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Stockholders and Management

THEIR OBLIGATIONS TO EACH OTHER AND TO THE PUBLIC



REMARKS OF EMIL SCHRAM · President of the New York Stock Exchange,

before THE ECONOMIC CLUB OF DETROIT · January 15, 1945 ...

A

s I look over this audience, and consider our subject, it occurs to me that the business which I represent may have more customers here than any other business. Not all of you patronize the same store—I am sure not all of you drive the same make of automobile. But it is a fair guess that most of you own securities listed on the New York Stock Exchange.

You are vitally interested in the obligations of the New York Stock Exchange to management and to stockholders; you are also vitally interested in the obligations of stockholders and management to each other.

Of course, the supreme obligation which today faces the whole nation is to maintain confidence, fearless and unshaken, in our commanders and our men—and in our complete victory.

These have been trying days—grim, terrible days. The taste of military reverses, such as we have not known since Bataan and Corregidor, is bitter in our mouths. One of our deadly enemies has broken out of our ring of fire and steel and lashed back with unforeseen cunning and strength. This has upset our time-table of victory in Europe. The consequences to the nation should not be underestimated. The consequences to suffering Europe, hoping for rescue, are past calculation.

These are days above all days to stand fast, to keep our confidence strong and unflinching. None of us doubts the final triumph of our arms. Our commanders—military, naval and in the air—have been tried in the fire of three years' war, and have presented us with matchless victories. Shall we, secure in our civilian ease, complain in dejection merely because total victory has not arrived as soon as was expected? That would be conduct unworthy of the heroism of our fighting forces.

We expect reasoned, responsible questioning. Our wars are run by professional soldiers of great ability, but our civilian government, representing all the people, still is in supreme command.

And so I say let question be raised, but let confidence, fundamental confidence, be unshaken.

Let us strip this nation to the bone, if that will give us victory.

Let us have confidence that our commanders, our men, will win this war.

Let us attend to our duty.

And now may I recall you and myself to a consideration of our obligations to each other, the performance of duties in our own spheres. These make their several contributions to national security both at this present moment and as they must in the peace which will surely come.

In sober fact, throughout this tremendous crisis of our national life,

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nothing has been more remarkable than the instinctive and immediate confidence of the nation in final victory. Nothing has done more to shatter the hopes of our enemies.

Our confidence in war must be carried forward into peace.

Confidence in time of peace is the confidence that provides an atmosphere in which a vigorous and productive national life can be lived. That is the only atmosphere in which business undertakings can be carried forward successfully.

Confidence is based upon responsible performance. The people of this country will have confidence in government, confidence in management, confidence in the Stock Exchange, confidence in the stockholder owners of business enterprises, in proportion as the people observe, and as they believe, that these groups perform their duties responsibly, that they fulfill their obligations to each other and to all the people.

This statement introduces principles of moral conduct operating as rules of restraint in all of our inter-relations.

Shall it be thought strange if in such a discussion as this I present the claims of moral restraint and moral leadership? It may, indeed, seem strange to a group of new economic theorists in our midst. These theorists would view with cynical unbelief any voluntary restraint upon the pursuit of self-advantage. Under their theory, the business man is helplessly obligated to pursue his own economic advantage, indifferent to the restraints which considerate human beings, in a modern civilization, employ in their conduct.

This cynical theory would place a large class of our citizens, the business men, on a level with the barbarians we are fighting. It is precisely the Nazis and the Japanese who have adopted, as their national and personal policy, the unrestrained pursuit of economic advantage. To this end they have employed enslavement, destruction and cruelty unspeakable.

Those who accept this theory, and their number is not inconsiderable, naturally demand that the business man shall work in chains. He must be held down by the severest rules, and his profits must be redistributed to the rest of society. It is a vicious doctrine of class warfare introduced into our free nation.

Speaking for the sections of the financial and business community that I know best, this theory of unrestrained pursuit of personal advantage has no application whatever. Our community has no franchise, no privilege, to conduct itself differently from the rest of its fellow human beings. Its members do not believe that they have any such franchise.

Speaking for management in general, as I know it, I deny and repudiate a theory which would declare it devoid of moral responsibility. The

observed conduct of management displays a constantly higher sense of responsibility.

The time to reflect upon the mutual obligations of management, of stockholders, of government and of finance, is now. Pressures that are building up could provide the causes of later catastrophe if we are complacent.

The most important area in which preparation for peace, and for a sound post-war economy, lies not in our factories and in our banks, but in our minds. This is the true area of urgency.

We are apt to assume that confidence rests entirely upon stability, upon that which is unchanging. At least we know that the laws of Nature, the fertility of the soil, certain qualities of human nature throughout the centuries, are not changed.

But is that our only reliance? Do we believe in a dynamic society, or in a frozen society? It seems to me that confidence rests also upon change, and this city provides one of the mightiest examples of the change which produces confidence.

A significant change in national living was produced first here in Detroit when suddenly, in the age of steel, steel was made to take on universal mobility. Steel was put on wheels—for use by everybody.

The men of Detroit who faced the gigantic change to war had confidence that they could meet this change, because already they had met changes of the first magnitude in peace-time.

Today our armed forces advance on the wheels you have made, fire your shells from your guns, rain down your bombs upon the enemy from the airplanes you have helped to build.

Whatever changes may be required in converting from war to peace, we have confidence they will be made.

We have confidence that our economy will remain dynamic. Only a dynamic economy can give high-level employment.

Today we are considering three fields particularly in which responsibility is needed as the basis of national confidence—the responsibility of management, the responsibility of security-holders, the responsibility of the financial community. And whether the people as a whole are actual or potential owners of securities, we have to consider the whole people as concerned with the inter-relationships to which I have alluded.

It is a good thing, before you talk about other people, to take a close look at yourself first.

The New York Stock Exchange, which I have the honor to represent, is only one among a great many financial institutions. But directly or indirectly, considering the use made of its facilities by individuals in

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the purchase and sale of securities; by banks, life insurance companies and the like, and by listed corporations, it is used by more people than any other financial institution.

It is the nation's principal market for securities.

We can take great pride in the fact that only free nations permit their securities markets to function freely in times such as these. The United States and England have kept their markets open throughout this war. The Secretary of the Treasury, Mr. Morgenthau, declared on the floor of the Stock Exchange, not so long ago, when the war was in a critical phase, that he knew of nothing which would better demonstrate to our enemies how strong this country is financially than to keep the New York Stock Exchange and other exchanges open.

This was evidence of confidence in high places, and we know today how well that confidence was justified. The markets in these nations have been, all along, free to reflect their appraisal of all the factors in their complex economies.

In contrast, the Axis nations, which made slaves of their own people before undertaking the enslavement of others, muzzled their markets, virtually suppressing them, not only to prevent the free flow of capital but to stifle any expression of those terrible apprehensions which the doomed nations have long felt.

But our moments of deadliest peril—the Battle of Britain, Dunkirk, the bare respite at Alexandria, Pearl Harbor, even those grim days of the Nazi break-through in Belgium—have not interfered with the open, orderly conduct of our free markets.

Our market today, as a matter of fact, is reflecting our confidence in the survival of the free system under which our business is done and our lives are lived, as well as confidence in victory.

What good use do we make of our freedom?

Manifestly, its position requires that the New York Stock Exchange perform responsibly. What can be said of its present performance?

The mechanism for the open establishment of prices by the public on our market has been worked out over a period exceeding one hundred and fifty years. It functions with smoothness and speed. This is the result of effort by men, by human beings trained to their task. I have high admiration for them.

As a result, a great body of opinion as to present-day values and prospects, centers in this one spot. It is the fairest system, I believe, that sincere men, men of good will, can devise.

At many points in the operations of the industry of finance, as in any large human undertaking, the opportunity is present for selfish or improper

conduct. All those points are well known. They are marked, like dangerous traffic intersections, with records of great volume safely handled—and with an occasional wreck.

Traffic officers and traffic lights will not prevent all accidents. People themselves must be careful. They must accept and practice responsibility.

The Exchange has machinery for preventing accidents. The rules of the road, both those made for us by government and those we have made ourselves, are constantly in our minds. There is no chance of their becoming dead letters—they are very live and they are honored in the observance. Where our rules and policies are abridged in any way, we take appropriate action.

The very essence of Stock Exchange principles is the disclosure of facts as the only sound basis upon which to pass judgment as to security values. Our member firms have invested large sums of money in research for preparing and analyzing factual information relating to the securities on our trading list. Those who scorn factual information and who conduct their operations on the basis of tips, rumors, hunches and impulses are misusing our facilities. They contribute to market instability and they render an absolute disservice to our general economy.

All groups, whether comprised of members of the financial community, of industrial and business managers, of labor, of investors or speculators—and of Government—have a direct responsibility, one to the other and to the public. Danger arises for any of these groups when it begins to entertain the feeling that it is isolated from others, that it is the judge of its own behavior and, finally, that it is privileged to make exceptions, in its own favor, to principles of conduct which apply to other people.

Here, I repeat, is the danger. We of the financial community can guard against it, first, by upholding high standards of ethics in every conscience and every corner, and, second, by exposing ourselves to constant scrutiny from those to whom we are responsible.

We do our utmost to run a well-ordered market. Ours is a serious business, a necessary part of the machinery which supplies capital to business so that business can supply jobs. The Exchange provides, in the interest of the public, a great many safeguards—too numerous to mention here.

The Stock Exchange, by very reason of the fact that it conducts a free market, is constantly exposed to certain dangers. One of the greatest of these dangers is that its facilities may be misused. Recognizing this danger and being jealous of its reputation, the Exchange has taken many precautions. Among these is a rule which requires that our member firms know their customers and the circumstances of these customers.

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I mention this rule for the purpose of emphasizing, as I have often done in the past, that anyone who is unwilling to inform himself as to values, or have some competent person inform him, or who cannot afford to take risks, should stay out of the market.

There is another type of business we do not want. Let me say it with a clearness to be understood by everyone: we do not want race-track money. I am not suddenly taking a pious attitude about horse racing. But we have seen so much in the newspapers recently to the effect that this type of money is now going to come into our market that I wish to make a passing comment. My point is that money which ordinarily would be wagered on horse races does not belong in our market. Mind you, I have no intention of reflecting discreditably upon the "sport of kings" when I say this.

Our purpose is to provide a market place that merits the confidence and use by responsible people—a market that helps the flow of money into business, so that business can provide goods for consumers and jobs for workers.

Now what shall be said of the responsibilities of management, and I refer particularly to the managers of publicly-owned companies.

The triumphant performance of American management in this war has brought to it a high degree of public confidence. It is no more than management has deserved.

When we enter the peace, I believe the public, which eagerly expects merchandise improved under war techniques, will desire not only to buy these goods but to buy into them, to buy into the companies that make them.

The public may prove more optimistic than management on the question whether profits will be ground small between taxes, the upper millstone, and wages, the lower. Accustomed to seeing management perform miracles, the public may expect a miracle of profits under impossible handicaps.

Let us talk frankly and often about making a profit.

Certainly profits have to be made if jobs are to be provided. Ability to show a reasonable profit is the acid test of success and of usefulness. All Americans know this. The people of this country have no respect for a deficit.

The relations between the financial community and management are necessarily numerous and close. These relations have already had the effect of increasing public confidence in the corporations listed on the Stock Exchange. Management has, in most cases, been cooperative with the Exchange in the many measures mutually agreed upon as in the public

interest. I might mention as an example the full and regular disclosure of pertinent information concerning the financial condition and operations of listed companies. Agreement to make this disclosure is a prerequisite to listing.

The task of persuading corporations that disclosure is needed, that it is in the public interest and in their own interest, has sometimes been difficult. This is understandable. A business man, particularly if he has been responsible in the past to himself or to a few owners, does not like to reveal his intimate affairs. But when he needs other people's money in his business, he has to take them into his confidence.

A thesis, set forth with ominous emphasis a dozen years ago, declared that, in the modern corporation, management was divorced from stockholders; and in consequence was responsible to no one. Stockholders, according to this thesis, had no practical method of enforcing their will upon management, or even of learning what was being done with their money.

However little this thesis may have been accepted, no one of us can afford to pass lightly over its implications, or its possible impact upon the public mind.

A power vacuum will not exist. Nature will abhor it as promptly as any other vacuum. Power from some source will rush in, and the state may be tempted to supply that source.

I have no sympathy with this whole thesis that management is not responsible. I consider it shallow and unrelated to realities.

But let us recognize frankly that we have a new situation on our hands, containing problems that are far from being solved, among them the problem of responsibility to owners.

Widespread ownership of corporations is hardly more than two decades old. It is one of the soundest things that could happen to the country. It distributes wealth. It mobilizes the savings of many for giant achievements. It has created a new type of professional manager of a competence hitherto unknown in economic history—of vast usefulness to society.

If, with these benefits, widespread ownership also presents problems, let us approach them with confidence that they can be solved.

Government itself in two World Wars has undertaken to educate the people to becoming security owners. A direct result of the first undertaking was a nation-wide ownership interest in corporate enterprises. The second undertaking already has created 80 million stockholders in government—owners of War Bonds.

The nation must find means of teaching these people how to be responsible owners of these bonds, how to hold them so as to realize their

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full value, how to guard against schemes to swindle them out of them. The way to protect the people is to inform them.

The problem of consulting owners of securities is not simple. Management in a small business can readily consult a few owners. But government with millions of bondholders and management in a corporation with thousands of stockholders must rely upon broader informational methods.

Making the corporation report truly readable and informative to the average stockholder is one answer to the problem. Some corporations have succeeded admirably in this direction. Others supply only meager information. Still others, even before the war, issued their reports later than seemed warranted.

The examples of the few can be commended to the many. Trained and responsible executives of top rank can well be assigned, as a major duty, to the task of maintaining relations not only with the public, but with security-holders.

Such measures are an essential element in the democratic process. Their greatest virtue lies in accustoming management to its public function, in keeping constantly before its eyes the duty to make frequent and lucid accounting to owners and to the public. Thus management is safeguarded from the dangers of isolation, among the most important of which is the possible encroachment of the bureaucratic state. Any pains taken by management to prevent this are well bestowed.

Nor are these mere idle fears. The temptation of management, under some conditions, to become bureaucratic cannot be overlooked. Then arises the danger to which I have already referred, the danger of feeling privileged to depart from principles of conduct which apply to others.

The sense of direct responsibility to the public must at all times pervade the management of every publicly-owned corporation. Stockholders sometimes complain, and sometimes with justice, that management gets paid and they do not. They question the size of salaries. They want dividends. After all, they own the business. Perhaps management has been too modest in failing to make its value and competence known to stockholders.

If owners are told how the business is run, and the results are satisfactory, the owners will not be ungenerous to management.

I wish to make the point, with full emphasis, that if anybody is the friend of the security-holder, it is the New York Stock Exchange. He is the customer of our membership.

We are also the friend of management, not less than of the stockholder. As stockholders understand the responsible performance of management, their confidence is increased.

What shall be said of the stockholding public? In what way can they strengthen the basis of confidence? Let us encourage practical, thoughtful public attitudes in owning securities. This means, among other things, doing business with responsible brokers.

How to own securities and manage investments is not well understood by many people who want to own them and who will own them. The Exchange frequently gets letters from people saying they have life savings of a few hundred or a few thousand dollars and want advice as to how to invest the nest-egg and get a good return. Our member firms, I am told, also receive such letters.

There is but one answer, "Buy War Bonds." That is sound advice for anyone, but particularly for the new and inexperienced investor of small means. The experienced investor does not need that advice. His portfolio will show a large percentage of his capital invested in Government securities.

But even experienced investors do not always act responsibly.

Stockholders too often disregard the efforts of management to give them information. They do not read reports, they do not return proxies, they do not attend meetings even when they easily could do so. Too many stockholders do not behave like responsible owners of property. They refuse their share in the democratic process as much as does the citizen who refuses to vote.

Our task, however, is not to find fault, but to find remedies. If the public should learn as much about owning and managing securities as it has learned, for example, about Victory Gardens, the public welfare would be served. If it was a national asset that city folks should know how to raise corn and tomatoes, and worthwhile to run a great public educational campaign about it, we might find some value in a program to teach folks how to own and manage securities intelligently and thus make a contribution to national wealth.

To be sure, the investor faces many uncertain factors in the movements of security markets, just as the farmer faces frosts, floods, droughts, corn borers, weeds and weevils. I am a corn farmer by trade, and so I can speak from experience.

Man is an animal who has to use judgment and take chances, no matter what he does. But the more he knows, the less he risks. All possible information should be marshalled for the benefit of security-holders. That has been a principal objective of the New York Stock Exchange for a great many years.

This nation will soon require venture capital, in very large amounts. The welfare of the people will depend upon the flow of such capital into

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business enterprises, to expand our economy and provide high level employment. The mass savings of the nation have been mobilized for this purpose before, and they will be so mobilized again.

Responsible performance by the industry of finance, by the managers of business enterprise, and by stockholders, each in their spheres, will form the basis of confidence. As performance is improved, confidence is increased.

I have spoken about these three areas of private obligation and responsibility, because, in my belief, if the various groups in our economy perform responsibly, less opportunity will be afforded those who would supersede private performance by an all-encroaching state.

So, I say, let us all fulfill our obligations with a high sense of responsibility so as to increase national confidence.

In the atmosphere of that confidence the nation will be better equipped to face the difficult tasks of peace. The confidence that has sustained us in battle must be carried forward into the difficult period that lies ahead.