Australian Equity Markets, Asymmetric Information and IPO Investors in 1920s.

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Paper presented at Asia Pacific Business and Economic History Conference, Sydney, 12-14 February, 2007

The impact of asymmetric information on today's arm's length equity markets is well understood. Although managers disclose considerable information to the market through standardised, audited financial statements and ad hoc notifications, they still have more and better information than arm's length investor/owners. Investors thus face the risk of making poor investment choices and, once they make their choice, they face the risk of managers performing in their own interests rather than the interests of shareholders. These risks are higher for new ventures raising capital through initial public equity offerings (IPOs), although signals and screening can reduce the costs[1]. In the 1920s, when arm's length equity was beginning to emerge as an important source of funds for many companies in NSW, disclosure was essentially unregulated and asymmetric information posed a much greater deterrent to arm's length investors. IPO investors faced the greatest risk, with some floats designed only to feather the promoter's nest.

There are a number of case studies of Australian firms that were able to overcome these imperfections and raise enough equity to build a successful firm. Some relied on private networks to raise capital but others raised funds from anonymous or arms' length investors. The petrol distributor Ampol, for instance, sold its shares to anonymous investors as well as to its petrol re-sellers.[2] There has also been some research on the role of new financial instruments, especially preference shares, and role of equity market intermediaries and their institutions in the development of the equity market. But we know almost nothing about who the equity investors were, other than that they were individual investors, rather than institutions, prior to the 1950s. These individuals were just as much pioneers as the firms they invested in; and they had neighbours, friends, and families – people who were likely to have similar wealth and income levels and similar risk preferences. By sharing their experiences, the pioneers could influence the perceptions of a much broader potential market. Yet we do not even know who the actual investors were, or why they invested. Were they wealthy individuals who could afford to bear the high risks of the early equity market? Or, were they ordinary Australians who were simply attempting to improve their lot, or perhaps provide an income for retirement, but who did not understand the risks they were taking? This paper addresses these questions by constructing an investor profile for one IPO, Australasian Motor Investment and Finance Company Ltd (AMI&F). First, the paper outlines the investment environment in NSW in the 1920s to establish the context in which AMI&F made its IPO, then it considers the specific risks faced by investors in this IPO, before determining who invested and why they invested. The paper concludes with a postscript on the outcome of the float: suffice to say that it was not a happy ending for investors.

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[1] W. G. Sanders & S. Boivie, 'Sorting Things Out: valuation of new firms in uncertain markets', *Strategic Management Journal,* 25 (2004), pp. 167-186

[2] Colin Simpson, *Show Me a Mountain: the rise of an Australian company* (Angus & Robertson, n.d.)

I

NSW passed its first Companies Act regulating the incorporation and conduct of limited liability companies in 1874. The NSW act was modelled on the English acts and provided model articles of association including the requirement that the company keep true accounts, but companies could modify these model articles in ways that provided investors with little, un-audited financial statement information. The English acts gradually introduced compulsion but NSW registered companies were not required to disclose standardised and audited accounts until after the more stringent 1936 Companies Act. [3] Thus, as the NSW equity market began to develop in the 1920s, potential investors had minimal statutory entitlement to financial statement information. The Sydney Stock Exchange attempted to improve the market's information by specifying higher levels of disclosure as a condition of listing but both it and the government faced compliance problems. The deficiencies were especially great in respect of the profit and loss statement, although the high level of aggregation in many balance sheets also limited their utility for investors. Instead, dividend history was used as a signal of investment quality. Unfortunately it was a poor signal with weaker performers able to maintain high dividends over extended periods at the expense of accumulating depreciation funds and reserves for doubtful debts.[4]

Preference shares gained in popularity in the NSW market in the 1920s because they appeared to economise on the need for financial statement information about each investment.[5] These shares had a specified dividend rate and ranked ahead of ordinary shareholders in the payment of dividends and capital, so were initially thought to provide low downside risk to both income and capital. However, by 1927 the Australian markets began to appreciate that preference shares could have high downside risks.[6] To evaluate these risks investors needed to know about the firm's liabilities, structure of its capital and its profitability – information that investors in ordinary equity also needed to make informed investment decisions.

If imperfect information posed a barrier to investment in seasoned equities in NSW, investment in an IPO to form a new venture represented a step into the unknown. IPOs posed three main sets of risks.[7] First, those who subscribed faced the risk that others would not, and that the venture would be undercapitalised. There were no regulations in NSW in 1920s governing the minimum subscription necessary to trigger allotment. Nor did NSW have genuine underwriters in the 1920s who could supply the funds by taking any

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[3] See R. W. Gibson, *Disclosure by Australian Companies (*Melbourne University Press, 1971) on the disclosure requirements of the various Australian Companies Acts. See Diane Hutchinson & Philip Lee,' Disclosure, Imperfect Information and the Development of an Equity Market', Paper No 61, Fourth Accounting History Conference, Braga, 2005, http://www2.eeg.uminho.pt/4ahic/conf_papers.htm
[4] 'Leaky Company Laws', *The Wild Cat Monthly,* September 1928, p. 395. See also 'The Vestibule" *The Wild Cat Monthly*, March 1925, p. 65
[5] See Hutchinson & Lee, *op. cit,* for data on the proportion of companies issuing preference shares in the 1920s
[6] See 'Points for Investors', *The Wild Cat Monthly,* May 1927, p. 201 and 'Preference Shares', *The Wild Cat Monthly,* June 1927, p. 245. By July 1927 this journal was advising investors that preference shares could be 'a delusion and a snare'. See 'Points for Investors', *The Wild Cat Monthly,* July 1927, p. 295.
[7] See N. B Rydge, *The Australian Stock Exchange,* (Rydge's Business Journal, 1934) p. 93, who used different terminology but essentially presented the same points to explain why investors had 'fallen victim' to astute IPO promoters.

unsubscribed securities on their own account and placing them at a later date.[8] In the extreme case, the entire subscribed capital in an unpopular IPO could be eaten up by floatation and establishment costs. The more common case was where companies raised enough capital to begin operating but not enough to fully implement their business plans, so that even potentially viable ventures were hamstrung by lack of capital. However, investors also faced a second risk: that the venture might not be potentially viable. And third, they faced risks due to asymmetric or private information held only by the promoters of the venture about factors that could impact on the venture's actual performance: whether the venture was being established in a way that would allow it to meet its potential; whether the promoters' or their nominee directors' had the expertise to manage the company and their strategies.

IPO promoters in Australia in the 1920s made extensive use of travelling salesmen - 'go-getters' or share hawkers - to sell shares in their IPO. The contemporary press was of the view that some share hawkers grossly misled investors in order to make sales, and indeed their commission payments did provide an incentive for them to sell at any cost. However, NSW promoters did not need to rely on share hawkers to guild their lilies. They could do this themselves through the Prospectus which *The Investment Digest (Jobson's)* argued gave 'virtually no protection for the investing public' in NSW.[9] *The Wild Cat Monthly* put the position more bluntly claiming that in NSW Prospectuses could contain 'statements that [were]…grossly misleading, if not absolutely false, without serious danger to the men who made them…..Even experts often cannot test all vital assertions [in the Prospectus]…Only the promoters know whether they are lying.'[10]

Promoters used the quality and reputation of Directors to signal managerial ability and operational viability, but in reality this was a weak signal. Directors eminent in one field were not necessarily equipped to operate in another, and their fiduciary responsibilities were poorly understood in the 1920s. Investors today use information on the rewards to IPO promoters and their nominee directors to infer whether they have an incentive to place the company on a sound footing and to manage it well. However, in NSW in the 1920s, promoters were not under any obligation to disclose any benefits that were not the subject of a contract at the time the Prospectus was issued. Even with contractual benefits, promoters were only required to provide a list of contracts and the signatories to these contracts.[11] They were not required to provide any details on the nature of these contracts. Investors could visit the offices of the company's solicitor and ask to see the contracts, so the information they contained was public information. Yet it was very costly public information, especially for non-metropolitan investors who had to add substantial travel costs. There was also the barrier for ordinary investors of interpreting any information contained in legal documents.

By the mid-1920s there were two Australian journals (*Jobson's) Investment Digest* and *The Wild Cat Monthly* which lowered the costs of obtaining public information on some IPOs.

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[8] Some Sydney brokers began to provide very small scale underwriting services in the 1920s, and twenty of them attempted to create a consortium to underwrite larger issues in 1937 but this was ineffective. Specialist underwriters with the resources to deal with large issues did not emerge in NSW until the 1950s. See Stephen Salsbury and Kay Sweeney, *The Bull, the Bear and the Kangaroo: the history of the Sydney Stock Exchange* (Allen & Unwin, 1988) pp.284-5

[9] See 'Company Law Reform Imminent', *The Investment Digest*, September 1925

[10] 'Leaky Company Laws', *The 'Wild Cat' Monthly*, September 1928, pp. 395-6.

[11] By contrast, even in the 1920s Victorian Prospectuses were required to disclose 'all facts that go to a formation of a judgment' on the venture (*The Wild Cat* Sept, 1928, p.395.).

Both journals inspected the contracts relating to some IPOs and reported on their findings. Some of their comments were clearly constrained by the threat of libel and readers needed to learn to read between the lines, but they certainly provided some key information on some promoters' benefits, allowing investors to draw inferences about the likelihood that these ventures would be established and operated in a way that would best serve investors' interests. The reports did not make this information freely available. If investors wanted to avoid NSW IPOs with contracts blatantly designed to provide short term benefits to promoters, they needed to subscribe to and regularly read and learn the nuances of both journals since neither investigated all IPOs. Of course even this would not protect them against cases where the promoters' benefits were more subtle or not the subject of written contracts.

In this environment, IPOs were high risk investments. *The Wild Cat* argued in 1927 that 'in every four [new ventures] there are three that can't make enough to warrant payment of a dividend.'[12] In commenting on specific IPOs, *Jobson's* and *The Wild Cat Monthly* also emphasised the risks to investors and seldom gave strong support. More normally they advised that investors should obtain more information. Yet the key information investors needed was private information. Even genuine promoters of potentially viable companies found it difficult to convince anonymous investors that they were not lying – that the IPO represented a good investment. Those who could draw on their social and business networks to more credibly disclose information about the value of an IPO were in a better position to raise the necessary capital, but not all promoters had access to these networks. They were forced instead to call on the anonymous market. The investors who answered the call pioneered the development of the arm's length equity market just as much as the companies they financed. Yet we do not know who these investors were who made arm's length investments in high risk IPOs.

The investment journals in the 1920s believed that there were different types of investors with different risk preferences, some of whom were willing and able to accept high risks for the chance of high returns. For instance, *The Wild Cat Monthly* in its investment advice columns of the later 1920s repeatedly drew a distinction between the 'man of means' who could afford to make high risk investments, and the 'widow' or 'man' with limited capital who needed a steady return and *The Wild Cat Monthly* believed that, compared to the US and the UK, the Australian equity markets were the 'little investor's paradise', with a wide range of relatively safe equities available for 'the man who cannot afford to lose his capital'.[13] Yet the advice they and *Jobson's* gave reflects a belief that many small investors did not follow their advice – rather that they speculated or gambled by investing in high risk stocks with neither income nor capital security. *The Wild Cat Monthly* believed this was especially likely among small rural investors who, it implies, were likely to be swayed by the 'go-getters' that brought new ventures to their notice, but who found it more difficult to obtain the information needed to make good investments.[14] Given the risks inherent in IPOs, we would not expect the informed 'widow', or indeed the informed man, who needed income security, to invest in these securities. Rather, if investors understood the risks of IPOs, we would expect it would be the relatively wealthy who invested in them. In the next section we consider the public information available to investors in AMI&F to provide the context for evaluating the nature of the specific risks of this IPO, and in the following section we draw on the data investors provided in their share applications, as recorded and

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12 *The Wild Cat* , 5 Feb., 1927
13 'Points for Investors', *The Wild Cat Monthly*, April 1928, p. 154
14 'The Vestibule', *The Wild Cat Monthly*, November 1928, p. 483

submitted to the Sydney Stock Exchange in 1929, to determine who they were and consider why they invested in this IPO.[15]

II

Australasian Motor Investment and Finance Co Ltd (AMI&F) was registered in 1926 with an authorised capital of 100,000 in £1 10% cumulative preference shares and 400,000 in £1 ordinary shares. In its Prospectus, it invited the public to invest in both classes of shares on a contributing or partly paid basis of 10/- per share.[16] The Prospectus stated Directors were of the 'opinion … *that it will not be necessary to call up the balance of 10/- per share'* but this counted for nothing. Legally investors would be liable to pay the remaining 10/- if called to do so.[17]

Business viability

AMI&F's Prospectus addressed the important issue of potential viability. It stated AMI&F's purpose - to provide hire purchase finance for consumer durables, especially motor vehicles - and presented data on the value and volume of motor vehicle chassis and body imports for the period up to the 1924-5 financial year in an effort to demonstrate the growth in this market. [18] This data actually showed that the dramatic growth in imports had occurred in 1923-4, with some decline in 1924-5. Nevertheless, the total number of motor vehicle imports represented a sizable potential market. The Prospectus also pointed to the profits made by another firm in this market to support its claims that AMI&F would be a viable venture. This naturally raised the question of competition. The Prospectus acknowledged that there were already several established hire purchase firms and others just being established, but argued that there was room for more. It also revealed a contract with British Motors that would provide AMI&F with an assured market of up to £4,000 per month, and presented an innovative plan to win other business, by offering deposit accounts (paying interest above the savings bank rate) to potential durable purchasers, and selling insurance on commission. It advised investors that it planned to also take out bank loans – essentially leveraging shareholders funds by borrowing cheaply (with uncalled equity as security) and lending at higher hire purchase rates.

Overall AIM&F presented a potentially viable business proposition for ordinary equity investors: it was entering a recently expanded industry with few but profitable established competitors, a contract to provide an initial market share and an innovative plan to win other business and the possibility of leveraging low cost bank debt, as well as preference share capital. Even the financial press could not really challenge the potential viability of this venture. *The Investment Digest* pointed out that the promoters' case rested on limited evidence -the volume of motor sales and the profits of other companies - and emphasised that AIM&F would face competition. *The Wild Cat Monthly* pointed out that the British Motors' sales contract would not be enough: AMI&F's would also have to 'join in the

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[15] Share register, *Australasian Motor Investment and Finance Company Limited,* Sydney Stock Exchange Company Papers, Held by Discipline of Accounting, University of Sydney

[16] *Prospectus: Australasian Motor Investment and Finance Company Limited*, 1926, p. 1. in Sydney Stock Exchange Company Papers, Held by Discipline of Accounting, University of Sydney

[17] The alternative was to forfeit their shares, but if the company went into liquidation within 12 months their unpaid calls would be considered one of the company's assets to be recovered by the liquidator.

[18] The Prospectus added an estimate for other consumer durables such as pianos, and on the assumption that 70% of consumer durable sales were provided under hire purchase, argued that there was a market for approximately £6m in hire purchase finance.

general hunt for business' but it acknowledged that this was a profitable and growing industry. It cautioned that there had been a growth in both hire purchase supply as well as demand, and believed there must be a 'saturation point' somewhere, although it ceded this was not likely to be reached quickly in 'good seasons'.[19]

This raised the issue of macro economic risks, since consumer durable purchases and hire purchase repayments are sensitive to employment and income levels. The volume of new loans could be expected to fall in an economic downturn and the number of defaults could be expected to rise. However, AMI&F's Prospectus was at pains to emphasise the protection against capital loss in the hire purchase business because the finance provider retained title to the durables until the loan payments were completed. This undoubtedly was one of the strong points which encouraged investors in both ordinary and preference shares. However, there were other risks stemming from asymmetric information.[20]

Asymmetric Information - Are the promoters lying? Do they and the Directors know how to run a hire purchase firm? Will they act in shareholder's interests?
The actual performance of AMI&F would depended heavily on the way in which the company was established and managed. Investors who consulted the Prospectus would have seen a number of reassuring but unenforceable statements about strategy, including that the company's capital will always remain in a 'liquid state'; that the "Directors will pursue a most conservative policy on investing', and that application to list the shares would be made 'as early as possible'. There were also assurances about the quality of AMI&F's management. The Prospectus lauded the attributes of its Board, arguing that it 'will inspire the confidence of the general public, consisting of men who have been eminently successful in other spheres of business and whose names are held in highest regard individually and who can be looked upon as capable and willing to devote their time and attention to ensuring the success of the business'.[21] Yet the only effort to add credibility to this statement was a list of the four directors' occupations: Merchant & Investor, Director of a firm of timber merchants, Grazier, and Factory Representative for a Bristol motor company (the last occupation being that of the managing director). Only the grazier appears to have held a position on the board of another public company[22], so there is little here to reinforce claims that these men knew how to run a hire purchase firm. In conclusion the Prospectus advised that 'Investors may place their capital in the Board's control with the full assurance that the affairs of the Company will be closely attended to and their interests carefully guarded. '

Investors would have been well advised to look for further assurance in the form of both the directors and promoters' incentives to act in investors' interests. However, AMI&F's Prospectus provided little relevant information on who stood to benefit and how they would benefit from this IPO. It did not even state who the promoters were. The only hint came from a statement that the solicitor was to receive 10,500 fully paid shares and a contract identifying that the four directors, the auditor and the solicitor himself were to receive shares issued to the solicitor. Investors simply reading the Prospectus had no way of knowing who was behind this float or what benefits they stood to gain. By making a visit to the solicitor's office to inspect the contracts, or by reading *Jobson's*, investors could

[19] *The Wild Cat Monthly*, Sept. 4, 1926, p. 258
[20] The risk that AMI&F would not be able to effectively implement its business plan due to undercapitalisation was relatively low. The nature of its business meant it could and did begin operating in 1927 on a small scale in a limited area, with only a very small amount of capital.
[21] Prospectus. *op. cit*., p. 4
[22] *Jobsons' Year Book of Public Companies,*1928

have considerably expanded their information set. After examining the contracts, *Jobson's* reported that the auditor was to receive 1,000 shares and the solicitor himself another 1,000, but the main beneficiaries were the four directors who were to receive 2000 shares each, in return for their services for the first year. *Jobson's* refers to these shares as vendor shares, implying that these 6 men were the promoters.[23] This was potentially a valuable benefit at a time when investors could buy a new brick bungalow in suburbs such as leafy Chatswood or the more convenient Ashfield for around £1,000![24] *Jobson's* was highly critical, stating that the vendor shares represented a 'handsome reward' for their single identifiable contribution – provision of a contract for up to £4,000 of hire purchase business per month. However, *Jobson's* also revealed that the directors were each to purchase 500 shares – a sizable upfront investment of their own money. After the Prospectus was circulated it was reportedly agreed that the vendors' shares would not be issued until after initial ordinary shareholders had received a 10% dividend.[25] The vendor shares would dilute other investors' equity. However these vendor shares, along with the Directors' own applications, did provide the Directors with an incentive to ensure that the company could and would pay at least one ordinary dividend and to ensure that company appeared viable, at least in the short term. But since they could sell their shares, they had no reason to ensure that the company was placed in a viable long term position. Indeed to the extent that they could create the appearance of viability by building business through high risk loans or by paying dividends at the expense of making provision for doubtful debts, their interests would conflict with those of less well informed investors.

Jobson's also revealed the details of another contract which provided quite different incentives. It reported that Options Limited had been appointed broker for AMI&F's share issue, at a rate of 10% of the nominal value of the shares or 20% of the subscribed capital, from which it only had to pay the costs of the prospectus, salesmen and advertising. Who owned Options and gained this generous reward? *Jobson's* checked the company register and reported seven owners of whom it named only the AMI&F company secretary.[26] Readers of *Jobson's* thus had ample warning that someone (likely the promoters) automatically benefited handsomely by selling as many shares as possible, irrespective of how viable a foundation they created. But investors who read only *The Wild Cat Monthly* would have been no more well informed than the investors who simply read the Prospectus.

The 'go-getters' undoubtedly portrayed AMI&F's shares as an opportunity to invest in the early stages of a company which offered the prospect of good returns and low risks. Investors who understood the risks posed by new ventures may have thought differently. If they viewed only the low cost information disclosed in the Prospectus they would have gained little reassurance that the promoters & directors could and would create a viable enterprise. Those who obtained the higher cost information disclosed by *Jobson's*, and understood its implications, would have perceived that the promoters/directors/brokers had reason to get the company off to a good start. The claim that the shares would be listed at the earliest opportunity – an act that would serve the promoters interests as well as

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[23] 'Australasian Motor Investment and Finance Company Limited', *The Investment Digest,* August 1 1926, p. 423-4

[24] See *Sydney Morning Herald*, 5 January 1928

[25] See *The Investment Digest*, August 1 1926, p. 424 and *The Wild Cat Monthly*, Sept. 4, 1926, p. 258. British Motors was also to receive 500 shares in return for a contract to provide finance for their trucks.

[26] *Jobson's* reticence undoubtedly was due to the fact that was highly critical of the 'heavy price' extracted through the brokerage deal, although it may also have felt constrained by Alex Jobson's role in a competing hire purchase company. See *The Investment Digest*, August 1926, p. 424

investors in allowing an easier exit - might also have provided some reassurance. However, there were no credible indicators that the promoters and directors knew how to run a hire purchase business.

The ordinary shares carried greater upside and downside risk than the preference shares but the reality was that AMI&F preference shares were also a high risk investment relative to other preference shares. This was reflected in the preference dividend rate of 10%, at a time when 8% was the norm for established companies. There was no guarantee AMI&F would be able to make enough profit to pay any dividends. The structure of capital was also unknown. The Prospectus stated the company's authorized capital: £400,000 in ordinary shares and £100,000 in cumulative preference shares, which may have reassured investors that there would be sufficient ordinary share backing for the preference shares. However, *Jobson's* revealed other, high cost, public information on the size of the IPO that painted a different picture. It reported that the broking agreement was for an IPO of only 100,000 shares of which up to 40,000 could be preference shares, creating the potential for a relatively highly geared company.[27] While *Jobson's* was becoming critical of preference share issues by 1927-8, it did not comment on the gearing implications in the case of AMI&F but those who were regular readers would have realised the implications.

Investors in both classes of shares had to judge the prospects of AMI&F, and they also had to make the related judgement about the likelihood of being called to pay the remaining 10/- per share. The low amount of capital AMI&F needed to start business, and that it actually begun to trade in 1927, eliminated the greatest danger to investors: that the IPO was an outright fraudulent one. But it nevertheless remained a high risk investment relative to established companies. If investors understood these risks, we would expect only the more affluent people who could afford the downside risk, to invest in this IPO. The more affluent were also those more likely to have obtained the high cost information which provided some assurances about the risks due to asymmetric information.

III

AMI&F received almost 500 applications for shares between June 1926 and June 1929. Many investors made multiple applications. In addition, 81 applicants invested in both ordinary and preference shares, reducing the total number of individual investors to 258, as shown in Table 1. If we exclude the 6 individuals involved in promoting the company, plus their broking vehicle, this leaves 251 independent investors, comprising 215 households, who judged AMI&F a worthwhile investment.[28]

Table 1: AMI&F: Share Applications

	Applications	Applicants	Households
Preference shares	205	132	114
Ordinary shares	286	207	182
Prefs and/or ords	491	258	221

[27] 'Australasian Motor Investment and Finance Company Limited', *The Investment Digest,* August 1 1926, p. 424

[28] This and all subsequent data on applications and applicants is derived from Share Register, *Australasian Motor Investment and Finance Company Limited,* Sydney Stock Exchange Company Papers, held by Discipline of Accounting, University of Sydney. In subsequent tables we exclude the four directors, auditor, solicitor and the broker, Options PL

Table 2 shows that these investors came predominantly from NSW, supporting our view that equity markets were more regional rather than national in the 1920s. However, almost 30% of investors did come from other states. The low proportion from Victoria – the second most populous state – may well reflect Victorians preference for local IPOs, based on their awareness that their companies' acts gave them better protection. The relatively high proportion of investors from regional areas is consistent with *The Wild Cat Monthly*'s view that investors in these areas were vulnerable to 'go-getters'. This is reinforced by the geographic clustering of investors – the strongest example of this is the Lismore/Casino region, including a number of very small settlements to the west. This is a relatively small area, but it provided almost a quarter of all NSW regional investors. While this clustering suggests the area was an effective go-getter's territory, equally it may have resulted from personal information networks, with friends, colleagues, and extended families discussing investments. There are certainly other examples of this: the only three investors from Port Pirie all had the same occupation of metallurgist; neighbours in Campsie and in Lithgow invested; and members of extended families invested. But these ordinary Australians were unlikely to have had any critical private information they could pass on to help evaluate this investment.[29]

Table 2: Investors' Locations[30]

	METROPOLITAN	REGIONAL
NSW	120	71
QUEENSLAND	4	23
VICTORIA	12	1
SA, WA & TAS	7	10
NZ	1	2

We cannot gauge the affluence of rural investors from their place of residence, but urban addresses are potentially more informative. People choose the suburb they live in for a range of reasons, including amenity, convenience, family, community and inertia, but income and wealth set a ceiling on their choices. If our investors were relatively wealthy and/or had relatively high incomes, we would expect to find them concentrated in the most affluent suburbs. The 1933 census provides data on the relative affluence of different local government areas. Taking £260 pa or £5 pw as the threshold income for affluence, Table 3 shows that Sydney local government areas were differentiated by the proportion of male breadwinners earning over this threshold in 1933. The census data clearly reflects the unequal impact of the 1930s depression, with poorer local government areas recording higher unemployment as well as lower average incomes among those employed, but there is no reason to suppose that the broad ranking of local government areas would have been greatly different in the late 1920s.

[29] The only exception may be the two principals of the timber company for which an AMI&F director was also on the Board.

[30] The metropolitan region has been broadly defined to include the market garden hinterland of each capital city.

Table 3: Sydney Investors' Local Government Area, ranked by male breadwinner's income (1933)

Income level (% of male breadwinners earning >£260)[31]	No	%
1.Poor : (>10%): Alexandria, Annandale, Auburn, Balmain, Bankstown, Botany, Darlington, Ermington, Erskinville, Glebe, Granville, Holroyd, Leichhardt, Lidcombe, Mascot, Newtown, Paddington, Redfern, St. Peters, Sydney, Waterloo	20	17%
2. Moderately Poor (10-19%): Bexley, Canterbury, Drummoyne, Eastwood, Enfield, Homebush, Hurstville, Kogarah, Marrickville, Parramatta, Petersham, Randwick, Rockdale, Ryde, Waverly	43	36%
3. Moderately Affluent (20-29%): Ashfield, Burwood, Concord, Dundas, Hunters Hill, Lane Cove, Manly, North Sydney, Willoughby	23	19%
4. Most Affluent (>30%) : Ku-ring-gai, Mosman, Strathfield, Vaucluse, Woollahra	15	12%
Other:		
Work address	12	10%
Sydney regional: Castle Hill, Baulkham Hills, Liverpool, Blackheath etc	7	6%

Table 3 shows that, contrary to our hypothesis, only a small proportion (12%) of AMI&F investors lived in the most affluent areas. Vaucluse, the most affluent area of all, was home to only one investor. Some of the 12 (10%) of investors who gave a work address may also have lived in the most affluent suburbs, but its likely that more did not.[32] It was not even the next ranked, moderately affluent, areas that provided the majority of investors – rather it was the areas we have classified as moderately poor. Even the very poor areas supplied a healthy 17% of investors. The addresses of our investors clearly cast doubt on our hypothesis that it was the most affluent who invested in high risk IPOs in the 1920s. This is reinforced when we focus on the big investors: those investing over £2,000. Three were from poor or moderately poor areas (Mays Hill, Marrickville/Petersham, Pyrmont) and two (husband and wife) were from moderately affluent Haberfield.[33] However, local government areas could include suburbs with different average incomes and wealth. And even poor suburbs had pockets of relative affluence, with larger houses often on a hill.

To evaluate whether AMI&F investors were in fact a cross-section of Australians, and included many people of moderate means, rather than the most affluent as we expected, we turn to the occupations they stated on their share applications. Occupation, along with inherited wealth, has a major bearing on employees' disposable income. Occupation provides less insight into the affluence of the self employed or those of 'independent means', but these potentially are among the more affluent, along with the higher income

[31] Classification of local government areas derived from data in Peter Spearritt, 'Sydney at the Census, 1911-1976, in Jill Roe (ed.) *Twentieth Century Sydney* (Hale and Iremonger, 1980), p. 266
[32] Four of these investors appear to have family connections to other investors, and in three of these cases the families live in moderately affluent or moderately poor suburbs. In only one case did the family live in a most affluent area.
[33] See Table 6 for more information

earning occupations such as medical practitioner, solicitor and manager. However, share applicants were only required to pay 2/6 of the 10/- per share on application, so it is likely that some inflated the status and income earning power of their occupation to demonstrate their ability to meet subsequent calls. Thus, in classifying investors' occupations, any choices we have made have been to also bias upwards the income earning power of the investors. For instance, any occupation which had the potential for self employment was classified as such. Table 4 shows that the potentially self-employed did form a sizable 28% of male investors. Farmers and graziers made a strong contribution but so too did urban activities such as wholesale and retail trades. However, those with the highest income earning potential - professionals and managers - together provided less than 10% of male investors. Similarly, the retired and those of independent means – potentially wealthy investors – together comprised less that 10% of the male total. Even with the upward bias in classifications, all these occupations which had the potential for greatest affluence together account for only half the total number of male investors. The remainder had other wage and salary earning occupations.

Table 4: Investor's Occupation Category

Occupation category	*Males**	*Females***
Domestic service/home duties		43
Investor/independent means	7 (4%)	1
Retired	11 (6%)	
Self Employment		
farmer/grazier	13	
horticulture	4	1
motor trade	6	
other retail/trade	15	
other self employment	12	2
Total:	50: (28%)	
Professional	10 (6%)	1
Managerial	6 (3%)	
Other employees & commission sales	89 (50%)	12
Not stated	6 (3%)	12
Total Independent Investors	179 (100%)	72
Directors, solicitor, auditor & broker	7	0

*Includes 6 joint applications by husband and wife
** Females as sole applicants (including those whose application was made by a trustee)

To gauge the relative affluence of the big group of wage and salary earners, the maximum annual income was calculated for each of their occupations, using 1928 award wages. It is true that award wages specified the minimum rate but by 1927-8 it is unlikely that many employers paid more than the minimum required. We have continued the upward bias by making the heroic assumption that each employee was paid for 50 weeks per year, and by using the maximum possible award wage. For instance all bank clerks or bank officials are assumed to been working for 17 years and so have been at the top of the scale for this occupation. The results are shown in Table 5, with employees allocated to income ranges.

Table 5: Other Employee Occupations

Maximum Annual Award Income Range[34]	*Number of males*	*Number of females*
<£200		1
£200-299 pa	16	2
£300-399 pa	23	9
£400-499 pa	33	
>£500pa	3	
Sales (commission)	7	
Unclassified	7	

The most interesting aspect of Table 5 is the dominance of the middle income ranges. At the top of the scale, there were few award occupations with incomes over £500 p.a. so the paucity of investors in this the top category – two town clerks and the master of a large junction railway station - was to be expected. The biggest number of investors was classified as belonging to the £400-499 p.a. income range. They mostly had white collar occupations such as bank officials, school teachers, clerks, and a book-keeper. Many of these, especially the clerks, likely had lower incomes than £400 but were classed as having the highest attainable award here. The next category, with an estimated income of £300-399 p.a. included skilled occupations such as colliery deputy, engineer, engine fitter, master chair-maker, carpenter and draftsman, as well as others such as jackaroo and miner who were classified here because of the possible influence of their remote location. These are not the most poorly paid occupations but they do represent a cross section of the more moderately paid occupations in Australian society. The number of investors with a maximum income in the range £200-£299 p.a. is surprising. This was a quite modest income, an included those with occupations such as labourer (2), linesman, engine driver, fireman, night officer, gardener, and steward. At the bottom of the scale, an income of less than £200 p.a. left little disposable income for investment. Only one investor – a general labour/laundress who made 2 very small investments each of 5 shares – was placed in this income range.

Many of these investors' relatively modest incomes were reflected in the size of their investments. Most of those with incomes under £200-299 applied for under 100 shares, while most school teachers and bank officials applied for less than 300. There were exceptions whose potential liability exceeded their estimated annual income. These included the linesman who applied for 400 shares and the colliery deputy and schoolteacher who each applied for 600. This suggests that at least some employee/investors were drawing on independent wealth, perhaps accumulated through past investments or through a bequest. Yet it is hard to escape the conclusion that they and many other employees who financed their investments from their disposable income were simply ordinary wage and salary earners with quite low or modest incomes.

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[34] Award rates used to calculate maximum possible annual income are those in *NSW Statistical Register, 1927-28*, Sydney, 1930, pp. 296-305

Only 11 of the AMI&F investors had retired by 1929. Of these, an hotelier, an orchardist and a builder listed their previous occupation, while a blacksmith, a teacher, and second hotelier only retired after their first application. Again, these were middle income occupations, not those of the elite. What does differentiate these investors is that they were able to retire, whereas many of our other investors were likely still trying to build the means to retire. The size of the retirees' investments also put several of them among the largest shareholders, as shown in Table 6.

Table 6: Top Investors (≥£2,000), ranked by size of investment

Investor	*Gender*	*Occupation 1*	*Occupation 2*	*Address(es)*
No. 1	Male	Hotelkeeper	retired	Guyra/Bondi
No. 2	Male	Builder	retired	Haberfield
No. 3	Male	Labourer	investor	Pyrmont
No. 4	Female*	domestic duties		Haberfield
No. 5	Female**	Tailoress	confectioner	Marrickville/ Petersham
No. 6	Male	Teacher	retired	Harden/ Drummoyne
No. 7	Male	Investor		Mays Hill

* Wife of Investor No 2
** Most likely the sister of AMI&F's managing director

The teacher and hotelkeeper began with a small investment while still working but made more and larger investments after retiring. The hotelkeeper, like the builder, was either very successful or, like the teacher, had access to other resources to have made the scale of investment that they did. But they did not retire to the most affluent of suburbs. Rather, they invested at least some of their wealth in AMI&F shares. These moderately affluent retirees were the very ones who should have been wary of high risk IPOs. That they did appreciate some of the risk is evident in the very distinctive structure of their investments. As Table 7 shows, all but one of those who had retired by 1929 invested at least some of their funds in preference shares.

Table 7: Occupations and Structure of Investment

Occupation/income categories	*No.*	*% with ords only*	*% with prefs only*	*% with both prefs & ords*
Domestic duties	43	26%	48%	26%
Investors/Indep. means	8	38%	37%	25%
Retired	11	9%	9%	82%
<£300 pa	19	58%	16%	26%
£300-399	32	62%	16%	22%
£400-499	33	46%	18%	36%
£500-599 & Managers	9	55%	22%	22%
Professional	11	64%	9%	27%
Self Employed	53	51%	23%	26%

Professional investors, those of independent means and those with domestic duties also favoured preference shares, indicating their concern with down-side risk although, unlike retirees, many of these investors also took some ordinary shares. By contrast, Table 7 shows a much higher proportion of investors in all the employed categories took only ordinary shares. The investment behaviour within some households indicates that this was a deliberate choice influenced by income earning potential, with the male taking ordinary shares but females in the same household taking preference shares. The popularity of ordinary shares among employed investors is fairly uniform. There is no real difference between the most affluent occupations and the most poorly paid – a high proportion of all categories took only ordinary shares to maximise their up-side rewards.

Whether these investors could evaluate the downside risks is the more vexing question. It is conceivable that the more affluent investors understood the general dangers of IPOs, and had access to the high cost information on the risks of this IPO, so they appreciated that the promoters and/or directors did have an incentive to get this venture off to a good start. Yet the further down the income scale we go, the less likely this becomes. While Australia had relatively high and evenly distributed incomes, an investment journal seems unlikely reading for a labourer, gardener or laundress, or even for a coal miner, poultry farmer or orchardist. But for those who did not read the investment journals regularly, the risks due to asymmetric information were very high indeed. Weak disclosure requirements meant they did not even know who was promoting this IPO, nor how the promoters stood to gain. Perhaps these investors had a low aversion to risk: perhaps they were prepared to risk their capital against even a small chance of good returns? More likely, they did not really understand the downside risks of the equity market.

IV

In its first two years of operation, AMI&F recorded good profits but returned almost all this profit to shareholders through dividends, rather than building up reserves for doubtful debts or writing off establishment (brokerage) costs. From 1930 it recorded trading losses and bad debts due to the depression, perhaps exacerbated by its loans policy. The losses and brokerage costs absorbed almost half the subscribed capital, so that once AMI&F returned to profitability in 1934, its earnings were restricted by the limited amount of capital it had for profit making activities. It struggled to earn enough to even pay preference dividends.[35] Meanwhile the high ratio of preference to ordinary capital had imposed relatively high fixed dividend obligations, and the arrears accumulated as a liability.[36] A conflict of interest between ordinary and preference shareholders prevented acceptance of either a takeover offer or one of several reconstruction proposals so AMI&F limped on until durable purchases were curtailed in the early 1940s.

Those who invested in AMI&F ordinary shares in the hope of high returns were sorely disappointed. The company paid an ordinary dividend of 10% in 1928 and 1929 but did not pay any dividends thereafter.[37] Ordinary shareholders had limited scope to sell because, despite a commitment to the contrary, ordinary shares were not listed on the Sydney Stock Exchange and they gradually became 'worthless'. The only good news for ordinary shareholders was that they were not called to pay the outstanding 10/- per share to fund the company's liabilities. Those who invested in preference shares fared only a little better with a 10% dividend in 1928 and 1929 and 5% in 1930, but they did not receive

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[35] *The Investment Digest*, December 1934, p. 571 and January 1936, p. 40

[36] AMI&F's preference issue proved relatively attractive, with subscriptions for 37,000 partly paid preference shares by June 1929 raising £18,500, while there were subscriptions for less than 50,000 partly paid ordinary shares, raising under £25,000.

[37] The first dividend payment should also have served as the trigger for the issue of 10,000 fully paid vendor shares but it seems an arrangement for a lesser reward had already been negotiated.

another dividend until 1938 and 1939 when 5% was paid on each occasion. Preference shares were listed in mid-1929, so perhaps some preference shareholders were able to sell, but as early as December 1929 the market had heavily discounted their 10/- per share investment, with a price of 7/- per share.[38] Once the arrears on preference dividends accumulated to over 50% of the preference share capital, these shares assumed a speculative (liquidation) value only.

By constructing a profile of investors' residential locations and occupations, we have shown that investors in this IPO were not primarily the most affluent who could bear the downside risks. Rather, the investors had a range of incomes, and included many with relatively low incomes. Our data thus bears out the investment journals' focus on the man and 'widow' of limited means as a substantial part of the equity market and their belief that, despite being unlikely to afford capital loss, these investors were attracted to high risk investments. Indeed, if we are correct in assuming that many of investors with lower incomes had access only to low cost public information, they faced very high risks due to asymmetric information. That many with relatively low incomes nevertheless invested in this IPO suggests that they did not fully understand the risks they faced.

Many of the ordinary Australians who invested in AMI&F were undoubtedly hurt financially by the loss of income and capital. Their experience must have seemed a long way from an investors' paradise. What tales might these investors have passed on to their friends, family and neighbours – other potential investors? Some might have put their losses down to the depression but, if they looked around them, they would have seen that other companies including other new hire purchase companies fared better. There is evidence at least some AIM&F investors thought they had not been well served by the promoters. Three large retiree investors – the school teacher, the hotel-keeper and the builder - took positions on the Board in 1928 ,then took legal advice on whether the company was liable to issue the vendor shares.[39] Whether these and other investors blamed the promoters, or whether they blamed the equity market, it did not auger well for the development of the market.

We have examined the investor profile for just one IPO: AMI&F. Ideally, we would like other case studies, including IPOs that were more risky. Perhaps our small investors, especially those who opted for preference shares, could identify and avoid IPOs with a high risk of abject failure or blatant fraud. Unfortunately, stock exchange listing applications are the only source of investor data, and immediate and abject failures did not reach the stage of making listing application. More important is to analyse the investor profile for lower risk established companies. Did the more affluent shy away from these too? If so, the development of the equity market would depend on attracting these more affluent investors into the market, as well as educating and wining back the less affluent investors. In this respect, the regulatory changes in 1936 can only have helped.

[38] *Sydney Stock and Share List,* December 17, 1929

[39] These directors also oversaw the listing of preference shares, and indeed increased their own investment in preference shares just prior to listing. While they had a strong incentive to make the company viable, they had little expertise in the field of hire purchase or in managing a public company. They made some poor decisions, including the payment of a 10% ordinary dividend in 1929. They left the Board soon after and a new Board began trying to deal with bad debts, although two of the retirees re-surfaced several times with reconstruction proposals aimed at salvaging the company.