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On the Nature of Capital: Investment, Intangible Assets, and the Pecuniary Magnate

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## ON THE NATURE OF CAPITAL:

### INVESTMENT, INTANGIBLE ASSETS, AND THE PECUNIARY MAGNATE.

#### SUMMARY.

Introductory summary, 104.—Certain effects of investment and the price system, 105.—Intangible assets, their nature, derivation, and basis, 111.—Summary of analysis of assets, 115.—Tangible and intangible assets distinct, but mutually convertible, 116.—Dependence of all assets on industrial production, 122.—Non-capitalizable income from assets, 125.—Place and function of the “Pecuniary Magnate,” 126.—“Timeless” gains from the use of (large) capital, 130.—Source of such “timeless” gains, 132.—Consequences for ordinary business men and ordinary profits, 135.

WHAT has been said in the earlier section of this paper<sup>1</sup> applies to “capital goods,” so called, and it is intended to apply to these in their character of “productive goods” rather than in their character of “capital”; that is to say, what is had in mind is the industrial, or technological, efficiency and subservience of the material means of production rather than the pecuniary use and effect of invested wealth. The inquiry has dealt with the industrial equipment as “plant” rather than as “assets.” In the course of this inquiry it has appeared that out of the profitable engrossing of the community’s industrial efficiency through control of the material equipment there arises the practise of investment, which has further consequences that merit more detailed attention.

Investment is a pecuniary transaction, and its aim is pecuniary gain,—gain in terms of value and ownership. Invested wealth is capital, a pecuniary magnitude, meas-

<sup>1</sup>See this Journal for August, 1908. By an oversight the sub-title of the earlier section was omitted. It should have read “The Productivity of Capital Goods.”

ured in terms of value and determined in respect of its magnitude by a valuation which proceeds on an appraisalment of the gain expected from the ownership of this invested wealth. In modern business practise, capital is distinguished into two co-ordinate categories of assets, tangible and intangible. "Tangible assets" is here taken to designate pecuniarily serviceable capital goods, considered as a valuable possession yielding an income to their owner. Such goods, material items of wealth, are "assets" to the amount of their capitalizable value, which may be more or less closely related to their industrial serviceability as productive goods. "Intangible assets" are immaterial items of wealth, immaterial facts owned, valued, and capitalized on an appraisalment of the gain to be derived from their possession. These are also assets to the amount of their capitalizable value, which has commonly little, if any, relation to the industrial serviceability of these items of wealth considered as factors of production.

Before going into the matter of intangible assets, it is necessary to speak further of the consequences which investment—and hence capitalization—has for the use and serviceability of (material) capital goods. It has commonly been assumed by economists, without much scrutiny, that the gains which accrue from invested wealth are derived from and (roughly) measured by the productivity of the industrial process in which the items of wealth so invested are employed, productivity being counted in some terms of material serviceability to the community, conduciveness to the livelihood, comfort, or consumptive needs of the community. In the course of the present inquiry it has appeared that the gainfulness of such invested wealth (tangible assets) is due to a more or less extensive engrossing of the community's industrial efficiency. The aggregate gains of the aggregate material

capital accrue from the community's industrial activity, and bear some relation to the productive capacity of the industrial traffic so engrossed. But it will be noted that there is no warrant in the analysis of these phenomena as here set forth for alleging that the gains of investment bear a relation of equality or proportion to the material serviceability of the capital goods, as rated in terms of effectual usefulness to the community. Given capital goods, tangible assets, may owe their pecuniary serviceability to their owner, and so their value, to other things than their serviceability to the community; altho the gains of investment in the aggregate are drawn from the aggregate material productivity of the community's industry.

The ownership of the material equipment gives the owner not only the right of use over the community's immaterial equipment, but also the right of abuse and of neglect or inhibition. This power of inhibition may be made to afford an income, as well as the power to serve; and whatever will yield an income may be capitalized and become an item of wealth to its possessor. Under modern conditions of investment it happens not infrequently that it becomes pecuniarily expedient for the owner of the material equipment to curtail or retard the processes of industry,—“restraint of trade.” The motive in all such cases of retardation is the pecuniary expediency of the measure for the owner (controller) of capital,—expediency in terms of income from investment, not expediency in terms of serviceability to the community at large or to any fraction of the community except the owner (manager). Except for the exigencies of investment, *i.e.*, exigencies of pecuniary gain to the investor, phenomena of this character would have no place in the industrial system. They invariably come of the endeavors of business men to secure a pecuniary gain or to avoid a pecuniary loss. More frequently, perhaps, manœuvres of inhibi-

tion—advised idleness of plant—in industry aim to effect a saving or avoid a waste than to procure an increase of gain; but the saving to be effected and the waste to be avoided are always pecuniary saving to the owner and pecuniary waste in the matter of ownership, not a saving of goods to the community or a prevention of wasteful consumption or wasteful expenditure of effort and resources on the part of the community. Pecuniary—that is to say, differential—advantage to the capitalist-manager has, under the régime of investment, taken precedence of economic advantage to the community; or rather, the differential advantage of ownership is alone regarded in the conduct of industry under this system.

Business practises which inhibit industrial efficiency and curtail the industrial output are too well known to need particular enumeration. Nor is it necessary to cite evidence to show that such inhibition and curtailment are resorted to from motives of pecuniary expediency. But an illustrative example or two will make the theoretical point clearer, and perhaps more plainly bring out the wholly pecuniary grounds of such business procedure. The most comprehensive principle involved in this class of business management is that of raising prices, and so increasing the net gains of business, by limiting the supply, or “charging what the traffic will bear.” Of a similar effect, for the point here in question, are the obstructive tactics designed to hinder the full efficiency of a business rival. These phenomena lie along the line of division between tangible and intangible assets. Successful strategy of this kind may, by force of custom, legislation, or the “freezing-out” of rival concerns, pass into settled conditions of differential advantage for the given business concern, which so may be capitalized as an item of intangible assets and take their place in the business community as articles of invested wealth.

But, aside from such capitalization of inefficiency, it is at least an equally consequential fact that the processes of productive industry are governed in detail by the exigencies of investment, and therefore by the quest of gain as counted in terms of price, which leads to the dependence of production on the course of prices. So that, under the régime of capital, the community is unable to turn its knowledge of ways and means to account for a livelihood except at such seasons and in so far as the course of prices affords a differential advantage to the owners of the material equipment. The question of advantageous—which commonly means rising—prices for the owners (managers) of the capital goods is made to decide the question of livelihood for the rest of the community. The recurrence of hard times, unemployment, and the rest of that familiar range of phenomena, goes to show how effectual is the inhibition of industry exercised by the ownership of capital under the price system.<sup>1</sup>

So also as regards the discretionary abuse of the community's industrial efficiency vested in the owner of the material equipment. Disserviceability may be capitalized as readily as serviceability, and the ownership of the capital goods affords a discretionary power of misdirecting the industrial processes and perverting<sup>2</sup> industrial efficiency, as well as of inhibiting or curtailing industrial processes and their output, while the outcome may still be profitable to the owner of the capital goods. There is a large volume of capital goods whose value lies in their turning the technological inheritance to the injury of mankind. Such are, *e.g.*, naval and military establishments, together with the docks, arsenals, schools, and manu-

<sup>1</sup> For the connection between prices and prosperity, hard times, unemployment, etc., see *The Theory of Business Enterprise*, chap. vii (pp. 185-252, especially 196-212).

<sup>2</sup> By "perversion" is here meant such disposition of the industrial forces as entails a net waste or detriment to the community's livelihood

factories of arms, ammunition, and naval and military stores, that supplement and supply such establishments. These armaments and the like are, of course, public and quasi-public enterprises, under the current régime, with somewhat disputable relations to the system of current business enterprise. But it is no far-fetched interpretation to say that they are, in great part, a material equipment for the maintenance of law and order, and so enable the owners of capital goods with immunity to inhibit or pervert the industrial processes when the exigencies of business profits make it expedient; that they are, further, a means—more or less ineffectual, it is true—for extending and protecting trade, and so serve the differential advantage of business men at the cost of the community; and that they are also in large part a material equipment set apart for the diversion of a livelihood from the community at large to the military, naval, diplomatic, and other official classes. These establishments may in any case be taken as illustrating how items of material equipment may be devoted to and may be valued for the use of the technological expedients for the damage and discomfort of mankind, without sensible offset or abatement.

Typical of a class of investments which derive profits from capital goods devoted to uses that are altogether dubious, with a large presumption of net detriment, are such establishments as race-tracks, saloons, gambling-houses, and houses of prostitution.<sup>1</sup> Some spokesmen of

<sup>1</sup> Should the connection at this point with the main argument of the paper as set forth in the earlier section seem doubtful or obscure, it may be called to mind that these dubious enterprises in dissipation are cases of investment for a profit, and that the "capital goods" engaged are invested wealth yielding an income, but that they yield an income only on the fulfilment of two conditions (a) the possession and employment of these capital goods enables their holder to turn to account the common stock of technological proficiency, in those bearings in which it may be of use in his enterprise; and (b) the limited amount of wealth available for the purpose enables their holder to "engross" the usufruct of such a fraction of the common stock of technological proficiency, in the degree determined by this limitation of the amount available. In so far, these enterprises are like any other industrial enterprise, but beyond this they have the peculiarity

the "non-Christian tribes" might wish to include churches under the same category, but the consensus of opinion in modern communities inclines to look on churches as serviceable, on the whole; and it may be as well not to attempt to assign them a specific place in the scheme of serviceable and disserviceable use of invested wealth.

There is, further, a large field of business, employing much capital goods and many technological processes, whose profits come from products in which serviceability and disserviceability are mingled with waste in the most varying proportions. Such are the production of goods of fashion, disingenuous proprietary articles, sophisticated household supplies, newspapers and advertising enterprise. In the degree in which business of this class draws its profits from wasteful practises, spurious goods, illusions and delusions, skilled mendacity, and the like, the capital goods engaged must be said to owe their capitalizable value to a perverse use of the technological expedients employed.

These wasteful or disserviceable uses of capital goods have been cited, not as implying that the technological proficiency embodied in these goods or brought into effect in their use, intrinsically has a disserviceable bearing, nor that investment in these things, and business enterprise in the management of them, need aim at disserviceability, but only to bring out certain minor points of theory, obvious but commonly overlooked: (a) technological proficiency is not of itself and intrinsically serviceable or disserviceable to mankind,—it is only a means of efficiency for good or ill; (b) the enterprising use of capital goods by their businesslike owner aims not at

that they do not, or need not, even ostensibly, turn the current knowledge and use of ways and means to "productive" account for the community at large, but simply take their stand on the (institutionally sacred) "accomplished fact" of invested wealth. They have less of the fog of apology about them than the common run of business enterprise.



serviceability to the community, but only at serviceability to the owner; (c) under the price system—under the rule of pecuniary standards and management—circumstances make it advisable for the business man at times to mismanage the processes of industry, in the sense that it is expedient for his pecuniary gain to inhibit, curtail, or misdirect industry, and so turn the community's technological proficiency to the community's detriment. These somewhat commonplace points of theory are of no great weight in themselves, but they are of consequence for any theory of business or of life under the rules of the price system, and they have an immediate bearing here on the question of intangible assets.

At the risk of some tedium it is necessary to the theory of intangible assets to pursue this analysis and piecing together of commonplaces somewhat farther. As has already been remarked, "assets" is a pecuniary concept, not a technological one; a concept of business, not of industry. Assets are capital, and tangible assets are items of material equipment and the like, considered as available for capitalization. The tangibility of tangible assets is a matter of the materiality of the items of wealth of which they are made up, while they are assets to the amount of their value. Capital goods, which typically make up the category of tangible assets, are capital goods by virtue of their technological serviceability, but they are capital in the measure, not of their technological serviceability, but in the measure of the income which they may yield to their owner. The like is, of course, true of intangible assets, which are likewise capital, or assets, in the measure of their income-yielding capacity. Their intangibility is a matter of the immateriality of the items of wealth—objects of ownership—of which they are made up, but their character and magnitude as assets is a matter

of the gainfulness to their owner of the processes which their ownership enables him to engross. The facts so engrossed, in the case of intangible assets, are not of a technological or industrial character; and herein lies the substantial disparity between tangible and intangible assets.

Mankind has other dealings with the material means of life, besides those covered by the community's technological proficiency. These other dealings have to do with the use, distribution, and consumption of the goods procured by the employment of the community's technological proficiency, and are carried out under working arrangements of an institutional character,—use and wont, law and custom. The principles and practise of the distribution of wealth vary with the changes in technology and with the other cultural changes that are going forward; but it is probably safe to assume that the principles of apportionment,—that is to say, the consensus of habitual opinion as to what is right and good in the distribution of the product,—these principles and the concomitant methods of carrying them out in practise have always been such as to give one person or group or class something of a settled preference above another. Something of this kind, something in the way of a conventionally arranged differential advantage in the apportionment of the common livelihood, is to be found in all cultures and communities that have been observed at all carefully; and it is perhaps needless to remark that in the higher cultures such economic preferences, privileges, prerogatives, differential advantages and disadvantages, are numerous and varied, and that they make up an intricate fabric of economic institutions. Indeed, peculiarities of class difference in some such respect are among the most striking and decisive features that distinguish one cultural era from another. In all phases of material civilization these preferential advantages are sought and valued. Classes or groups which

are in a position to make good a claim to such differential advantages commonly come, in due course, to put forward such claims; as, *e.g.*, the priesthood, the princely and ruling class, the men as contrasted with the women, the adults as against minors, the able-bodied as against the infirm. Principles (habits of thought) countenancing some form of class or personal preference in the distribution of income are to be found incorporated in the moral code of all known civilizations and embodied in some form of institution. Such items of immaterial wealth are of a differential character, in that the advantage of those who secure the preference is the disadvantage of those who do not; and it may be mentioned in passing, that such a differential advantage inuring to any one class or person commonly carries a more than equal disadvantage to some other class or person or to the community at large.<sup>1</sup>

When property rights fall into definite shape and the price system comes in, and more particularly when the practise of investment arises and business enterprise comes into vogue, such differential advantages take on something of the character of intangible assets. They come to have a pecuniary value and rating, whether they are transferable or not; and if they are transferable, if they can be sold and delivered, they become assets in a fairly clear and full sense of that term. Such immaterial wealth, preferential benefits of the nature of intangible assets, may be a matter of usage simply, as the vogue of a given public house, or of a given tradesman, or of a given brand of consumable goods; or may be a matter of arrogation, as the King's Customs in early times, or

<sup>1</sup>This statement may not seem clear without indicating in a more concrete manner some terms in which to measure the relative differential advantage and disadvantage which so emerge in such a case of prerogative or privilege. Where, as in the earlier, non-pecuniary phases of culture, no price test is applicable, the statement in the text may be taken to mean that the differential disadvantage at the cost of which the differential benefit in question is gained is greater than the beneficiary would be willing to undergo in order to procure this benefit

the once notorious Sound Dues, or the closing of public highways by large land-owners; or of contractual concession, as the freedom of a city or a gild, or a franchise in the Hanseatic League or in the Associated Press; or of government concession, whether on the basis of a bargain or otherwise, as the many trade monopolies of early modern times, or a corporation charter, or a railway franchise, or letters of marque, or letters patent; or of statutory creation, as trade protection by import, export, or excise duties or navigation laws; or of conventionalized superstitious punctilio, as the creation of a demand for wax by the devoutly obligatory consumption of consecrated tapers, or the similar devout consumption of and demand for fish during Lent.

Under the régime of investment and business enterprise these and the like differential benefits may turn to the business advantage of a given class, group, or concern, and in such an event the resulting differential business advantage in the pursuit of gain becomes an asset, capitalized on the basis of its income-yielding capacity, and possibly vendible under the cover of a corporation security (as, *e.g.*, common stock), or even under the usual form of private sale (as, *e.g.*, the appraised good-will of a business concern).

But the régime of business enterprise has not only taken over various forms of institutional privileges and prerogatives out of the past: it also gives rise to new kinds of differential advantage and capitalizes them into intangible assets. These are all (or virtually all) of one kind, in that their common aim and common basis of value and capitalization is a preferentially advantageous sale. Naturally so, since the end of all business endeavor, in the last analysis, is an advantageous sale. The commonest and typical kind of such intangible assets is "good-will," so called,—a term which has come to cover a great variety

of differential business advantages, but which in the original business usage of it meant the customary resort of a clientèle to the concern so possessed of the good-will. It seems originally to have implied a kindly sentiment of trust and esteem on the part of a customer, but as the term is now used it has lost this sentimental content. In the broad and loose sense in which it is now currently employed it is extended to cover such special advantages as inure to a monopoly or a combination of business concerns through its power to limit or engross the supply of a given line of goods or services. So long as such a special advantage is not specifically protected by special legislation or by a due legal instrument,—as in the case of a franchise or a patent right,—it is likely to be spoken of loosely as “good-will.”

The results of the analysis may be summed up to show the degree of coincidence and the distinctions between the two categories of assets: (a) the value (that is to say, the amount) of given assets, whether tangible or intangible, is the capitalized (or capitalizable) value of the given articles of wealth, rated on the basis of their income-yielding capacity to their owner; (b) in the case of tangible assets there is a presumption that the objects of wealth involved have some (at least potential) serviceability at large, since they serve a materially productive work, and there is therefore a presumption, more or less well founded, that their value represents, tho it by no means measures, an item of serviceability at large; (c) in the case of intangible assets there is no presumption that the objects of wealth involved have any serviceability at large, since they serve no materially productive work, but only a differential advantage to the owner in the distribution of the industrial product;<sup>1</sup> (d) given tangible assets may

<sup>1</sup> A doubt has been offered as to the applicability of this characterization to such intangible assets as a patent right and other items of the same class. The

be disserviceable to the community,—a given material equipment may owe its value as capital to a disserviceable use, tho in the aggregate or on an average the body of tangible assets are (presumptively) serviceable; (e) given intangible assets may be indifferent in respect of serviceability at large, tho in the aggregate, or on an average, intangible assets are (presumably) disserviceable to the community.

On this showing it would appear that the substantial difference between tangible and intangible assets lies in the different character of the immaterial facts which are turned to pecuniary account in the one case and in the other. The former, in effect, capitalize such fraction of the technological proficiency of the community as the ownership of the capital goods involved enables the owner to engross. The latter capitalize such habits of life, of a non-technological character,—settled by usage, convention, arrogation, legislative action, or what not,—as will effect a differential advantage to the concern to which the assets in question appertain. The former owe their existence and magnitude to the usufruct of technological expedients involved in the industrial process proper; while the latter are in like manner due to the usufruct of what may be called the interstitial correlations and ad-

doubt seems to arise from a misapprehension of the analysis and of its intention. It should be remarked that there is no intention to condemn or disapprove any of the items here spoken of as intangible assets. The patent right may be justifiable or it may not; there is no call to discuss that question here. Other intangible assets are in the same case in this respect.

Further, as to the character of a patent right considered as an asset. The invention or innovation covered by the patent right is a contribution to the common stock of technological proficiency. It may be (immediately) serviceable to the community at large, or it may not;—e.g., a cash register, a bank-check punch, a street-car fare register, a burglar-proof safe, and the like are of no immediate service to the community at large, but serve only a pecuniary use to their users. But, whether the innovation is useful or not, the patent right, as an asset, has no (immediate) usefulness at large, since its essence is the restriction of the usufruct of the innovation to the patentee. Immediately and directly the patent right must be considered a detriment to the community at large, since its purport is to prevent the community from making use of the patented innovation, whatever may be its ulterior beneficial effects or its ethical justification.

justments both within the industrial system and between industry proper and the market, in so far as these relations are of a pecuniary rather than a technological character. Much the same distinction may be put in other words, so as to bring the expression nearer the current popular apprehension of the matter, by saying that tangible assets, commonly so called, capitalize the processes of production, while intangible assets, so called, capitalize certain expedients and processes of acquisition, not productive of wealth, but affecting only its distribution. Formulated in either way, the distinction seems not to be an altogether hard-and-fast one, as will immediately appear if it is called to mind that intangible assets may be converted into tangible assets, and conversely, as the exigencies of business may decide. Yet, while the two categories of assets stand in such close relation to one another as this state of things presumes, it is still evident from the same state of things that they are not to be confounded with one another.

Taking "good-will" as typical of the category of "intangible assets," as being the most widely prevalent and at the same time the farthest removed in its characteristics from the range of "tangible assets," some slight further discussion of it may serve to bring out the difference between the two categories of assets and at the same time to enforce their essential congruity as assets as well as the substantial connection between them. In the earlier days of the concept, in the period of growth to which it owes its name, when good-will was coming into recognition as a factor affecting assets, it was apparently looked on habitually as an adventitious differential advantage accruing spontaneously to the business concern to which it appertained; an immaterial by-product of the concern's conduct of business,—commonly presumed to be an adventitious blessing incident to an upright and

humane course of business life. Poor Richard would express this sense of the matter in the saying that "honesty is the best policy." But presently, no doubt, some thought would be taken of the acquirement of good-will, and some effort would be expended by the wise business man in that behalf. Goods would be given a more elegant finish for the sake of a readier sale, beyond what would conduce to their brute serviceability simply; smooth-spoken and obsequious salesmen and solicitors, gifted with a tactful effrontery, have come to be preferred to others, who, without these merits, may be possessed of all the diligence, dexterity, and muscular force required in their trade; something is expended on convincing, not to say vain-glorious, show-windows that shall promise something more than one would like to commit one's self to in words; itinerant agents, and the like, are employed at some expense to secure a clientèle; much thought and substance is spent on advertising of many kinds.

This last-named item may be taken as typical of the present stage of growth in the production or generation of good-will, and therefore in the creation of intangible assets. Advertising has come to be an important branch of business enterprise by itself, and it employs a large and varied array of material appliances and processes (tangible assets). Investment is made in certain material items (productive goods), such as printed matter, sign-boards, and the like, with a view to creating a certain body of good-will. The precise magnitude of the product may not be foreseen, but, if sagaciously made, such investment rarely fails of the effect aimed at—unless a business rival with even greater sagacity should outmanœuvre and offset these endeavors with a superior array of appliances (productive goods) and workmen for the generation of good-will. The product aimed at, commonly with effect, is good-will,—an intangible asset,—which



may be considered to have been generated by converting certain tangible assets into this intangible; or it may be considered as an industrial product, the output of certain industrial processes in which the given items of material equipment are employed and give effect to the requisite technological proficiency. Whichever view be taken of the causal relation between the material equipment and processes employed, on the one hand, and the output of good-will, on the other hand, the result is substantially the same for the purpose in hand.

The ulterior end of the advertising is, it may be said, the sale of an increased quantity of the advertised articles, at an increased net gain; which would mean an increased value of the material items offered for sale; which, in turn, is the same as saying an increase of tangible assets. It may be assumed without debate that the end of business endeavor is a gain in final terms of tangible values. But this ulterior end is, in the case of advertising enterprise, to be gained only by the intermediate step of a production of an immaterial item of good-will, an intangible asset.

So the case in illustration shows not only the conversion of tangible assets (material capital goods, such as printed matter) into intangible wealth, or, if that formula be preferred, the production of immaterial wealth by the productive use of material wealth, but also, conversely, in the second step of the process, it shows the conversion of intangible assets into tangible wealth (enhanced value of vendible goods), or, if the expression seems preferable, the production of tangible assets by the use of intangible wealth.

This creation of tangible wealth out of intangible assets is seen perhaps at its neatest in the enhancement of land values by the endeavors of interested parties. Real estate is, of course, a tangible asset of the most authentic tangibility, and it is an asset to the amount of its value, which is determined, say, by the figures at which the real estate

in question is currently bought and sold. This is the current value of the real estate, and therefore its current actual magnitude as a tangible asset. The value of the real estate might also be computed by capitalizing its rental value; but, where the current market value does not coincide with the capitalized rental value, the former must, according to business conceptions, be accepted as the actual value. In many parts of this country, perhaps in most, but particularly in the Western States and in the neighborhood of flourishing towns, these two methods of rating the pecuniary magnitude of real estate will habitually not coincide. Due allowance, often very considerable, being made, the capitalized rental value of the land may be taken as measuring its current serviceability as an item of material equipment; while the amount by which the market value of the land exceeds its capitalized rental value may be taken as the product, the tangible residue, of an intangible asset of the nature of good-will, turned to account, or "productively employed," in behalf of this parcel of land.<sup>1</sup>

Some of the lands of California may be taken as a very good, tho perhaps not an extreme, example of such a creation of real estate by spiritual instrumentalities. It is probably well within the mark to say that some of these lands owe not more than one-half their current market value to their current serviceability as an instrument of production or use. The excess may be attributable to illusions touching the chances of future sale, to anticipation of a prospective enhanced usefulness, and the like; but all these are immaterial factors, of the nature of good-

<sup>1</sup> Neither as a physical magnitude ("land") nor as a pecuniary magnitude ("real estate") is the capitalized land in question an item of "good-will"; but its value as real estate—*i e*, its magnitude as an asset—is in part a product of the "good-will" (illusions and the like) worked up in its behalf and turned to account, by the land agent. The real estate is a tangible asset, an item of material wealth, while the "good-will" to which in part it owes its magnitude as an item of wealth is an intangible asset, an item of immaterial wealth.

will. Like other assets, these lands are capitalized on the basis of the anticipated income from them, part of which income is anticipated from profitable sales to persons who, it is hoped, will be persuaded to take a very sanguine view of the land situation, while part of it may be due to oversanguine anticipations of usefulness generated by the advertising matter and the efforts of the land agents directed to what is called "developing the country."

To any one preoccupied with the conceit that "capital" means "capital goods" such a conversion of intangible into tangible goods, or such a generation of intangible assets by the productive use of tangible assets, might be something of a puzzle. If "assets" were a physical concept, covering a range of physical things, instead of a pecuniary concept, such conversion of tangible into intangible assets, and conversely, would be a case of transubstantiation. But there is nothing miraculous in the matter. "Assets" are a pecuniary magnitude, and belong among the facts of investment. Except in relation to investment the items of wealth involved are not assets. In other words, assets are a matter of capitalization, which is a special case of valuation; and the question of tangibility or intangibility as regards a given parcel of assets is a question what article or class of articles the valuation shall attach to or be imputed to. If, *e.g.*, the fact to which value is imputed in the valuation is the habitual demand for a given article of merchandise, or the habitual resort of a given group of customers to a particular shop or merchant, or a monopolistic control or limitation of price and supply, then the resulting item of assets will be "intangible," since the object to which the capitalized value in question is imputed is an immaterial object. If the fact which is by imputation made the bearer of the capitalized value is a material object, as, *e.g.*, the merchantable goods of which the supply is arbitrarily limited or the price arbitrarily fixed,

or if it is the material means of supplying such goods, then the capitalized value in question is a case of tangible assets. The value involved is, like all value, a matter of imputation, and as assets it is a matter of capitalization; but capitalization is an appraisalment of a pecuniary "income-stream" in terms of the vendible objects to the ownership of which the income is assumed to inure. To what object the capitalized value of the "income-stream" shall be imputed is a question of what object of ownership secures to the owner an effectual claim on this "income-stream"; that is to say, it is a question of what object of ownership the strategic advantage is assumed to attach to, which is a question of the play of business exigencies in the given case.

The "income-stream" in question is a pecuniary income stream, and is in the last resort traceable to transactions of sale. Within the confines of business—and therefore within the scope of capital, investments, assets, and the like business concepts—transactions of purchase and sale are the final terms of any analysis. But beyond these confines, comprehending and conditioning the business system, lie the material facts of the community's work and livelihood. In the final transaction of sale the merchantable goods are valued by the consumer, not as assets, but as livelihood;<sup>1</sup> and in the last analysis and long run it is to some such transaction that all business imputations of value and capitalistic appraisalment of assets must have regard and by which they must finally be checked. Dissociated from the facts of work and livelihood, therefore, assets cease to be assets; but this does not preclude their relation to these facts of work and livelihood being at times somewhat remote and loose.

<sup>1</sup> "Livelihood" is, of course, here taken in a loose sense, not as denoting the means of subsistence simply or even the means of physical comfort, but as signifying that the purchases in question are made with a view to the consumptive use of the goods rather than with a view to their use for a profit.

Without recourse, immediately or remotely, to certain material facts of industrial process and equipment, assets would not yield earnings; that is to say, wholly disjoined from these material facts, they would in effect not be assets. This is true for both tangible and intangible assets, altho the relation of the assets to the material facts of industry is not the same in the two cases. The case of tangible assets needs no argument. Intangible assets, such as patent right or monopolistic control, are likewise of no effect except in effectual contact with industrial facts. The patent right becomes effective for the purpose only in the material working of the innovation covered by it; and monopolistic control is a source of gain only in so far as it effectually modifies or divides the supply of goods.

In the light of these considerations it seems feasible to indicate both the congruence and the distinction between the two categories of assets a little more narrowly than was done above. Both are assets,—that is to say, both are values determined by a capitalization of anticipated income-yielding capacity; both depend for their income-yielding capacity on the preferential use of certain immaterial factors; both depend for their efficiency on the use of certain material objects; both may increase or decrease, as assets, apart from any increase or decrease of the material objects involved. The tangible assets capitalize the preferential use of technological, industrial expedients,—expedients of production, dealing with the facts of brute nature under the laws of physical cause and effect,—this preferential use being secured by the ownership of material articles employed in the processes in which these expedients are put into effect. The intangible assets capitalize the preferential use of certain facts of human nature—habits, propensities, beliefs, aspirations, necessities—to be dealt with under the psychological laws of human motivation; this preferential use being secured by

custom, as in the case of old-fashioned good-will, by legal assignment, as in patent or copyright, by ownership of the instruments of production, as in the case of industrial monopolies.<sup>1</sup>

Intangible assets are capital as well as tangible assets; that is to say, they are items of capitalized wealth. Both categories of assets, therefore, represent expected "income-streams" which are of such definite character as to admit of their being rated in set terms per cent. per time unit; altho the expected income need not therefore be anticipated to come in an even flow or to be distributed in any equable manner over a period of time. The income-streams to be so rated and capitalized are associated in such a manner with some external fact (impersonal to their claimant), whether material or immaterial, as to permit their being traced or attributed to an income-yielding capacity on the part of this external fact, to which their valuation as a whole may be imputed and which may then be capitalized as an item of wealth yielding this income-stream. Income-streams which do not meet these requirements do not give rise to assets, and so do not swell the volume of capitalized wealth.

There are income-streams which do not meet the necessary specifications of capitalizable wealth; and in modern business traffic, particularly, there are large and secure sources of income that are in this way not capitalizable and yet yield a legitimate business income. Such are, indeed, to be rated among the most consequential factors in the current business situation. Under the guidance of traditions carried over from a more primitive business

<sup>1</sup> The instruments of production so monopolized are, of course, tangible assets, but the ownership of such means of production in amount sufficient to enable the owner to monopolize or control the market, whether for purchase (as of materials or labor) or for sale (as of marketable goods or services), gives rise to a differential business advantage which is to be classed as intangible assets.

situation, it has been usual to speak of income-streams derived in such a manner as "wages of superintendence," or "undertaker's wages," or "entrepreneur's profits," or, latterly, as "profits" simply and specifically. Such phenomena of this class as are of consequence in business are commonly accounted for, theoretically, under this head; and the effort so to account for them is to be taken as, at least, a laudable endeavor to avoid an undue multiplication of technical terms and categories.<sup>1</sup> Yet the most striking phenomena of this class, and the most consequential for modern business and industry, both in respect of their magnitude and in respect of the pecuniary dominion and discretion which they represent, cannot well be accounted undertaker's gains, in the ordinary sense of that term. The great gains of the great industrial financiers or of the great "interests," *e.g.*, do not answer the description of undertaker's gains, in that they do not accrue to the captain of industry on the basis of his "managerial ability" alone, apart from his wealth or out of relation to his wealth; and yet it is not safe to say that such gains (which are over and above ordinary returns on his investments) accrue on the ground of the requisite amount of wealth alone, apart from the exercise of a large business discretion on the part of the owner of such wealth or on the part of his agent to whom discretion has been delegated. Administrative, or strategic, discretion and activity must necessarily be present in the case: otherwise, the income in question would rightly be rated as income from capital simply.

The captain of industry, the pecuniary magnate, is normally in receipt of income in excess of the ordinary

<sup>1</sup> One writer even goes so far in the endeavor to bring the facts within the scope of the staple concepts of theory at this point as to rate the persons concerned in such a case as "capital," after having satisfied himself that such income-streams are traceable to a personal source—See Fisher, *Nature of Capital and Income*, chap. v

rate per cent. on investment; but apart from his large holdings he is not in a position to get these large gains. Dissociated from his large holdings, he is not a large captain of industry; but it is not the size of his holdings alone that determines what the gains of the pecuniary magnate in modern industry shall be. Gains of the kind and magnitude that currently come to this class of business men come only on condition that the owner (or his agent) shall exercise a similarly large discretion and control in the affairs of the business community; but the magnitude of the gains, as well as of the discretion and control exercised, is somewhat definitely conditioned by the magnitude of the wealth which gives effect to this discretion.

The disposition of pecuniary forces in such matters may be well seen in the work and remuneration of any coalition of "interests," such as the modern business community has become familiar with. The "interests" in such a case are of a personal character,—they are "interested parties,"—and the sagacity, experience, and animus of these various interested parties counts in the outcome, both as regards the aggregate gains of the coalition and as regards the distribution of these gains among the several parties in interest; but the weight of any given "interest" in a coalition or "system" is more nearly proportioned to the wealth controlled by the given "interest," and to the strategic position of such wealth, than to any personal talents or proficiency of the "interested party." The talents and proficiency involved are not the main facts. Indeed, the movements of such a "system," and of the several component "interests," are largely a matter of artless routine, in which the greatest ingenuity and initiative engaged in the premises are commonly exercised by the legal counsel working for a fee.

A dispassionate student of the current business traffic, who is not overawed by round numbers, will be more im-



pressed by the ease and simplicity of the manœuvres that lead to large pecuniary results in the higher business finance than by any evidence of pre-eminent sagacity and initiative among the pecuniary magnates. One need only call to mind the simple and obvious way in which the promoters of the Steel Corporation were magnificently checkmated by the financiers of the Carnegie "interest," when that great and reluctant corporation was floated, or the pettyfogging tactics of Standard Oil in its later career. In extenuation of their visible lack of initiative and insight it may not be ungraceful to call to mind that many of the discretionary heads of the great "interests" are men of advanced years, and that in the nature of the case the pecuniary magnates of the present generation must commonly be men of a somewhat advanced age; and it is only during the present generation that the existing situation has arisen, with its characteristic opportunities and demands. To take their present foremost rank in the new business finance which is here under inquiry, they have had to accumulate the great wealth on which alone their discretionary control of business affairs rests, and their best vigor has been spent in this work of preparation; so that they have commonly attained the requisite strategic position only after they had outlived their "years of discretion."

But there is no intention here to depreciate the work of the pecuniary magnates or the spokesmen of the great "interests." The matter has been referred to only as it bears on this category of capitalistic income which accrues on other ground than the "earning-capacity" of the assets involved, and which still cannot be imputed to the "earning-capacity" of these business men apart from these assets. The case is evidently not one of "wages of superintendence" or "undertaker's profits"; but it is as evidently not a case of the earning-capacity of the

assets. The proof of the latter point is quite as easy as of the former. If the gains of the "system" or of its constituent "interests" and magnates were imputable to the earning-capacity of the assets involved,—in any accepted sense of "earnings,"—then it would immediately follow that these assets would be recapitalized on the basis of these extraordinary earnings, and that the income derived in this class of traffic should reappear as interest or dividends on the capital so increased to correspond with the increased earnings. But such recapitalization takes place only to a relatively very limited extent, and the question then bears on the income which is not so accounted for in the recapitalization.

The gains of this class of traffic are, of course, themselves capitalized,—for the most part they accrue in the capitalized form, as issues of securities and the like; but the sources of this income are not capitalized as such. The (large) accumulated wealth, or assets, which gives weight to the movements of the "interests" and magnates in question, and which affords the ground for the discretionary control of business affairs exercised by them, are, for the most part at least, invested in ordinary business ventures, in the form of corporation securities and the like, and are there earning dividends or interest at current rates; and these assets are valued in the market (and thereby capitalized) on the basis of their current earnings in the various enterprises in which they are so invested. But their being so invested in profitable business enterprises does not in the least hinder their usefulness in the hands of the magnates as a basis or means of carrying on the large and highly profitable transactions of the higher industrial finance. To impute these gains to these assets as "earnings," therefore, would be to count the assets twice as capital, or rather to count them over and over.

An additional perplexity in endeavoring to handle gains of this class theoretically as earnings, in the ordinary sense, arises from the fact that they stand in no definable time relation to their underlying assets. They have no definable "time-shape," as Mr. Fisher might put it.<sup>1</sup> Such gains are timeless, in the sense that the time relation does not count in any substantial manner or in any sensible degree in their determination.<sup>2</sup>

In a more painstaking statement of this point of theory it would be necessary to note that these gains are "timeless," in the sense indicated, in so far as the enterprise from which they accrue is dissociated from the technological circumstances and processes of industry, and only in so far. Technological (industrial) procedure, being of the nature of physical causation, is subject to the time relation under which causal sequence runs. This is the basis of such discussions of capital and interest as those of Böhm-Bawerk, and of Fisher. But business traffic, as distinguished from the processes of industry, being not immediately concerned with the technological process, is also not immediately or uniformly subject to the time relation involved in the causal sequence of the technological process. Business traffic is subject to the time relation because and in so far as it depends upon and follows up the processes of production. The commonplace or old-fashioned business enterprise, the competitive system of investment in industrial business simply, commonly rests pretty directly on the due sequence of the industrial processes in which the investments of such enterprise are placed. Such enterprise, as conceived by the current theories of capital, does business at first hand

<sup>1</sup> Cf. Fisher, *Rate of Interest*, chap. vi.

<sup>2</sup> This conclusion is reached, *e g.*, by Mr. G. P. Watkins (*The Growth of Large Fortunes*, chap. iii, sec. 10), altho through a curious etymological misapprehension he rejects the term "timeless" as not available.

in the industrial efficiency of the community, which is conditioned by the time relation of the causal sequence, and which is, indeed, in great measure a function of the time consumed in the technological processes. Therefore, the gains, as well as the transactions, of such enterprise are also commonly somewhat closely conditioned by the like time relation, and they typically emerge under the form of a per cent. per time unit; that is to say, as a function of the lapse of time. Yet the business transactions themselves are not a matter of the lapse of time. Time is not of the essence of the case. The magnitude of a pecuniary transaction is not a function of the time consumed in concluding it, nor are the gains which accrue from the transaction. In business enterprise on the higher plane, which is here under inquiry, the relation of the transactions, and of their gains, to the consecution of the technological processes remotely underlying them is distant, loose, and uncertain, so that the time element here does not obtrude itself: rather, it somewhat obviously falls into abeyance, marking the degree of its remoteness. Yet this phase of business enterprise, like any other, of course takes place in time; and, it is also to be remarked, the volume of the traffic and the gains derived from it are, no doubt, somewhat closely conditioned in the long run by the time relation which dominates that technological (industrial) efficiency on which this enterprise, too, ultimately and indirectly rests and from which in the last resort its gains are finally drawn, however remotely and indirectly.

An analysis of these phenomena on lines similar to those which have been followed in the discussion of assets above is not without difficulty, nor can it fairly be expected to yield any but tentative and provisional results. The matter has received so little attention from economic theoreticians that even significant mistakes in this con-

nection are of very rare occurrence.<sup>1</sup> The cause of this scant attention to these matters lies, no doubt, in the relative novelty of the facts in question. The facts may be roughly drawn together under the caption "Traffic in Vendible Capital"; altho that term serves rather as a comprehensive designation of the class of business enterprise from which these gains accrue than as an adequate characterization of the play of forces involved.<sup>2</sup> Traffic in vendible capital has not been unknown in the past, but it is only recently that it has come into the foreground as the most important line of business enterprise. Such it now is, in that it is in this traffic that the ultimate initiative and discretion in business are now to be found. It is at the same time the most gainful of business enterprise, not only in absolute terms, but relatively to the magnitude of the assets involved as well. One reason for this superior gainfulness is the fact that the assets involved in this traffic are at the same time engaged as assets to their full extent in ordinary business, so that the peculiar gains of this traffic are of the nature of a bonus above the earnings of the invested wealth. "It is like finding money."

As was said above, the method, or the ways and means, characteristic of this superior business enterprise is a traffic in vendible capital. The wealth gained in this field is commonly in the capitalized form, and constitutes in each transaction, or "deal," a deduction or abstraction from the capitalized wealth of the business community in favor of the magnates or "interests" to whom the gains accrue. Its proximate aim is a transfer of capital-

<sup>1</sup> Even Mr. Watkins (as cited above), *eg*, is led by a superficial generalization to class these gains as "speculative," and so to excuse himself from a closer acquaintance with their character and with the bearings of the class of business enterprise out of which they arise

<sup>2</sup> Cf. Theory of Business Enterprise, chap v. pp. 119-130; chap vi pp. 162-174

ized wealth from other capitalists to those who so gain. This transfer or abstraction of capitalized wealth from the former owners is commonly effected by an augmentation of the nominal capital, based on a (transient) advantage inuring to the particular concerns whose capitalization is so augmented.<sup>1</sup> Any such increase of the community's aggregate capitalization, without a corresponding increase of the material wealth on which the capitalization is based, involves, of course, in effect a redistribution of the aggregate capitalized wealth; and in this redistribution the great financiers are in a position to gain. The gains in question, it will be seen, come out of the business community, out of invested wealth, and only remotely and indirectly out of the community at large from which the business community draws its income. These gains, therefore, are a tax on commonplace business enterprise, in much the same manner and with much the like effect as the gains of commonplace business (ordinary profits and interest) are a tax on industry.<sup>2</sup>

In a manner analogous to the old-fashioned capitalist-employer's engrossing of the industrial community's technological efficiency does the modern pecuniary magnate engross the business community's capitalistic efficiency. This capitalistic efficiency lies in the capitalist-employer's ability—by force of the ownership of the material equipment—to induce the industrial community, through suitable bargaining, to turn over to the owner of the material equipment the excess of the product above the industrial

<sup>1</sup> Cf. *Theory of Business Enterprise*, footnote on pp 169–170.

<sup>2</sup> As should be evident from the run of the argument in the earlier portions of this paper, the use of the words "tax," "deduction," "abstraction," in this connection, is not to be taken as implying approval or disapproval of the phenomena so characterized. The words are used for want of better terms to indicate the source of business gains, and objectively to characterize the relation of give-and-take between industry and ordinary capitalistic business, on the one hand, and between ordinary business and this business enterprise on the higher plane, on the other hand.

community's livelihood. The fortunes of the capitalist-employer are closely dependent on the run of the market,—the conjunctures of advantageous purchase and sale; and it is his constant endeavor to create or gain for himself some peculiar degree of advantage in the market, in the way of monopoly, good-will, legalized privilege, and the like,—something in the way of intangible assets. But the pecuniary magnate, in the measure in which he truly answers to the concept, is superior to the market on which the capitalist-employer depends, and can make or mar its conjunctures of advantageous purchase and sale of goods; that is to say, he is in a position to make or mar any peculiar advantage possessed by the given capitalist-employer who comes in his way. He does this by force of his large holdings of capital at large, the weight of which he can shift from one point of investment to another as the relative efficiency—earning-capacity—of one and another line of investment may make it expedient; and at each move of this kind, in so far as it is effective for his ends, he cuts into and assimilates a fraction of the invested wealth involved, in that he cuts into and sequesters a fraction of the capital's earning-capacity in the given line. That is to say, in the measure in which he is a pecuniary magnate, and not simply a capitalist-employer, he engrosses the capitalistic efficiency of invested wealth; he turns to his own account the capitalist-employer's effectual engrossing of the community's industrial efficiency. He engrosses the community's pecuniary initiative and proficiency. In the measure, therefore, in which this relatively new-found serviceability of extraordinarily large wealth is effective for its peculiar business function, the old-fashioned capitalist-employer loses his discretionary initiative and becomes a mediator, an instrumentality of extraction and transmission, a collector and conveyer of revenue from the community at large to the pecuniary

magnate, who, in the ideal case, should leave him only such an allowance out of the gross earnings collected and transmitted as will induce him to continue in business.

To the community at large, whose industrial efficiency is already virtually engrossed by the capitalist-employer's ownership and control of the material equipment, this later step in the evolution of the economic situation should apparently not be a matter of substantial consequence or a matter for sentimental disturbance. On the face of it, it should appear to have little more than a speculative interest for those classes of the community who do not derive an income from investments; particularly not for the working classes, who own nothing to speak of and whose only dependence is their technological efficiency, which has virtually ceased to be their own. But such is not the current state of sentiment. This inchoate new phase of capitalism, this business enterprise on the higher plane, is in fact viewed with the most lively apprehension. In a maze of consternation and solicitude the boldest, wisest, most public-spirited, most illustrious gentlemen of our time are spending their manhood in an endeavor to make the hen continue sitting on the nest after the chickens are out of the shell. The modern community is imbued with business principles—of the old dispensation. By precept and example, men have learned that the business interests (of the authentic superannuated scale and kind) are the palladium of our civilization, as Mr. Dooley would say; and it is felt that any disturbance of the existing pecuniary dominion of the capitalist-employer—as contrasted with the pecuniary magnate—would involve the well-being of the community in one common agony of desolation.

The merits of this perturbation, or of the remedies proposed for saving the pecuniary life of the old-fashioned capitalist-employer, of course do not concern the present



inquiry; but the matter has been referred to here as evidence that the pecuniary magnate's work, and the dominion which his extraordinarily large wealth gives him, are, in effect, substantially a new phase of the economic development, and that these phenomena are distastefully unfamiliar and are felt to be consequential enough to threaten the received institutional structure. That is to say, it is felt to be a new phase of business enterprise, —distasteful to those who stand to lose by it.

The basis of this business enterprise on the higher plane is capital-at-large, as distinguished from capital invested in a given line of industrial enterprise, and it becomes effective when wealth has accumulated in holdings sufficiently large to give the holder (or combination of holders, the "system") a controlling weight in any group or ramification of business interests into which he may throw his weight by judicious investment (or by underwriting and the like). The pecuniary magnate must be able effectually to engross the pecuniary initiative and the business opportunities on which such a section or ramification of the business community depends for its ordinary gains. How large a proportion of the business community's capital is needed for such an effectual engrossing of its capitalistic efficiency, in any given bearing, is a question that cannot be answered in anything like absolute terms, or even in relative terms of a satisfactorily definite kind. It is, of course, evident that a relatively large disposable body of capital is needed for such a purpose; and it is also evident, from the current facts of business, that the body of capital so disposed of need not amount to a majority, or anything near a majority, of the investments involved, —at least not at the present relatively inchoate phase of this larger business enterprise. The larger the holdings of the magnate, the more effectual and expeditious will be his work of absorbing the holdings of the smaller

capitalist-employer, and the more precipitately will the latter yield his assets to the new claimant.

Evidently, this work of the pecuniary magnate bears a great resemblance to the creation of intangible assets under the ordinary competitive system. This is, no doubt, the point of its nearest relation to the current capitalistic enterprise. But, as has already been indicated above, it cannot be said that the magnate's peculiar work is the creation of intangible, or other assets, altho there is commonly some recapitalization involved in his manœuvres, and altho his gains commonly come as assets, *i.e.*, in the capitalized form. Nor can it, as has also been indicated above, be said that the wealth which serves him as the means of his peculiar enterprise stands in the relation of assets to this enterprise or to the gains in question, since this wealth already stands in an exhaustive relation as assets to some corporate enterprise in ordinary business and to the corresponding items of interest and dividends. It may, of course, be contended that the present state of things on this higher plane of enterprise is transient and transitional only, and that in the settled condition which may conceivably supervene the magnate's relation to business at large will be capitalized in some form of intangible assets, after the manner in which the monopoly advantage of an ordinary "trust" is now capitalized. But this is at the best only a surmise, guided by inapplicable generalizations drawn from a past situation in which this higher enterprise has not engrossed the pecuniary initiative and played the ruling part.

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