

January 29, 1938

MEMORANDUM TO: THE PRESIDENT

FROM: WILLIAM O. DOUGLAS, CHAIRMAN

RE: Financial Problems of Small Business

The memorandums of January 5, 1938, from Lyle T. Alverson, a copy of which I attach, raises some points on which I should like to make some comments of my own.

In the first place, I am not in complete accord with his analysis of the causes for the closure of the capital markets, although I do agree that there are real difficulties standing in the way of their automatic reopening. I do not think, however, that the Securities and Exchange Commission or the registration requirements of the Securities Act of 1933 are any more than minor secondary factors in impeding the flow of capital to industry. The real causes are basic, and as far as the difficulties of small companies are concerned, they existed even before 1929. The growth of such enterprises has, in general, been due either to the reinvestment of earnings or to funds obtained from a limited circle of personal acquaintances or from local investors, rather than from funds obtained through the normal investment banking machinery. Furthermore, quite a considerable number of issues of small or new enterprises have been registered under the Securities Act and attempts have been made by underwriters, distributors and issuers to sell them. Such attempts have, in general, met with poor response. But this is certainly not a result of the Securities Act. Whatever may or may not be the contributing influence of the Securities Act, it is my confident belief that even though that entire Act were scrapped, we would have the same (and even a worse) situation the capital markets as we have today.

In the second place, I do not agree with the specific remedies proposed by Mr. Alverson. But I do think that some steps supplementing the existent mechanism and the archaic investment banking machinery are necessary. These conclusions of mine are based on the study and observation which we have been making of the problems of small industries during the last six months. There is lack of unanimity as to causes and remedies. As you know, we have at the present time some such facilities. Section 5d of the Reconstruction Finance Corporation Act authorizes the Corporation to make loans to any industrial or commercial business "when credit at prevailing bank rates for the character of loans applied for is not otherwise available at banks". And Section 13b of the Federal Reserve Act, as amended, authorizes the Federal Reserve banks to make working capital loans to established industrial and commercial business

which are “unable to obtain requisite financial assistance on a reasonable basis from the usual sources”, and to discount for or purchase from other financial institutions up to 80% of loans of that type made by such financial institutions. I do not believe that the loans so made have been extensive nor of major significance.

I feel that a broader for federal government activity in this field is necessary. It is necessary from the viewpoint of the health and vitality of small business – the backbone of the country. It is desirable as perhaps the cheapest way to alleviate the problems of unemployment and relief.

Accordingly, I recommend that consideration be given to setting up, preferable under the Reconstruction Finance Corporation, a system of industrial banks to service the capital requirements of legitimate small business. I have not endeavored to work out refinements or detail. Such industrial banks might be wholly financed by the government through purchase by the Reconstruction Finance Corporation of their stock; or they might be particularly financed by such method, additional capital being furnished the banks by sale of their debentures to the public.

To be sure, this introduces a venturesome element not heretofore present in the government’s lending and financing policies. But in my judgment the exigencies of the situation justify it.