholders, with the market pricing their shares well below the value of the arrears.³⁴ Other companies who continued to pay preference dividends in the 1930s but at a reduced rate. Some were eager to retain preference shares in the 1930s and attempted to reassure these shareholders by granting equal voting rights.³⁵ Union Theatres attempted to provide further assurance to its preference shareholders by creating positions on the board specifically for their representatives.³⁶ But the bubble had broken. Preference shares were revealed for what they were: a form of equity that carried no guarantee for capital or income. The issuing of preference shares likely did help attract investors to the NSW equity market in the 1920s, but it was a short-lived role.

Signals and Private Information

Investors had highly imperfect public information with which to value individual equities, but they also had the signals of investment quality provided by the companies. Signaling involves making available information which is correlated with the unknown.³⁷ Dividend record was the major signal used by companies in this period. The emphasis was on providing good and especially stable dividends, and many companies adopted Newcastle Wallsend Coal Co’s policy of disclosing only enough profit to cover those dividends. The dividend record was publicized through financial journals and by the SSX, and was the prime indicator of viability. However, it proved a relatively weak signal as because the disclosure requirements meant companies could and did pay dividends out of capital rather than profit, at least in the short to medium term.

New listings had to rely on even weaker signals. Longevity was one such signal. Companies themselves highlighted their longevity. When *The Digest Yearbook of*

Public Companies was first issued in 1928, many companies did include information on their initial date of registration but by the late 1930s and 1940s this information became more common and often companies added information about their early history. This was not treated as a legal technicality. Reorganisations and re-registrations were often omitted to emphasise the longevity of the company. The investment journals also considered longevity in evaluating IPOs, with those that involved the acquisition of an established private company generally evaluated more highly than new ventures. However, the main reason for this was, as *The Wild Cat Monthly* repeatedly explained in its articles on investing, that the management of a new venture still had to 'prove' itself. The same reasoning applied where the owner manager was retiring, and *The Wild Cat Monthly* viewed these ventures with caution too.³⁸ In effect it was arguing that longevity was not a reliable indicator of future survival, let alone success.

Another signal which is still important today was the appointment to the Board of Directors of prominent and skilled individuals. Prominent identities such as Members of Parliament were in strong demand in the inter-war period. Senator McLachlan, for example, was on the board of 6 companies in 1930. Those with knighthoods, or with other titles such as Brigadier-General' or 'Doctor' were also common. So too were accountants and successful business people. The need for such individuals to protect their reputation would normally offer investors protection from blatantly fraudulent companies. However, it provided a much weaker signal of the prospects for good future returns. Directors' fiduciary responsibilities were poorly articulated prior to the late 1980s and the presence of prominent or skilled individuals did not ensure good corporate governance, let alone good corporate performance. The investment journals seem to have recognized this. They argued that the quality of management was important, and pointed to the qualifications and reputation of Board members on many occasions, but implied that investors needed more information than this. For instance, in 1923 *Jobson's Investment Digest*, concluded that the success of one new company rested 'largely on the personality and business ability of the management [and that] 'intending investors should make their own enquiries'.³⁹

Networks

The question of how investors should go about following the investment journals oft-repeated advice of making their own enquiries, brings us to an alternative mechanism: market networking and the dissemination of private information on companies and their prospects. This was likely a major means by which investors gained some assurance about the value of individual equities in the early stages of the development of the market. The number of active investors was relatively small in each state market, and they were serviced by a limited number of stock broking houses. While the NSW broking houses did not produce the sophisticated written analyses that they do today, they undoubtedly collected and informally disseminated information on individual securities. Information likely also passed more directly from informed insiders to investors. The issue here is the quality of that information and the strength of the network. In a small, relatively closed investment community such as in the 1920s and 1930s, being privately exposed as a provider of incorrect/misleading information and being distrusted by the network may have been sufficient deterrent to ensure the integrity of most information provided. But while networks may convey high quality information, it was information only available to insiders. And with brokers likely to be an important participant in these networks, their homogeneous

background and conservative, clubbish business practices would ensure that the array of insiders were very limited.

By default, the equity market assumed great importance as a source of corporate finance during the early stages of the growth of large firms in many manufacturing and service industries, but that equity market was clearly marred by serious imperfections. By comparison with today's investors, potential investors prior to 1950 had more highly imperfect public information with which to value both IPOs and seasoned equities. Signals provided only a weak solution. With IPOs, investors faced the additional risk that even potentially successful companies could be hampered by inadequate capital, because of the absence of underwriting facilities. We turn now to the implications of these equity market imperfections for the flow of funds to industry.

III

We know from the data presented in Section 1 that the market did provide equity finance for a host of new ventures in the 1920s, and for a lesser but still substantial number in the 1930s and 1940s. We do know that a number of clearly esoteric ventures, such as Prickly Pear Eradicator Ltd, did not convince the market. But we cannot determine if the market directed its funds to those with the best prospects. All that we can say is that, given the quality of information available, it is highly unlikely that investors were able to identify those ventures. Nor can we determine if the market supplied those it did support with enough funds to allow them to succeed. But we believe it likely that many new listings struggled to gain enough finance. We are able to draw stronger conclusions about the implications of the equity market imperfections by analyzing the industries where market did direct its funds.

Industry Distribution

A glance through the names of new listings in each decade indicates that they included many companies from relatively new and expanding industries. This conclusion is reinforced by the ANZSIC sector distribution in Table 3, which shows that large numbers of new listings were from the growth sectors of manufacturing and finance throughout the period. The number of new listings from these fields is clearly related to the development of the economy, and in particular the opportunity to build first mover advantages in these industries, which created the demand for arm's length equity finance. Yet there often was a lag between the formation of a new company and its listing. This is clearly demonstrated by a more detailed two digit ANZSIC industry breakdown of companies in the manufacturing sector, shown in Table 4. The clothing and textile industry developed in the 1920s, but the main growth in SSX listings in this industry occurred in the 1930s. Similarly with motor vehicles and equipment manufacturing – another emerging industry of the 1920s – where the main growth in listing occurred in the 1930s. Century Storage Batteries, for instance, was formed in the mid-1920s and listing in the 1930s, and the petrol distributor Ampol, formed in the mid-1930s and listed in the 1940s. The lag between formation and listing can be explained by the company starting on a smaller scale in industries where that was technically possible, in order to gain a track record and increase its subsequent market appeal.

Table 3: SSX NSW Ltd Companies by ANZSIC Sectors⁴⁰

ANZSIC SECTOR	As at 1919	New 1920-9	New 1930-9	New 1940-9
Unknown	5	5	2	5
Rural	3	3	0	2
Mining	53	40	48	12
Manufacturing	35	38	43	85
Electricity & Gas	14	0	1	0
Construction	0	1	1	2
Wholesale	15	20	8	15
Retail	8	14	3	5
Hotels & Rest.	7	7	1	2
Transport	7	1	0	1
Communication	0	0	0	0
Finance & Insurance	14	15	10	4
Property & Bus	7	6	3	6
Govt & Admin	0	0	0	0
Education	0	0	0	0
Health & Community	0	0	0	0
Culture & Rec	5	4	5	2
Personal Services	0	1	0	2
Conglomerates	0	0	0	1
Total	173	155	125	144

Sources: Compiled from *Sydney Stock and Share List*, December 1919, 1929, 1939 and 1949; *Digest Yearbook of Public Companies*, various years.

The growth in listings from new industries, albeit often with a lag, might suggest that despite its imperfections the equity market succeeded in channeling finance to firms with new opportunities. Yet Table 3 demonstrates that there were also many new listings from well-established sectors. Retailing made a strong contribution to the total in the 1920s, with firms such as Anthony Horden & Sons, David Jones, Gowing Bros and Woolworths joining the list; hotels and restaurants, prominent among them the Carlton and Manly Hotels, made a strong contribution in both the 1920s and 1930s. Within manufacturing, new listings also came from established industries with the brewer Tooheys' joining the list in the 1930s, and several textile and clothing manufacturers in the 1940s. There were also new listings in well-established areas of the distribution sector such as food products and softgoods. The listing by companies from already well-established industries suggests that the supply side – the increased ability and/or willingness of investors to provide equity finance in an arm's length market – played at least some role in the growth of the market, despite the persistence of serious information imperfections in that market. It also suggests a backlog in demand which could not be satisfied until investors became more willing to channel funds to industry through arm's length equity.

Table 4: SSX NSW Ltd Manufacturing Sector Companies by 2 Digit Industry

ANZSIC 2 digit industry	1919		New 1920-9		New 1930-9		New 1940-9	
Unknown		(0%)	1	(3%)		(0%)		(0%)
Food & drink	12	(34%)	7	(18%)	5	(12%)	5	(6%)
Clothing & textiles	2	(6%)	4	(11%)	9	(21%)	18	(21%)
Wood & paper	6	(17%)		(0%)	2	(5%)	4	(5%)
Printing & pub.	3	(9%)	7	(18%)	2	(5%)	1	(1%)
Chemicals	1	(3%)	2	(5%)	3	(7%)	11	(13%)
Non-metal minerals	4	(11%)	6	(16%)	3	(7%)	5	(6%)
Metal products	4	(11%)	5	(13%)	4	(9%)	17	(20%)
Machinery & equip	3	(9%)	4	(11%)	14	(33%)	20	(24%)
Misc.		(0%)	2	(5%)	1	(2%)	4	(5%)
Total	35	(100%)	38	(100%)	43	(100%)	85	(100%)

Sources: Compiled from *Sydney Stock and Share List*, December 1919, 1929, 1939 and 1949; *Digest Yearbook of Public Companies*, various years.

The industry distribution of new listings shown in Table 3 indicates a relatively high number of the listings came from the property sector, and hotels and theatres. The characteristic these companies have in common is that land and building was their major asset. This asset was relatively easy for investors to value, being verifiable and having an observable public market. It also had the potential to provide better protection against capital loss in the event of failure than for instance a manufacturing company's assets.⁴¹ Thus, we see attenuation of some of the information asymmetry through choice of securities.⁴² Companies in sectors with substantial real estate holdings actively reinforced the impression of strong asset backing by describing their business as, for instance 'proprietor' of a theatre, rather than operator of the theatre, or by selecting a name that identified the company's prime asset. For instance Central Railway Palace Buildings Ltd acquired the Hotel Sydney in 1923, and in the 1930s changed its name to Hotel Sydney Ltd. The number of new listings whose securities were backed by real estate suggests they were relatively attractive to the market, because they economize on the need for financial statements. The irony is that these companies were the same ones who could also offer the security to gain mortgage finance – the only form of debt that was relatively widely available in this period.

Several retailers emulated the real estate based companies by spinning off their real estate into a separate company which then sought funds in the market. For instance Joe Gardiner Ltd. (boot & shoe merchants) converted the majority of its ordinary shares to preference shares in 1925, and then raised additional ordinary capital, but it clearly was an expanding company that needed more finance. In 1926 it joined forces with Edward Fay Limited to form Real Investments Ltd. whose business was to acquire shops for lease to the two retailers. The two retailers retained all the ordinary shares in their joint real estate arm, but offered preference shares to the public.⁴³ Woolworths is a prominent example of a firm that adopted the same financing strategy, forming Woolworths Properties Limited in 1938 whose purpose was to take over from it all its freehold retail properties and to acquire funds for further

acquisitions.⁴⁴ However, manufacturers or distributors could not adopt the same financing strategy and as a result they likely experienced greater difficulty in financing growth.

IV

Conclusions

From the 1920s there was increased demand for investment funds as firms in new industries joined those in more established industries to begin the process of building large managerial firms. The investors who answered the call undoubtedly were risk takers, and perhaps the very early investors accustomed to mining equities were the greater risk takers. But they and the new investors who invested in equities made their investments in the expectation of earning an acceptable return on their investments. Yet they operated in an environment where disclosure requirements and practices made it difficult to evaluate the risk and expected return of individual securities. Our analysis indicates that a number of factors, both real and apparent, helped mitigate their perception of the impact of imperfect information.

First, if preference shares were perceived to offer a guaranteed and stable return on investment, they economized on the apparent need for financial statement information to evaluate expected returns. The popularity of preference shares with investors in the 1920s indicates that they did play this role in mitigating the apparent impact of imperfect information. However, this role was short-lived as the downturn of the late 1920s demonstrated the reality - that preference shares were also risk capital. Investors could also look to indicators or signals of investment quality. Dividend record was one such signal but it was not available for new listings. In these cases only signals available to investors were longevity and the reputation of the directors. These were relatively weak signals. It is likely that, in a small investment community, private information was also important in helping some investors to evaluate securities. But what of outsiders – those that were not part of an established financial community network? Undoubtedly some potential investors chose to invest their funds elsewhere for want of enough information to evaluate equities, and companies that offered good prospects were unable to convince the market to provide the necessary finance.

In evaluating the risk of capital loss, the securities of companies whose main asset was visible and easily-valued real estate economized on the need for financial statements. These were also popular with investors, as demonstrated by the relatively high proportion of total new listings they comprised in the 1920s. But not all companies could offer visible and readily-valued assets. Even the introduction of more stringent and compulsory disclosure of information on assets did not place these companies in a comparable position, in part because of compliance shortcomings, but also because most other assets were not so easily realised. These companies likely experienced the greatest difficulty in raising equity. For the development of the economy as a whole, this meant a bias towards commercial real estate at the expense of other types business.

Endnotes

¹ Ideally we would like to have also examined the phase prior to 1919, when the first investment grade mining companies, banks and a small number of other companies sought listing but the data was not available. Publication of our key data source *Sydney Stock and Share List*, only began in 1914, while the national investment journals which we also employ began publication in the 1920s.

² This would explain the seemingly random distribution of NSW companies that did issue debentures, including the small company, Illawarra Fireclay and Brick, which issued debentures in 1922 and 1925, and the larger Australian Iron and Steel which issued debentures to help finance its re-location and construction of a new plant in the early 1930s. (See *Digest Yearbook of Public Companies* and *Jobson's Investment Digest* for the capital structure of individual companies but note that debentures were often included in the catch-all item, 'creditors').

³ See Grant Fleming, David Merrett and Simon Ville, *The Big End of Town*, Cambridge, CUP, 2004 for the available data and the most recent analysis of the financing of Australia's emerging large firm sector.

⁴ For companies whose shares were narrowly held by original owners, shares had to be sold prior to listing from the 1880s, when the Sydney Stock Exchange began to require an adequate spread and volume of shares to ensure an active market, although its initial spread requirements were not onerous. However the prospect of listing increased the appeal of those shares to investors. (Stephen Salsbury and Kay Sweeney, *The Bull, the Bear and the Kangaroo: the history of the Sydney Stock Exchange*, Sydney, Allen & Unwin, 1988, p. 144-5)

⁵ Loughheed, A. L., *The Brisbane Stock Exchange, 1884-1984*, Brisbane, Brisbane Stock Exchange, 1984. For the early development of a stock exchange in Victoria, see Hall, A.R., *The Stock Exchange of Melbourne and the Victorian Economy 1852 – 1900*, Canberra, ANU Press, 1968.

⁶ Salsbury, *op.cit.*

⁷ See Morris, R.D. and M.R. Barbera, 'A Chronology of the Development of Corporate Financial Reporting in Australia: 1817 to 1988' in Parker, R.H. (ed.), *Accounting in Australia: Historical Essays*, Garland Publishing, New York, 1990

⁸ See R. T. Appleyard and C. B. Schedvin (eds.), *Australian Financiers: biographical essays*, Melbourne, Macmillan, 1988, Chapters 14 and 18.

⁹ These snap shot years were chosen for convenience and are not comparable: 1919 includes those listed in the last 10 years, but also the pioneering industrials that had been listed for longer, while the later dates include only those listed in the preceding decade. Of those later dates, we would expect most of the new listings in the 1920s to have occurred in the first part of the decade so our 1929 snapshot will be dominated by firms listed early in the decade, and many of the weaker companies would have already been weeded, while in the 1930s and 1940s we would expect the majority of new listings to have occurred in the later part of the decade so the 1939 and 1949 snapshots will be dominated by very recent additions

¹⁰ We have however included the relatively small number of companies whose place of registration is unknown, on the grounds that, since so little is known about them, they are likely to be local companies listed only on the SSX

¹¹ DeAngelo, L., Equity Valuation and Corporate Control, *The Accounting Review* 65:1 (January, 1990) pp. 93-112; Demirakos, E., N. Strong and M. Walker, What Valuation Models Do Analysts Use?, *Accounting Horizons* 18:4 (December, 2004) pp. 221-240.

¹² See the numerous articles in offering advice to investors in *The WildCat* in the 1920s. See also N. B Rydge, *The Australian Stock Exchange*, Sydney: Rydge's Business Journal, 1934, which in itemizing what investors should look for, advocated that they first look at the balance sheet to determine if the company's 'general financial position' was sound, and to determine the asset value of the shares, and that they should also look at the profit and loss statement to determine the company's past returns, but that they should also ensure that prudent allocations have been made to reserves. (See pp. 70-80)

¹³ NSW passed the Companies Act 1874, while for the other states the relevant laws were: Queensland's Companies Act 1863, Victoria's Companies Statute 1864, South Australia's Companies Act 1864, Western Australia's Companies Act 1893 and Tasmania's Companies Act 1869. All of these were based on the English Companies Act 1862. While the accounting and auditing requirements at this stage were optional, in the UK they gradually became compulsory through subsequent enactments: auditing (1900), balance sheets (1907), profit and loss accounts (1929). See Nobes and Parker's chronology of British company financial reporting in TA Lee and RH Parker (eds), *Evolution of Corporate Financial Reporting* 1979.

¹⁴ See R. W. Gibson, *Disclosure by Australian Companies*, Melbourne University Press, 1971, on the disclosure requirements of the various Australian Companies Acts.

¹⁵ *Ibid.*, pp. 64-5.

¹⁶ Gibson, *op. cit.*, pp. 65-6. The NSW Companies Act of 1936 was modeled on the British Companies Act of 1929, which was an implementation of the recommendations from the Greene Company Law Amendment Committee (1925) report.

¹⁷ *Jobson's Australian Investment Digest*, 1940.

¹⁸ See Gibson's own analysis of the 42 leaders (*op. cit.*) but also other works he references. See also Whittred, G., "The Evolution of Consolidated Financial Reporting in Australia", *Abacus* 22:2 (1986), pp 103-120

¹⁹ Note that these were not necessarily consolidations (eliminating inter-company transactions), just simple aggregations. See Gibson, *op.cit.* pp. 76-80.; Whittred, *op. cit.*; and Walker, R.G. and J. Mack, 'The Influence of Regulation on the Publication of Consolidated Statements', Vol.34. No.1, *Abacus*, 1988

²⁰ Gibson, *op.cit.*, pp. 78-83.

²¹ See Gibson, *op. cit.*, pp.17-23.

²² Not all companies feared fuller disclosure. Gibson and more recently Whittred found that there were some companies that adopted reporting practices well in advance of the requirements. See *ibid* and Whittred, *op. cit.*

²³ It contrasted NSW with Victorian where prospectuses were required to disclose 'all facts that go to a formation of a judgement' on the venture. *The Wild Cat* Sept 1, 1928. While the SSX listing requirements were stricter, companies could and did begin operating, then amend their articles of association before seeking listing.

²⁴ At least one firm of accountants publicly acknowledged this by deciding in 1927 that it would no longer certify to the estimates of future profits in prospectuses. This decision produced considerable debate and comment. On one side it was argued that certification of profit forecasts protected investors against truly amateur statements, but conversely it was clear that at least in the case of a new venture even certifiers had little data on which to base a judgment. See *The Wild Cat*, July 2, 1927

²⁵ Gibson, *op. cit.* p. 57.

²⁶ *Op. cit.*, 5 Feb., 19

²⁷ Rydge, *op. cit.*

²⁸ There was one, largely ineffective, attempt by 20 Sydney brokers to create an underwriting consortium in 1937. See Salsbury, *op. cit.*, pp.284-5

²⁹ Their main targets were government and semi government securities and the larger public companies.

³⁰ *Ibid*, p. 279

³¹ The Melbourne SX was not so restrictive, allowing advertising as well as investment trusts in the interwar period, but the majority of Melbourne brokers also appear to have been quite conservative in their practices. The major difference was that two Melbourne brokers - J. B Were & Son and later Ian Potter & Co - challenged conventional practices, while Sydney brokers for the most part seemed to accept the status quo.

³² Central Milk and Freezing Company Ltd, *Jobson's Investment Digest*, 1923

³³ Baskin, J.B. and P. J. Miranti, 'A History of Corporate Finance', Cambridge University Press, 1997.

³⁴ *Jobson's Investment Digest*, 1940, p.141

³⁵ See for example Cox Bros (Australia) Limited, *The Digest Yearbook of Public Companies*, 1938, p.78.

³⁶ *ibid*, p 250

³⁷ Akerlof discusses the problems of information asymmetry and the need for signals. Engers highlights the need for the signal to be costly for low quality firms to duplicate, in order to get a separating equilibrium. See Akerlof, G.A., 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism', *The Quarterly Journal of Economics*, 1970, and Engers, M., 'Signaling with many signals', *Econometrica*, 1987.

³⁸ See the section titled 'Points for Investors' which offered advice for investors in most 1927 issues of *The Wild Cat Monthly*

³⁹ Commercial Discount Finance and Investment Company of Australia Ltd, *Jobson's Investment Digest*, 1923

⁴⁰ In allocating companies to ANZSIC sector and industry, we used the company's own description of its activities at the earliest date possible. On some occasions this description was available only a decade after it initially listed. Where the description covered two sectors (such as the common pairing of manufacturing and merchanting) it was normally allocated to the sector with the highest value added. While this most certainly overstates the activities of some companies, it represents the image they were portraying to the equity market

⁴¹ However, prior to 1936, NSW shareholders did not know how much debt was secured by the real estate

⁴² Myers uses a parallel argument in relation to information asymmetry with creditors. See Myers, S.C., 'Determinants of Corporate Borrowing', *Journal of Financial Economics*, 1977.

⁴³ *Digest Yearbook of Public Companies*, 1930 p.108 and 172

⁴⁴ *Digest Yearbook of Public Companies*, 1939

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