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INTRODUCTION AND SUMMARY

The growth of direct placements has been one of the most striking developments, since the mid-thirties, in the market for long-term capital. Direct placements are long-term loans made directly to business by life insurance companies and pension and mutual funds.¹

In the thirty-four years from 1900 to 1934, about 3 per cent of all corporate debt cash offerings, or approximately \$1 billion, were directly placed. However, in the ensuing thirty-one years, from 1935 to 1965, 46 per cent, or \$85 billion, were directly placed.²

This growth is shown in detail, both in absolute terms and relative to the growth of public offerings, in Tables 1 through 5. These tables indicate that industrials, utilities, and rails have contributed by no means equally to the total growth of direct placements.

Industrial direct placements have grown by far the most, both in absolute terms and relative to public offerings (Table 2). In recent years they have accounted for more than 70 per cent of all corporate direct placements (Table 5)³ and have constituted as much as 91 per cent of all industrial cash debt offerings (Table 2). Since 1951, they have fluctuated between 46 per cent (1958) and 85 per cent (1951) of all such offerings.

¹ For detailed definition, see below, p. 8.

² The figures for the earlier period were derived from data given in W. B. Hickman, *The Volume of Corporate Bond Financing Since 1900*, Princeton University Press, for National Bureau of Economic Research, 1953. Table A-10. Data for the later period are from *32nd Annual Report of the Securities and Exchange Commission, 1966*. Table 5.

³ Including the issues of finance companies.

TABLE 1

*Total Corporate Debt Cash Issues, Publicly Offered and
Directly Placed, 1935-65*

(dollar figures in millions)

Year	Publicly ^a Offered	Directly Placed	Total	Per Cent Directly Placed
1935	1,840	385	2,225	17
1936	3,660	369	4,029	9
1937	1,291	327	1,618	20
1938	1,353	691	2,044	34
1939	1,276	703	1,979	36
1940	1,628	758	2,386	32
1941	1,578	811	2,389	34
1942	506	411	917	45
1943	621	369	990	37
1944	1,892	778	2,670	29
1945	3,851	1,004	4,855	21
1946	3,019	1,863	4,882	38
1947	2,889	2,147	5,036	43
1948	2,965	3,008	5,973	50
1949	2,437	2,453	4,890	50
1950	2,360	2,560	4,920	52
1951	2,364	3,326	5,690	58
1952	3,645	3,957	7,601	52
1953	3,856	3,228	7,083	46
1954	4,003	3,484	7,488	46
1955	4,119	3,301	7,420	44
1956	4,225	3,777	8,002	47
1957	6,118	3,839	9,957	39
1958	6,332	3,320	9,653	34
1959	3,557	3,632	7,190	50
1960	4,806	3,275	8,081	40
1961	4,706	4,720	9,425	50
1962	4,487	4,516	9,016	50
1963	4,714	6,158	10,872	57
1964	3,623	7,243	10,865	67
1965	5,570	8,150	13,720	59

Note: In Tables 1 through 4 and Table 6, detail will not always add to total due to rounding.

Source: Securities and Exchange Commission.

^aIncludes railway equipment trust certificates.

TABLE 2

*Industrial, Financial, and Service: Total Debt Cash Issues,
Publicly Offered and Directly Placed, 1948-65*

(dollar figures in millions)

Year	Publicly Offered	Directly Placed	Total	Per Cent Directly Placed
1948	271	2,263	2,534	89
1949	459	1,493	1,952	76
1950	165	1,679	1,844	91
1951	458	2,502	2,960	85
1952	1,218	2,886	4,104	70
1953	1,539	2,250	3,789	59
1954	968	2,275	3,243	70
1955	1,622	2,326	3,948	59
1956	1,925	2,875	4,800	60
1957	2,078	2,630	4,708	56
1958	2,544	2,130	4,674	46
1959	1,150	2,233	3,383	66
1960	1,724	2,395	4,119	58
1961	2,252	3,442	5,694	60
1962	1,222	3,678	4,900	75
1963	1,855	4,872	6,727	72
1964	1,217	5,895	7,112	83
1965	2,942	6,685	9,627	69

Source: Securities and Exchange Commission. Figures by industrial class are available from the SEC only since 1948.

Public utility direct placements have grown less than industrial direct placements (Table 3). Since 1950, they have fluctuated between 21 per cent (1962) and 38 per cent (1965) of all public utility cash debt offerings, and have constituted, on the average, about 25 per cent of all corporate direct placements (Table 5).

Rail direct placements (excluding equipment financing) have been negligible both in dollar terms (Table 4) and relative to total corporate direct placements (Table 5).

TABLE 3

*Public Utilities: Total Debt Cash Issues, Publicly Offered
and Directly Placed, 1948-65*

(dollar figures in millions)

Year	Publicly Offered	Directly Placed	Total	Per Cent Directly Placed
1948	2,076	740	2,816	26
1949	1,518	957	2,475	39
1950	1,654	868	2,522	34
1951	1,580	821	2,401	34
1952	1,954	1,017	2,971	34
1953	2,020	971	2,991	32
1954	2,596	1,169	3,765	31
1955	1,969	960	2,929	33
1956	1,932	890	2,822	32
1957	3,697	1,209	4,906	25
1958	3,552	1,191	4,743	25
1959	2,255	1,377	3,632	38
1960	2,888	862	3,750	23
1961	2,326	1,229	3,555	35
1962	3,048	829	3,877	21
1963	2,482	1,237	3,719	33
1964	2,119	1,301	3,420	38
1965	2,369	1,444	3,813	38

Source: Securities and Exchange Commission. Figures by industrial class are available from the SEC only since 1948.

The proximate reasons for the growth of direct placements have been discussed extensively elsewhere ⁴ but some of the consequences of that growth are worth mentioning here.

1. Substantial competitive pressure has been put on investment

⁴ See R. E. Corey, *Direct Placement of Corporate Securities*, Boston, 1951, pp. 51-68 and *passim*. See also A. B. Cohan, *Private Placements and Public Offerings: Market Shares Since 1935*, Chapel Hill, North Carolina, January 1961, pp. 15-24.

TABLE 4
*Rails: Total Debt Cash Issues, Publicly Offered and
 Directly Placed, 1948-65*
 (dollar figures in millions)

Year	Publicly ^a Offered	Directly Placed	Total	Per Cent Directly Placed
1948	618	5	623	1
1949	458	2	460	b
1950	542	12	554	2
1951	326	4	330	1
1952	472	52	524	10
1953	296	6	302	2
1954	440	39	479	8
1955	527	15	542	3
1956	369	12	381	3
1957	344	0	344	0
1958	238	1	238	b
1959	151	22	174	13
1960	194	18	211	9
1961	128	52	180	29
1962	216	9	226	4
1963	381	49	431	11
1964	286	47	333	14
1965	259	22	281	8

Source: Securities and Exchange Commission. Figures by industrial class are available from the SEC only since 1948.

^aIncludes railway equipment trust certificates.

^bLess than one-half of 1 per cent.

bankers, and the cost of flotation of publicly offered industrial and utility issues has declined sharply.⁵

2. Certain types of unconventional ventures have been able to

⁵ The growth of direct placements was only partly responsible for this decline. See A. B. Cohan, *Cost of Flotation of Long Term Corporate Debt Since 1935*. Chapel Hill, North Carolina, 1961, pp. 87-89.

TABLE 5

*Industrial, Utility, and Rail Debt Direct Placements as
Per Cent of Total Corporate Debt Directly Placed, 1948-65*

Year	Industrials	Utilities	Rails	Total ^a
1948	75.2	24.6	0.2	100.0
1949	60.9	39.0	0.1	100.0
1950	65.6	33.9	0.5	100.0
1951	75.2	24.7	0.1	100.0
1952	73.0	25.7	1.3	100.0
1953	69.7	30.1	0.2	100.0
1954	65.3	33.6	1.1	100.0
1955	70.5	29.1	0.5	100.0
1956	76.1	23.6	0.3	100.0
1957	68.5	31.5	0	100.0
1958	64.1	35.9	0	100.0
1959	61.5	37.9	0.6	100.0
1960	73.1	26.3	0.5	100.0
1961	72.9	26.0	1.1	100.0
1962	81.4	18.4	0.2	100.0
1963	79.1	20.1	0.8	100.0
1964	81.4	18.0	0.6	100.0
1965	82.0	17.7	0.3	100.0
Average	73.7	25.8	0.5	100.0

^aDue to rounding, will not always add to total.

obtain financing that would not have been so readily available, and might not have been available at all, elsewhere. The financial institutions are able to provide this "custom tailoring" service because they enter the market as ultimate purchasers (i.e., they are not wholesalers as are investment bankers), and they are free therefore to buy issues on the merits thereof, without regard to whatever fashions, traditions, or prejudices may dominate the *public securities market*.

3. Many small, relatively unknown firms, which would probably

have found the cost of a public offering prohibitive, have been able to obtain long-term debt financing at moderate cost.⁶ The financial institutions are able to provide funds to such firms because they buy for their own portfolios and not, as do the investment bankers, for resale to the general public. An investment banker would only rarely be able to buy a small issue (say, \$500,000) from a small, little-known company without making a high, perhaps a prohibitively high, charge to cover the cost required to sell such an issue to the public.⁷

Purposes of the Study

Although we know enough about direct placements to be conscious of the prominent place they have come to occupy in the market for corporate long-term funds, we have very little systematic information about them. This rather large subcontinent of the capital market is virtually unexplored.

In addition to the aggregate figures published by the Securities and Exchange Commission on total dollar volume, a few series have been published for 1951-58 on average (unadjusted) yields, dollar volume by industrial category, average size, and maturity. But all these series are annual and some of them are, unavoidably, inadequate conceptually; the yield series, for example, were constructed of raw, unadjusted data and, as a result, are far from being homogeneous through time.⁸

The primary purpose of this study, then, is to initiate the

⁶ Bank term loans would be available to such firms for not more than five years. Direct placements are only rarely as short as five years.

⁷ Between 1951 and 1958 the average size, annually, of industrial public offerings ranged between \$28 million and \$70 million. The average size of industrial direct placements ranged between \$2 million and \$3 million. See Chapter 6 for estimates of cost of flotation of small issues.

For further discussion of the pros and cons of direct placement, see Roscoe Steffen, "The Private Placement Exemption," *The University of Chicago Law Review*, Winter, 1963, p. 211, and A. B. Cohan, "Should Direct Placements be Registered?" *The North Carolina Law Review*, February 1965, p. 298.

⁸ See *28th Annual Report of the Securities and Exchange Commission, 1962*, Table 3, Part 4; and A. B. Cohan, *Private Placements and Public Offerings*, pp. 15-24.

collection and analysis of systematic "relevant" data on direct placements by: (1) Constructing series on yields on direct placements which would be homogeneous through time; (2) constructing series on various other aspects of direct placements; (3) making selected comparisons between the characteristics of direct placements and those of public offerings.

Some Definitions

What is a direct placement? For the purposes of this study a direct placement is defined as a long-term corporate security, either debt or equity, sold for cash to a restricted number of institutional investors, without public offering.

The meaning of this definition will perhaps be clearer if the two essential distinctions between a direct placement and a public offering are made explicit. First, in a direct placement the corporate issuer and the (prospective ultimate) investors deal directly with each other, with or without the aid of an intermediary, in establishing the terms of a security issue.⁹ In a public offering, on the other hand, the ultimate purchasers are a widely scattered multitude of individual investors and, although the issuer may attempt to sense their wishes, he does not negotiate terms with them. He either sets the terms himself and then throws the issue on the market, as in the case of a competitively bid utility issue, or he negotiates terms with an intermediate purchaser (in effect with a wholesaler), usually an investment banker.

Second, in a direct placement all the prospective ultimate purchasers must be "sophisticated," which in practice means that their number tends to be small. In a public offering, on the other hand, the prospective ultimate purchasers are in fact the entire public at large.

Issues which satisfy these criteria, i.e., which are negotiated directly with a *small number of sophisticated lenders*, are usually

⁹ Intermediaries help the issuer in about half of all direct placements.

considered as "not involving any public offering" under Section 4 (1) of the Securities Act and, as such, are exempt from registration.¹⁰

The above definition excludes bank term loans and mortgages on business property, and is therefore somewhat arbitrary.¹¹ Both bank term loans and mortgages on business property are sold directly to a limited number of sophisticated investors. Both provide substantial amounts of long-term funds to business, and both are regarded, at least by some issuers, as sources of funds alternative to direct placement.¹²

The distinction between so-called direct placements, on the one hand, and bank term loans and mortgages on business property on the other, is sometimes made in terms of size and maturity: term loans and mortgages on business property are usually small, and the former rarely run over ten years and have an average maturity in the neighborhood of five years. The distinction is sometimes made in terms of the business of the borrower: mortgages on business property are made mostly to commercial rather than

¹⁰ Prior to 1953, the Commission described direct placements as "offerings to a single investor or a small number of investors, the offering being handled directly by the company itself (i.e. the issuer) or by an investment banker. The bulk of private (direct) placements are corporate securities exempt from registration under Section 4 (1) of the Securities Act of 1933. . . ." (Securities and Exchange Commission, *Privately-Placed Securities—Cost of Flotation*, Washington, D.C., corrected printing, September 1952, p. 2). Since 1953, however, doubtless as a result of the Supreme Court's decision in the *Ralston Purina* case, the Commission has tended to refer to direct placements simply as "issues exempt under Section 4 (1) of the Securities Act—that is, issues not involving any public offering," without making clear what, in its view, constitutes a public offering. See 346 U.S. 119 (1953). The Supreme Court said: "An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering'" and ". . . there is no warrant for superimposing a quantity limit on private offerings as a matter of statutory interpretation. . . ."

¹¹ It also excludes, of course, loans made or equity issues bought by small business investment corporations and small groups of individuals, etc.

¹² Financial officers of life insurance companies have been heard to say that many of the business loans made through their mortgage departments could just as well have been made through their securities departments. However, the survey made by the Life Insurance Association of America for the Patman Committee indicated that life insurance companies do not often make really "small" loans through their securities departments. U.S. Congress, House Select Committee on Small Business, "Problems of Small Business Financing," *Hearings*, 85th Congress, 1st Session, November 1957, Part I, pp. 142-170.

to industrial borrowers. It is sometimes made in terms of form: neither the business mortgage nor the bank term loan uses an indenture or a trustee; in the strict sense, therefore, neither is a "security." In addition, the terms of the typical direct placement agreement tend to go beyond the terms of the typical mortgage loan. Direct placements will often, for example, impose restrictions on working capital and the payment of dividends.¹³

The foregoing distinctions, although useful for some purposes, are obviously not essential. All three types of loans are long term and all are negotiated directly between the borrower and a limited number of lenders.

The distinction drawn in this study is simply a practical one. The study covers only those issues bought directly by the securities departments of life insurance companies and pension funds and by other nonbank financial institutions such as benevolent associations and mutual funds. Hence, it does *not* include business mortgages, except to the extent that loans which are in every respect mortgage loans may have been made by such securities departments. And it does not include bank term loans, except to the extent that banks may have taken the first few years of a longer loan, or otherwise participated in a loan with one or more insurance companies or pension funds.¹⁴

Public offerings are defined as issues of any size or maturity sold for cash, either directly by the issuer or by the issuer through an intermediary (such as an investment banker) to the public at

¹³ For a discussion of these points, see Corey, *Direct Placements*, pp. 4, 116-117; and W. B. Hickman, *The Volume of Corporate Bond Financing*, p. 30. The distinction in terms of form is tending to become less important as, for example, the insurance companies seek (and find) simpler ways of doing things. For instance, many private placement agreements make no provision for a trustee.

¹⁴ This is, in fact, the "definition" used in the trade and which underlies the SEC's series on the dollar volume of direct placements. That series is based to a large extent on data obtained from life insurance companies under the designation "securities issues." The SEC does not, of course, examine individual agreements, so that if a large loan closely resembling a mortgage happened to have been made, for one reason or another, by the securities department of a life insurance company, such a loan might well have been reported to the SEC under the designation "securities issues," and if so would have been included in the series referred to above.

large or to the issuer's own stockholders. Public offerings include both underwritten issues and those not underwritten. The latter include both those made without the assistance of an intermediary and those in which the intermediary acts on an agency or "best efforts" basis. With one or two relatively unimportant exceptions (e.g., issues which are sold intrastate), public offerings must be registered with the Securities and Exchange Commission. As indicated above, direct placements need not be so registered.

This study is occupied solely with *pure debt* corporate direct placements. A small portion of all direct placements are equities (Table 6). In addition, a small but increasing portion are debt issues with equity features—convertibility, warrants to purchase common stock, and so forth.

The term debt, as used here, includes debentures, notes, mortgage bonds and notes of whatever kind, collateral trust bonds or notes, notes secured by leases, and so forth—in short, every obligation which would be carried by the issuing company as a long-term liability. The term pure debt, as used here, includes all such debt issues except those with equity features.

To summarize: the phenomena studied are new pure debt issues of maturity longer than one year, bought directly from corporate borrowers by the securities departments of life insurance companies, pension funds, and various other nonbank financial institutions such as benevolent societies and mutual funds. Among these issues are surely some which are indistinguishable in substance, size, or form (or for that matter by any other test) from bank term loans and business mortgages.

The Sample

A very large percentage of all the pure debt corporate direct placements bought in the United States during the period under review were bought by one or some combination of about sixty organizations: fifty-odd life insurance companies, three or four benevolent associations, two or three large pension funds, and one large

TABLE 6
Direct Placements Sold in the United States, by
Type of Security, 1935-65
 (million dollars)

Year	Bonds and Notes	Equities ^a	Total	Equities as Per Cent of Total
1935	385	2	387	0.5
1936	369	4	373	1.1
1937	327	3	330	0.9
1938	691	1	692	0.1
1939	703	4	706	0.6
1940	758	7	765	0.9
1941	811	2	813	0.2
1942	411	9	420	2.1
1943	369	3	372	0.8
1944	778	9	787	1.1
1945	1,004	18	1,022	1.8
1946	1,863	54	1,917	2.8
1947	2,147	88	2,235	3.9
1948	3,008	79	3,087	2.6
1949	2,453	49	2,502	2.0
1950	2,560	120	2,680	4.5
1951	3,326	88	3,415	2.6
1952	3,957	45	4,002	1.1
1953	3,228	90	3,318	2.7
1954	3,484	185	3,668	5.0
1955	3,301	176	3,477	5.1
1956	3,777	109	3,886	2.8
1957	3,839	86	3,925	2.2
1958	3,320	169	3,490	4.8
1959	3,632	122	3,755	3.2
1960	3,275	221	3,497	6.3
1961	4,720	279	4,999	5.6
1962	4,529	113	4,643	2.4
1963	6,158	255	6,413	4.0
1964	7,243	261	7,504	3.5
1965	8,150	399	8,550	4.7

Source: Securities and Exchange Commission.

^aIncludes both common and preferred.

TABLE 7

*Per Cent of Total Dollar Amount of Debt Direct
Placements Bought by Various Classes of Buyers,
Selected Years, 1947-55*

	1947	1950	1953	1955
Life insurance companies	93.0	83.4	87.0	85.0
Other insurance companies	0.1	0.7	0.1	0.3
Banks	2.7	12.1	5.7	5.8
Eleemosynary institutions	2.5	0.5	0.4	1.2
Others ^a	0.4	2.5	5.5	6.0
Unknown	1.3	0.8	1.3	1.7
Total	100.0	100.0	100.0	100.0

Source: Securities and Exchange Commission

^aIncludes other corporations, pension and retirement funds, partnerships and individuals.

mutual fund.¹⁵ The insurance companies and the benevolent associations had total assets, as of December 31, 1959, of \$103.7 billion.

The sample of direct placements used in this study consists, in principle, of all the pure debt direct placements bought by twenty-three of the insurance companies and one large pension fund.¹⁶ The twenty-three companies were selected (from a somewhat larger number of companies which had agreed to participate in the study) to approximate as closely as possible the size distribution of assets of the sixty-odd organizations mentioned above. The twenty-three insurance companies had total assets, as of December 31, 1959,

¹⁵ Data prepared by the Securities and Exchange Commission suggest that by far the largest portion, in dollar terms, was taken by the life insurance companies. See Table 7.

¹⁶ Every effort was made to collect data on all, but this effort was not always successful.

TABLE 8

Distribution of Assets by Size Class, Total Life Insurance Companies and Benevolent Associations, and Life Insurance Companies Included in Sample, as of December 31, 1959

Asset Size Class (million dollars)	Fifty-Three Life Insurance Companies and Three Benevolent Associations		Twenty-Three Life Insurance Companies Included in Sample		Coverage Ratio (Col. 4 ÷ Col. 2) (5)
	Million Dollars (1)	Per Cent ^a (2)	Million Dollars (2)	Per Cent ^a (4)	
100-500	5,725.2	5.5	1,937.4	2.6	.34
501-1,000	8,840.9	8.5	2,805.5	3.7	.32
1,001-2,500	16,395.0	15.8	12,322.3	16.2	.75
2,501-5,000	17,532.9	16.9	10,538.7	13.9	.60
5,001-10,000	22,429.4	21.6	15,505.9	20.4	.69
Over 10,000	32,809.5	31.6	32,809.5	43.2	1.00
Total	103,732.9	100.0	75,919.3	100.0	

^aDue to rounding, will not necessarily add to total.

of \$75.9 billion (Table 8).¹⁷ Table 8 compares the size distribution of assets of the twenty-three companies with the size distribution of the sixty-odd organizations active in the direct placement market. This table indicates that the two distributions are very much alike in the middle but differ some in the tails; the sample companies include a smaller percentage of very small and a larger percentage of very large companies. This result suggested the possibility that the distribution of placements in the sample might not be representative.

¹⁷ The fact that data were collected only at twenty-three life insurance companies (and one pension fund) does not mean that the other forty-odd organizations were not represented in the sample. The companies in the sample participated in the purchase of placements not only with each other but also with various other life insurance companies, the benevolent associations, the other pension funds, and the mutual fund. Some issues, however, had no chance to appear in the sample, namely, those which were wholly bought by one or more of the other forty-odd organizations.

TABLE 9

Industrials: Direct Placements, Average Yield and Average Size of Issue, Sample Compared with "Universe," Annually, 1951-65

Year	Sample		"Universe"	
	Yield (per cent)	Size (million \$)	Yield (per cent)	Size (million \$)
1951	3.95	15.3	3.84	6.4
1952	4.19	7.0	4.30	7.2
1953	4.59	4.2	4.43	5.6
1954	4.29	7.4	4.44	5.4
1955	4.41	4.1	4.35	5.7
1956	4.82	10.0	4.78	6.3
1957	5.45	9.1	5.21	5.7
1958	5.29	6.5	5.31	5.7
1959	5.77	4.9	5.58	4.3
1960	5.94	7.0	5.98	4.1
1961	5.76	5.6	5.76	5.4
1962	n.a.	n.a.	5.81	4.5
1963	n.a.	n.a.	5.65	6.0
1964	n.a.	n.a.	5.64	6.2
1965	n.a.	n.a.	5.67	5.7

An attempt to test this hypothesis was made by using the data on direct placements provided by the *Investment Dealers' Digest* (IDD). The IDD regularly publishes data on the dollar amount and the yield of virtually the whole "universe" of direct placements. These data were used to construct annual series on average yield and average size of issue for industrial, utility, and finance company placements separately.¹⁸ Chart 5 and Tables 9, 10, and 11 compare the yield series with sample averages. On the whole, both sets of series are much the same, and yield, of course, is the best single test of homogeneity.

¹⁸ The IDD does not date issues *within* the year and hence quarterly or monthly series could not be constructed.

Certain life insurance company officers have suggested to me that the IDD's coverage is not complete. But the IDD data were the only data available for the purpose at hand, inasmuch as the SEC does not publish information on individual placements.

TABLE 10

Public Utilities: Direct Placements, Average Yield and Average Size of Issue, Sample Compared with "Universe," Annually, 1951-65

	Sample		"Universe"	
	Yield (per cent)	Size (million \$)	Yield (per cent)	Size (million \$)
1951	3.71	2.9	3.59	4.0
1952	3.78	4.4	4.01	5.2
1953	4.12	9.0	4.15	8.8
1954	3.67	4.3	4.07	6.0
1955	3.86	3.8	4.01	4.0
1956	4.56	4.0	4.36	4.3
1957	5.27	5.5	5.13	4.9
1958	4.92	5.6	5.03	4.5
1959	5.31	9.2	5.34	5.3
1960	5.64	5.4	5.69	4.6
1961	5.26	4.9	5.37	4.6
1962	n.a.	n.a.	5.24	4.6
1963	n.a.	n.a.	5.07	5.6
1964	n.a.	n.a.	5.17	4.8
1965	n.a.	n.a.	5.11	4.2

Data were collected from the twenty-three companies and the pension fund on about 3,800 direct placements, of which about 2,300 were industrial, 900 were utility, and 600 were finance company placements. Of these, some 1,400 eventually turned out to be incomplete in some essential respect. Data collected by the IDD suggest that over the eleven years in question some 8,800 direct placements were negotiated. The effective sample used in this study, then, constitutes about 27 per cent by number of the underlying population.¹⁹

According to SEC figures, \$39.9 billion of directly placed bonds and notes were "taken down" during the period 1951-61, of which

¹⁹ *Investment Dealers' Digest, Corporate Financing Directory*, first half of 1961, p. 10. The SEC does not make available data on number of direct placements. The IDD figures include an indeterminate number of debt issues with equity features.

TABLE 11

Finance Companies: Direct Placements, Average Yield and Average Size of Issue, Sample Compared with "Universe," Annually, 1951-65

	Sample		"Universe"	
	Yield (per cent)	Size (million \$)	Yield (per cent)	Size (million \$)
1951	4.12	5.7	4.02	3.1
1952	4.74	6.7	4.57	2.5
1953	4.91	4.7	4.73	6.3
1954	4.16	13.6	4.54	6.5
1955	4.23	7.3	4.66	3.5
1956	4.78	7.0	4.68	5.9
1957	5.75	5.9	5.45	3.4
1958	5.45	2.5	5.45	3.5
1959	5.84	7.0	5.65	5.9
1960	6.09	7.6	6.04	5.9
1961	5.90	5.1	5.89	4.0
1962	n.a.	n.a.	5.72	5.2
1963	n.a.	n.a.	5.68	4.7
1964	n.a.	n.a.	5.48	5.7
1965	n.a.	n.a.	5.46	5.1

about \$20.0 billion were taken down by industrial companies, \$11.7 billion by utilities, and the remainder by finance and real estate companies and rails (rails accounted for only \$219 million). The effective sample used in this study constitutes about 21 per cent by value of utilities placements and about 50 per cent by value of industrial, financial, and real estate placements—or about 44 per cent of all types taken together.

Summary of Findings

DETERMINANTS OF YIELD

The yields on the direct placements bought at any given time—on any given day or in any given week—vary widely from one another. They vary because borrowers vary and because the issues

borrowers sell vary. Borrowers vary from one another in a good many ways: in size, capital structure, working capital, efficiency, and so forth. Issues also vary in a good many ways: in size, maturity, refundability, restrictive covenants, and so forth. This study has endeavored, first, to ascertain which characteristics of borrowers and of issues exert a perceptible influence on yield, and which do not—time held constant. Nineteen characteristics were tested for industrial, eighteen for utility, and seventeen for finance company placements. These are discussed in Chapter 2 and listed in Tables 12 and 13. Results are summarized below.

1. For industrials, the primary determinants of yield, in the order of their importance, were total pro-forma interest, size of company (as measured by total capital), earnings before interest and taxes, and size of issue. (See footnote 20 below.)

2. For utilities, the primary determinants were total pro-forma interest, size of company, average term, and earnings before interest and taxes.

3. For both classes of issues, variables such as type of security, industrial class, years nonrefundable, and maturity, while significant, did not have much impact on yield.

4. For finance company placements, the primary determinants of yield were size of issue, earnings, and type of security.

5. Growth in earnings, which had been expected to show strong significance for all three types of issues, showed none at all. The variability of earnings showed slight significance for finance company issues only.

6. The effect of duration (i.e., average term and maturity) on yield is not consistently in one direction: during some periods, higher yields were associated with shorter duration, and in other periods the reverse was the case. This was true for both industrials and utilities. In general, the direction of the effect of duration on yield appears to depend on expectations as to the future course of interest rates. When yields are expected to rise, longer duration tends to be associated with higher yields, and vice versa.

THE YIELD SERIES

Three types of series were constructed.

The first type simply represented average quarterly yields for 1951–61, unadjusted in any way, on all the issues in the sample. Separate series of this type were constructed for industrials, utilities, and finance companies.

The second, termed cross-classified yields, were also constructed quarterly for 1951–61. These series, which are based on the original observations, hold two of the most important variables approximately constant through time: times charges earned and size of company.²⁰ In effect, these series represent the changing cost, over time, of issues which are reasonably homogeneous over time. Separate series of this type were constructed for industrials and utilities only.

The third type, termed computed yields, and constructed quarterly for 1951–61, are series that hold *all* significant variables constant at their 1951–61 mean values. They are therefore, for all practical purposes, perfectly homogeneous through time. In effect, each of these series represents the changing cost over time of an issue of fixed characteristics. Separate series of this type were constructed for industrials, utilities, and finance companies.

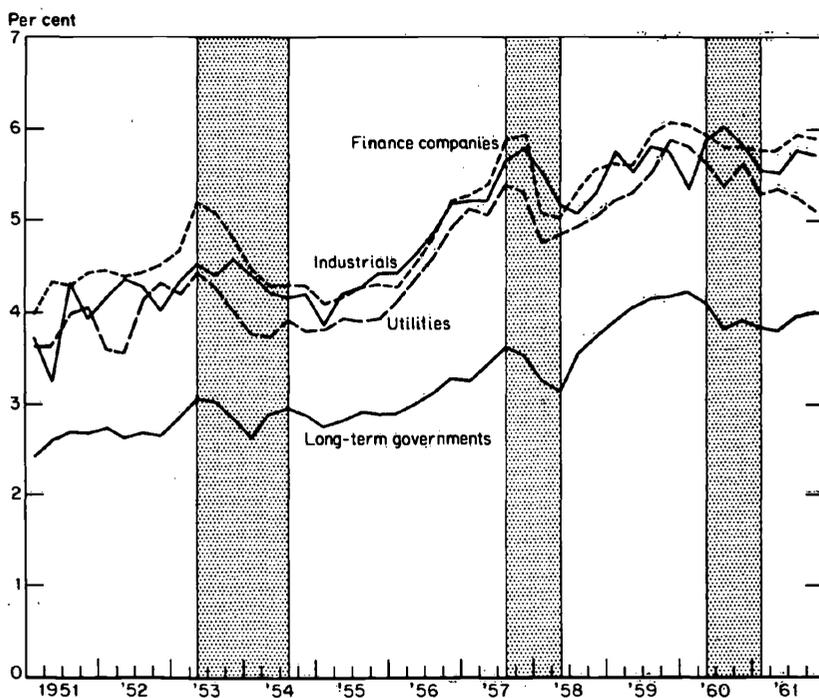
Chart 1 compares the three computed series with each other and with long-term governments. Charts 2, 3, and 4 compare the computed series with the actuals for industrial, utility, and finance company placements, respectively.

Except for two or three erratic fluctuations in the industrial series at the outset of the period, all three series moved in much the same way. In addition, all conformed fairly closely to quarterly

²⁰ When *all* the significant variables were run simultaneously, times charges earned was broken into two separate variables: earnings before interest and taxes (EBIT) and total pro-forma interest. But, for the purpose of constructing the cross-classified series, EBIT and total pro-forma interest were combined into a measure of times pro-forma interest earned. See discussion of this matter on pp. 59ff.

CHART 1

Computed Yields on Industrial, Utility, and Finance Company Direct Placements Compared with Yields on Long-Term Governments, Quarterly, 1951-61



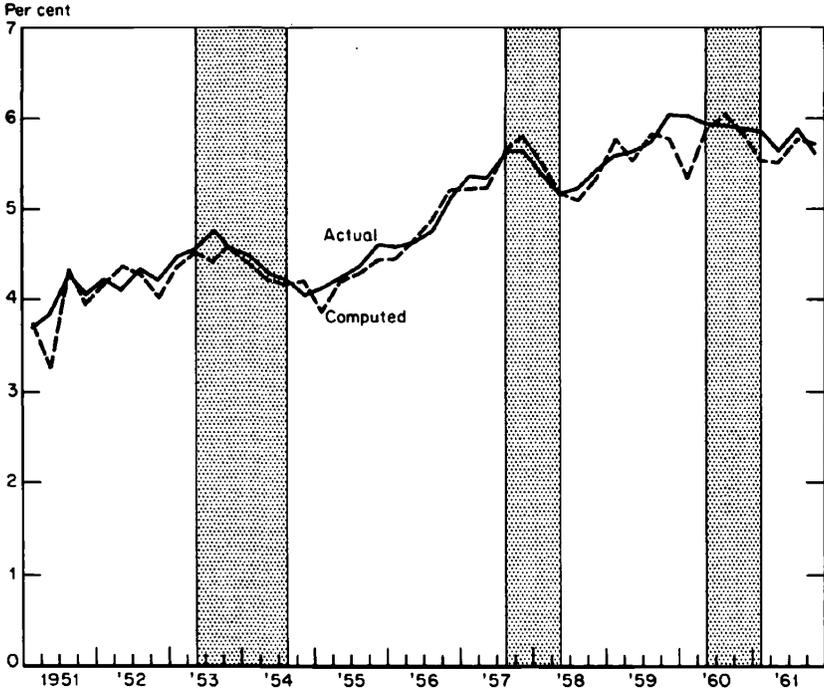
Shaded areas represent business contractions; white areas, expansions.
SOURCE: Tables 32, 48, 60; and *Federal Reserve Bulletin*.

turning points in business cycles and to the movements of long-term governments.

The utility series is lower than the industrial series in thirty-nine of forty-four quarters, despite the fact that the average industrial issue seems to be of substantially better "quality" than the average utility issue (the average industrial issue is larger and of shorter duration and is supported by higher average earnings and by much higher coverage of interest charges). The explanation of this anomaly is very likely to be found in the fact that lenders believe

CHART 2

Industrials: Actual Average Yields and Computed Yields on Issue of Fixed Characteristics, Quarterly, 1951-61



Shaded areas represent business contractions; white areas, expansions.

SOURCE: Table 32.

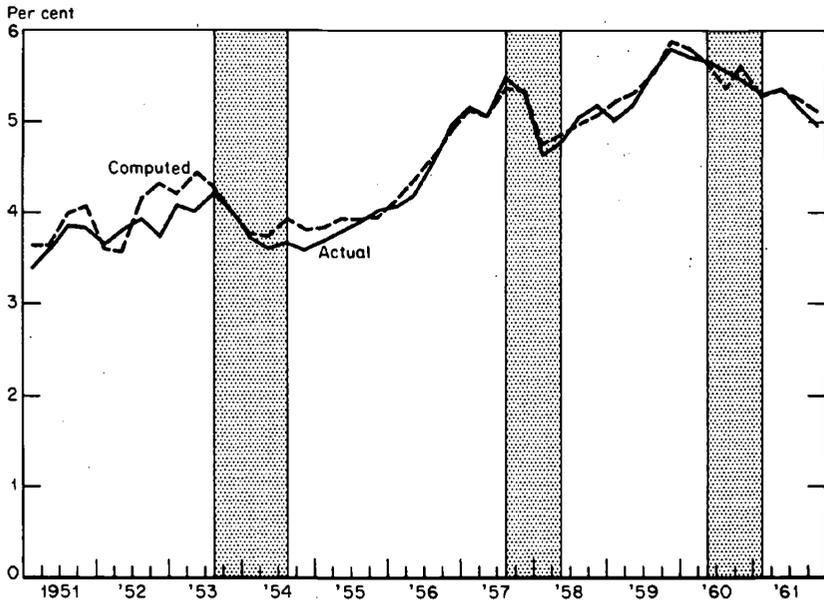
that utilities would fare better than industrials under conditions of extreme adversity.

The quarterly differences between the actuals and the computed yields range up to about seventy basis points for industrials, up to about sixty basis points for utilities, and up to about 100 basis points for finance companies. But on the whole, the actuals and the computed series move in much the same way.²¹ This could not, of course, have been known in advance.

²¹ This means that the "universe" series given in Chart 5 and Tables 9, 10, and 11 probably represent fairly well the behavior of yields since 1961.

CHART 3

Utilities: Actual Average Yields and Computed Yields on Issue of Fixed Characteristics, Quarterly, 1951-61



Shaded areas represent business contractions; white areas, expansions.
SOURCE: Table 48.

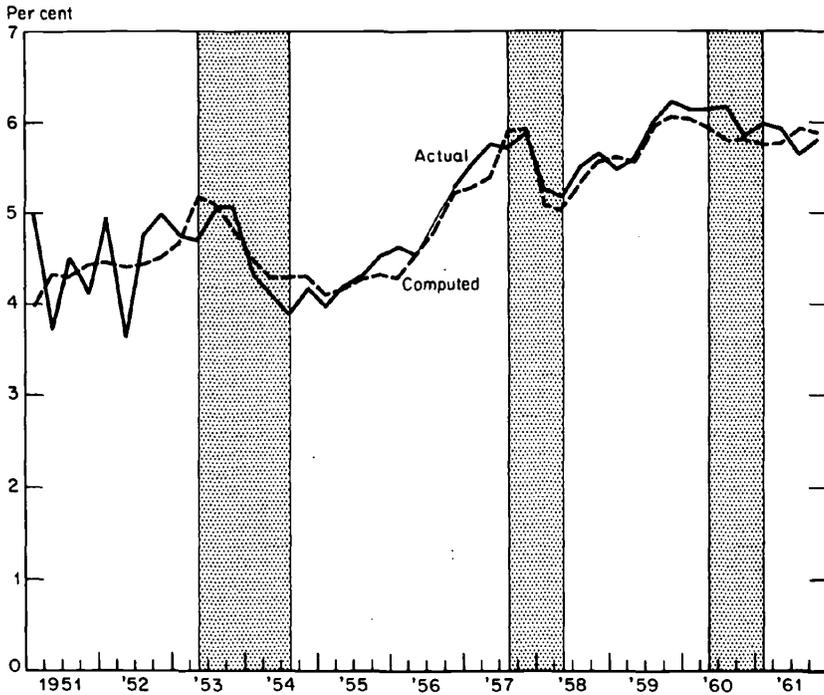
YIELDS ON DIRECT PLACEMENTS COMPARED WITH YIELDS ON PUBLIC OFFERINGS

The findings suggest that yields on direct placements were higher, on the average over the whole period, than yields on public offerings, even after the latter were adjusted for cost of flotation. The difference in favor of public offerings is not, however, constant for all types of issues. For the smaller issues *alone*, the difference appears to be negative for industrials (i.e., direct placements have lower yields) and close to zero for utilities.²² The explanation is, very likely, that the direct placement market prefers higher-yielding (lower-quality) issues and tends, therefore, to compete more

²² This comparison was made for industrials and utilities only.

CHART 4

Finance Companies: Actual Average Yields and Computed Yields on Issue of Fixed Characteristics, Quarterly, 1951-61



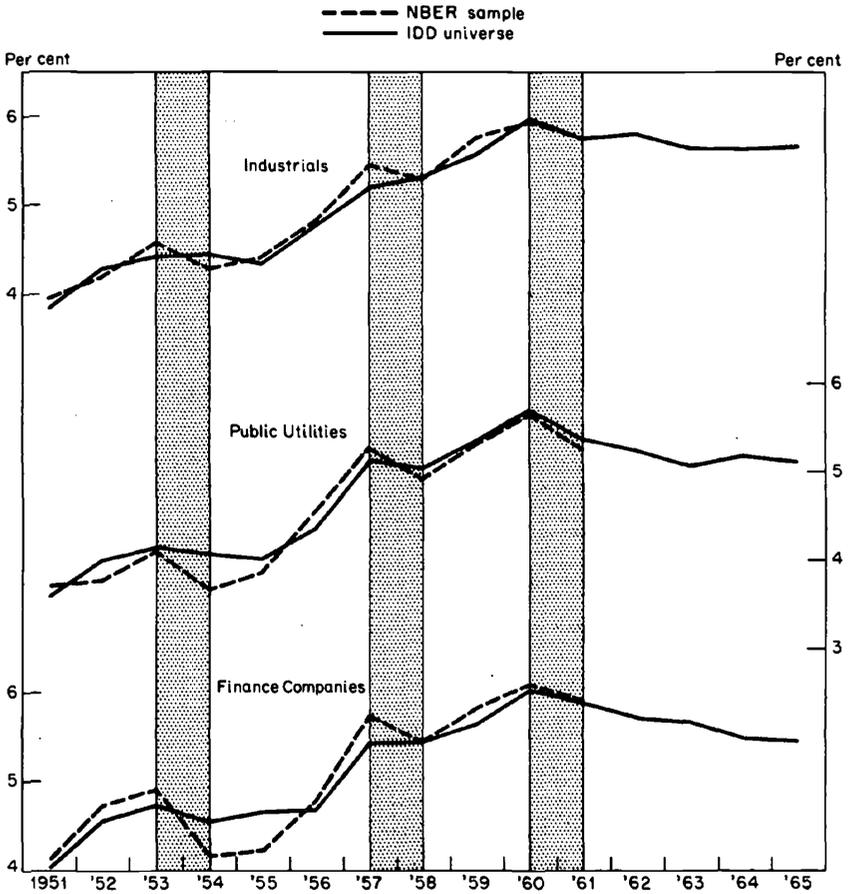
Shaded areas represent business contractions; white areas, expansions.
SOURCE: Table 60.

vigorously with the public market for such issues. This means that yields on lower-quality issues tend to be lower in the direct placement market than in the public market. It means also, conversely, that the direct placement market, especially when money is "tight," is little interested in the lower-yielding (higher-quality) issues and tends therefore to compete less vigorously with the public market for such issues. Hence, yields on such issues tend to be lower in the public market than in the direct placement market.²³

²³ Of course, in trying to decide whether to sell an issue publicly or directly, issuers take *all* things into account, not just price. A small issuer may place a

CHART 5

*Industrial, Utility, and Finance Company Direct Placements:
Average Yields in Sample, Annually, 1951-61, and Average
"Universe" Yields, Annually, 1951-65*



Shaded areas represent business contractions; white areas, expansions.
 SOURCE: Tables 9, 10, and 11.

DISTRIBUTION OF DIRECT PLACEMENTS BY CLASS

In order to construct the "cross-classified" series described above, it became necessary to construct classes for direct placements. These classes were used to compare the distribution of direct placements by class with the distribution of public offerings by class. The principal finding was that the average "quality" of public offerings is probably substantially higher than the average "quality" of direct placements—virtually all public offerings fell in classes 1 through 4, whereas 49.5 per cent of industrial and 31.0 per cent of utility direct placements fell in those classes.²⁴ As indicated above, these classes were based on a combination of two variables: size of company and times pro-forma interest earned.

CHARACTERISTICS OF DIRECT PLACEMENTS

With respect to the individual characteristics of direct placements, three facts stand out: (1) the size and earnings variables increased, on the average, from the first half of the period to the second half; (2) although earnings rose, pro-forma interest rose more rapidly and hence times pro-forma interest earned declined; (3) the other variables—maturity, average term, lien position, and years nonrefundable—remained much the same.

high value on wide distribution of an issue and may therefore be willing to pay a premium to the public market to obtain it. A larger issuer, on the other hand, may want a firm commitment quickly and, in order to obtain it, may be willing to pay a premium to the direct placement market. See Chapter 6, below.

²⁴ These comparisons were made for industrials and utilities only.