FROM "BOOM" TO "BUST," THE DECLINE OF
THE "BUSINESS PREEMINENCE" CONCEPT

by

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Two events of the 1980s will put into perspective the potential of utilizing business lessons from the past such as the "Roaring 20s" or the "Depression 30s." First event: Ronald Reagan was no sooner reelected by a landslide victory on Tuesday, November 6, 1984, than the stock market started to slide with a small decrease beginning on November 7. The Security & Exchange Commission was open on Election Day -- a most unusual event in itself -- and saw an almost 15-point increase on the Dow Jones Industrial Average to 1,244. It also turned out to be a day of brisk volume with over 100,000,000 shares being traded.

The second event: Four years earlier the Republican challenger Ronald Reagan defeated incumbent President Jimmy Carter. In January 1981, shortly before Reagan's inauguration, there was a flurry of activity on Wall Street. First, the Dow Jones Industrial Average (DJIA) exceeded 1,000 for the first time in four years, a long-awaited goal. Yet it triggered a two-day series of events which were manifested by a decrease in the DJIA to 964, a loss of approximately 4 percent (a \$40-billion "paper loss"). During this period a record 93,000,000 shares of stock were traded on a single day (the other day saw sales of 56,000,000 shares). This significant decrease was blamed on a single analyst's comment in The Granville Market Letter when he advised his readers "sell what you have..." Are there comparisons from the past which can be made with these two events?

Examples of recurring events in America business history should help. (The Wall Street Journal noted this cyclical pattern in "The Business Cycle Endures" by Alfred L. Malabre, Jr., on the editorial page of November 1, 1984.) Using our "20/20 hindsight" we can go back fifty years or more and review the 1920s (a prosperous time) and the 1930s (a depression time) and look for the comparisons.

This overview looks at the 1920s from the business point of view. The hope would be to see if lessons could be learned that might assist in preventing a similar financial disaster in the future.

A 1930s university student studying the business collapse which began in October 1929 might hear the words of some venerable professor report: "The crash came and the bottom fell out!" Discussions might be exchanged between student and teacher, but the vague generalities of the times and the catastrophic collapse of the business world would do little except develop acute negative viewpoints. Researchers have spent years reviewing the background and sifting through the ashes of the economic failure to produce meaningful logic of what caused the crash, what actually occurred, and the unfortunate aftermath which we refer to as the "Great Depression."

The 1920s were indeed buoyant and blithe. Positive business attitudes prevailed. If a lawyer or doctor were told he had a "good head for business," it was a fine compliment. If a witness in a Congressional Hearing had made a significant contribution to the committee in progress, the chairman might compliment the witness with an observation that the testimony was "business-like."

In 1925 Bruce Barton wrote a best seller on the life of Jesus Christ entitled The Man Nobody Knows. In his enthusiasm, the author used the business language or jargon of the times with the term "sales pitches" instead of the old "parables" or "Bible stories."

During the 1920s the idea of mass producing hard goods had caught on so successfully in this country that European authors, who were pursuing concepts of nationalism, were writing about mass production providing the answers to national goal questions. Between 1921 and 1929 output in this country doubled by using the new mass production methods and with no significant increase in the size of the labor force. Electric power increased by 19 times between 1902 and 1929, setting the stage for the electric light and power industry to expand greatly and provide a fertile field for mergers, combinations, and integrations to form gigantic companies. Banking, as one might expect, would keep up with the times in expansion efforts. Huge segments of the railroad industry and the entertainment industry were held together during the 1920s with the thin thread of wiring diagrams known as holding companies. Growth was the key, and keeping up with the movement, across the nation was the chain store expansion of retail grocery outlets which backed up into an expansion of the nations's meat packers, stockyards, food processors, and cannaries.

These material benefits would now spill over into personal fortunes which would be glamorized by F. Scott Fitzgerald or acrimoniously detailed by Thorstein Veblen. Yet the personal fortunes were only one side--the personal consumption side. Another side showed that the country was spending twice as much on libraries and three times as much on hospitals as had been spent before World War I. The world of education also benefited from the world of business. All these expenditures were necessary in view of the departure of the "vanishing philanthropists" who were no longer around to build and donate libraries for the benefit of local communities or donate organs to churches. The money was rolling in, the cash registers were ringing up sales, and on the other side of the ledger the expenditures were constantly increasing with businesses' and governments' assumption of social responsibilities. America, which had ended World War I with a national debt of approximately \$26 billion reduced the deficit by \$10 billion during the Roaring Twenties. It would total only \$16 billion at the end of the decade. (Reduction of the national debt was later suggested by Keynes': "spend in a weak economy, save and pay back when times are good!")

But there were signals of doom along the way. In the mid-20s the "land bubble" burst in Florida, which was a major catastrophe for the developers and speculators who had invested.

Bernard Baruch, author and financier, withdrew from the stock market and advised others to do the same in 1928. Joseph P. Kennedy, an immensely successful investor, also departed from the market in 1928 and invested in bonds and more secure investments. Numerous financial authors and counseling services noted the capability of business reversals--among them, Paul Warburg, a financial advisor; a writer of the New York Times, Alexander Dana Noyes; Colonel Leonard P. Ayres of the Cleveland Trust Company; and the investment counselor, Roger W. Babson. The latter, in a Labor Day speech in early September 1929, noted the weaknesses in the marketplace and predicted a decrease of the Dow Jones averages by about "60 points or more" and used the expression "a serious depression." This speech created a break on the market, the "Babson Break," as it would be called. Unfortunately, Mr. Babson was taken to task by the analysts of the time who were predicting more blithe, buoyant things for the marketplace. The market weakened, steadied somewhat, but continued to be irregular. Even a sharp break on the London Stock Exchange following disclosure of a stock promotion fraud did not discourage "sympathetic reaction," with funds moving not to New York but the reverse. That is, funds moved from America to England to support the London Stock Exchange, even after the unfavorable press reports persisted.

The stage was now set for economic and business problems which had not been anticipated, either in the financial districts of the large urban centers in America, or in capitals of foreign governments.

The flow of money seemed easy and plentiful. The fact that this sea of funds was deep enough to engulf investors and speculators alike might not have been considered. The instability of the situation was identified as "opportunity" not "peril."

A word on "margin" buying of the time frame is appropriate here. A speculative buyer with exactly \$100 would not buy exactly one (1) share of stock selling at \$100. Rather, the speculative framework of the time would dictate a margin purchase. Only 10 percent of the price need be paid. Therefore, this speculative buyer would use his \$100 to buy ten shares of stock selling at \$100 (not one share). Actually he/she only owned the top 10 percent of the stock, but if it is appreciating in value, who would worry about reverse leverage?

A "very weak" market is how business historians usually describe the situation after mid-October 1929. Finally on Wednesday, October 23, the ticker tape ran over one hundred minutes late and reflected sales of over six million shares--almost half of which were traded in the final hour.

The next day, Thursday, October 24, 1929, has been best described as "hysteria day" because of the wild rumors sweeping Wall Street and other financial centers concerning suicides of individuals "wiped out" by stock price declines. The earlier example of buying stock on a 10 percent margin indicated that if the stock declines, the stock broker could call the buyer and ask that more margin be paid to cover the 10 percent. If more dollars were not forthcoming from the buyer, the stocks were

"sold out from under him." This same problem of margin calling occurred recently in the late 1970s; however, one must recall that the percentages of margin purchases are different today. In any event, almost thirteen million shares were traded on Thursday, October 24, 1929.

On Friday the market steadied but fell again on Saturday. Another decline occurred on Monday with a volume of over nine million shares changing hands. The stage was set for Black Tuesday, October 29, 1929, when a record of almost sixteen-and-one-half-million shares were traded. Announcement of a shortened session Thursday and closing of the stock exchange on Friday and Saturday followed.¹

Within the first month following "the crash," the "paper losses" exceeded \$30 billion. In spite of a slight upsurge from time to time (the early months of 1930, for instance), there was a continual slide downward until mid-1932; finally the low point of the drop was ultimately attained in July 1933 when the "paper losses" exceeded \$74 billion. (It is not recommended that one use the term "paper losses" when discussing the crash with people who lost heavily in the stock market during this time.) As the business year of 1933 began the Dow Jones industrial stock average was 62.7.

If the 1920s are seen as a time of upsurge in the marketplace (one exception was the 1921 post-World War I recession of some significance), the 1930s are viewed as a time of dismal depression. It is called the "Great Depression." The post-World War I period was a time of rapidly changing systems, in America and abroad. Old solutions did not fit new problems. The prosperity of the 1920s was unevenly felt. The dependence on an industrial system was obvious. Manufacturing output increased by 4.5 percent per year, but employment increased by only 1 percent per year. This was due to newer mass-production techniques--Henry Ford's workers took 14 hours to assemble a Model-T Ford, "Tin Lizzie," in 1913; but by 1914 they took only 1 1/2 hours. There was only a modest 1.6 percent pay increase per year for the workers. Still more and more new production lines and plants were built from profits generated to produce more and more goods which could not be purchased by the consumer. By some standards it appeared to be a problem of overproduction, in actuality the problem of underconsumption was the more serious. Some mention of installment buying will remind us that credit purchases were virtually unheard of in pre-World War I. By 1929, eager sellers extended an estimated \$7 billion worth of credit to eager buyers without cash. Therefore, if cash sales could not be made, then credit sales were registered, but there were not enough!

Where were the signs? What "economic indicator" might have forecast the financial debacle? Why? How? Serious scholars of real estate history will note the post-World War I period as one of intense activity in residential construction. But the market for new homes was satisfied by the mid-1920s. Also, if auto sales fell by one quarter in the late 1920s, the market for auto accessories would fall, too. Many of these areas are watched more closely today, and are highlighted in

periodic publications of the economic indicators by the U.S. Department of Commerce. Accounting students would now note the emphasis placed on the income statement today whereas in the earlier days it was the balance sheet that was considered more important for purposes of financial analysis.

A keen analytical mind avoids a recital of the "causes" or "reasons" for the "Great Crash of 1929." There were so many reasons, some related closely, some sequentially triggered by another event, and some mutually exclusive of others, but in concert all had an exceedingly deleterious and debilitating impact on the business economy and inevitably would lead to the "Great Depression of the 1930s." Most authors review the impact of the bad or uneven distribution of income of the American population. Many authors note that bad or top-heavy corporate structure and the troublesome banking practices (straight-line mortgage notes, for example). Some authors compare the "tricks of the trade" in this period with the old time "con artists" of earlier years. Even the valued reference of Walter Bagehot and his 1873 edition of Lombard Street (London's version of Wall Street) permit a perceptive reader the chance to see that, where chicanery and trickery are concerned, no parameters are set; the gullible are taken advantage of or bilked of their money in almost any era. The old Latin saying, Caveat Emptor or Let the Buyer Beware does have value. And finally many authors conclude that we are not utilizing our analytical ability to recognize the newer 1920s problems. But if the problems could be articulated, then to use the same old solutions without trying to find better solutions is indicative of being too stereotyped to make progress.

But whatever the reasons or causes for the Crash and Depression, the cold business facts are irrefutable--Gross National Product, the measuring yardstick of growth within the United States, fell from \$104 billion in 1929, to \$58 billion in 1932. National income, fell \$40 billion, from \$81 billion to \$41 billion, in effect cut in half. The industrial production average, taken for the years 1923-1925 to average the 100 base, first went up to 119 (1929) and then to 64 (1932). Over 85,000 businesses failed in the first three years following the crash. One out of four workers was unemployed, reflecting the 25 percent unemployment totals. Unemployment statistics are usually difficult to determine during times of business stress, and the 1930s were no exception.

If the male bread winner was unemployed, the wife would be job hunting (or the other way around). Children of unemployed or partially employed parents would be dropping out of school and seeking employment. [In mid-1980 the average civilian and government workers concerned themselves with hopeful pay increases in order to keep up with inflation in the 17 to 18 percent range. Compare this situation with subject with the subject material here where even the most secure employee would accept wage reductions just to maintain employment. As a matter of fact, shortly after President Franklin D. Roosevelt took office (March 4, 1933) the Congress passed the Economy Act of 1933 which reduced the pay of every government worker, both

military personnel and civilian employees, from the President of the United States to the most recent private, by fifteen percent (except for Supreme Court Judges).] The period of "business preeminence" had come to a halt. Faith in the American free enterprise system was shaken.

A decade of Americans have been born, raised, and educated in this crucible or testing area known today as the Great Depression. The Americans have learned the bitter lessons of self-discipline, matured and then "carried the country through the rigors of World War II and into the post-war prosperity." And finally these individuals, as years progressed, assumed leadership and managerial roles and made decisions to lessen the probability that another depression would arrive on the scene. They suggested honesty, thrift, frugality, industry, dedication, and loyalty to all within earshot so the lessons learned were not forgotten, lest we repeat our depression experiences. The final point to be made is: can each of us learn something from the past financial problems which have been encountered? Or do we ignore the lessons of business history, gain nothing from the past, and run the risk of repeating the financial disaster all over again. As the late President Harry Truman repeated so many times in rephrasing George Santayana (who first wrote, shortly after the turn of the century): "One who does not understand his/her history is doomed to repeat it."

ENDNOTE

1. While the sale of sixteen-and-one-half-million shares was a significant amount by 1929 standards, this "record" has been eclipsed any number of times since then.