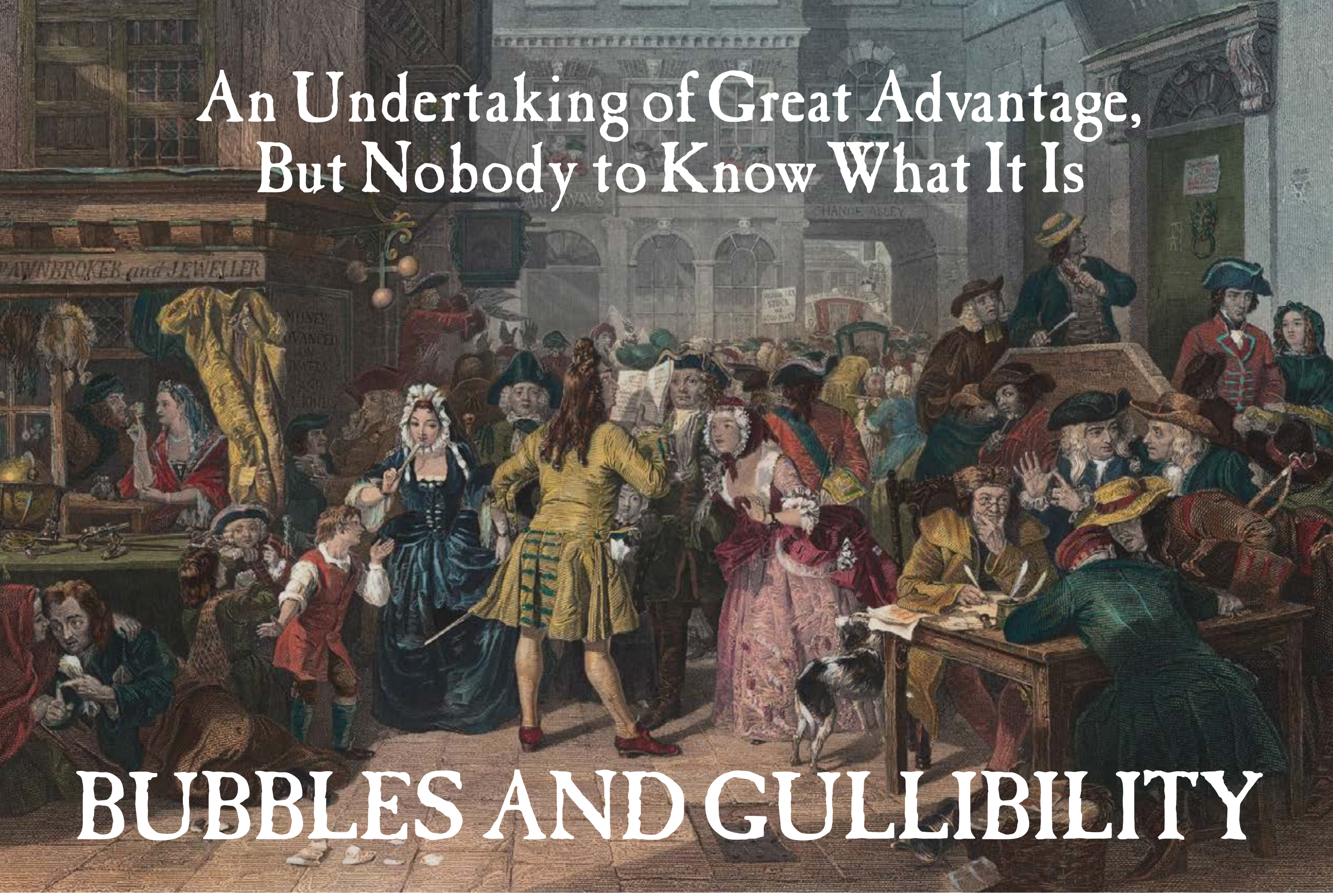
An Undertaking of Great Advantage, But Nobody to Know What It Is

BUBBLES AND GULLIBILITY



By Andrew Odlyzko

One of the most famous anecdotes in finance is of a promoter in the 1720 South Sea Bubble who lured investors into putting money into "an undertaking of great advantage, but nobody to know what it is." This tale is apocryphal, but it is only a slight embellishment of some documented cases. Most were slightly less preposterous than the anecdotal one, when considered in the context of the time, but they all reflect the high level of credulity displayed by the investors of 1720. However, it is debatable whether their gullibility was greater than that of the most sophisticated investment professionals in recent times. This leads to some intriguing thoughts about the nature of financial markets and human society in general.

A reference that is often cited for this and other colorful tales of investor irrationality is Charles Mackay's ever-popular *Extraordinary Popular Delusions and the Madness of Crowds.* It was first published in 1841 under a slightly different title and had the following account, which was basically copied from John Oldmixon's *The History of England* a century earlier:

> [T]he most absurd and preposterous of all [the new projects of 1720 in London], and which showed, more completely than any other, the utter madness of the people, was one started by an unknown adventurer, entitled "*A company for carrying on an undertaking of great advantage, but nobody to know what it is.*" Were not the fact stated by scores of credible witnesses, it would be impossible to believe that any person could have been duped by such a project. The man of genius who essayed this bold and successful inroad upon public credulity, merely stated in his prospectus that the required capital was half a million, in five thousand shares of [£100] each, deposit [£2] per share. Each subscriber, paying his deposit, would be entitled to [£100] per annum per share. How this immense profit was to be obtained, he did not condescend to inform them at that time, but promised, that in a month full particulars should be duly announced, and a call made for the remaining [£98] of the subscription. Next morning, at nine o'clock, this great man opened an office in Cornhill. Crowds of people beset his door, and when he shut up at three o'clock, he found that no less than one thousand shares had been subscribed for, and the deposits paid. He was thus, in five hours, the winner of [£2,000]. He was philosopher enough to be contented with his venture, and set off the same evening for the Continent. He was never heard of again.

Note that although this project is described by Mackay as "absurd and preposterous," it did promise "full particulars" of the scheme in a month. Is that much different from what happens today when people give their savings to investment managers,

Image of the South Sea Bubble, by artist Edward Matthew Ward (1816–1879).

venture capitalists or, even more, to general "blind pools"? Such investors do not find out "full particulars" of what is done with their money for quite a while.

Just how much was this £2,000 that the "great man" of the Mackay version of the story is supposed to have made? Based on GDP per capita, which grew by about 1,000 over the last three centuries, the gains reaped by the projector are comparable to about £2 million, or $2 million today. That is not shabby. But it pales when compared to the sums collected by promoters of the innumerable ICOs (initial coin offerings) in the last few years.

Various observers have doubted the literal truth of the anecdote, and some details in the Oldmixon/Mackay narrative are simply not consistent with how new ventures were set up in 1720. The most plausible scenario is that this story is an amalgam and embellishment of several actual occurrences, an account that is "too good not to be true." But it is only a slight embellishment. Oldmixon's version of this story concluded with an observation about the irrational behavior that crowd psychology lures investors into. He wrote that, "What, at another time, when people were in their senses, and knew what to do with their money, would have occasional a hue and cry after the cheat, was then only a matter of laughter, and the crime and the sum hardly thought worth taking notice of." And that seems very accurate, as speculative excitement does warp people's perception of what is sensible. It did so in 1720, and does so today.

Before considering projects from the 1720 era that may have contributed to the creation of the anecdote, let us say a few words on the background of the South Sea Bubble. There is much publicly available material on this historical event online. A short overview is available in a chapter in Edward Chancellor's book, *Devil Take the Hindmost*. The main book-length recent treatment is in John Carswell's *The South Sea Bubble*. This episode of extreme investor excitement had huge financial flows centered on the South Sea Company. Figure 1 shows the price of its main security.

The South Sea Bubble was largely inspired by John Law's Mississippi Scheme in Paris, which reached its peak at the end of 1719. Both the French and the British manias were enabled by the return to relative peace and tranquility after several prolonged and debilitating wars. Interest rates were dropping,

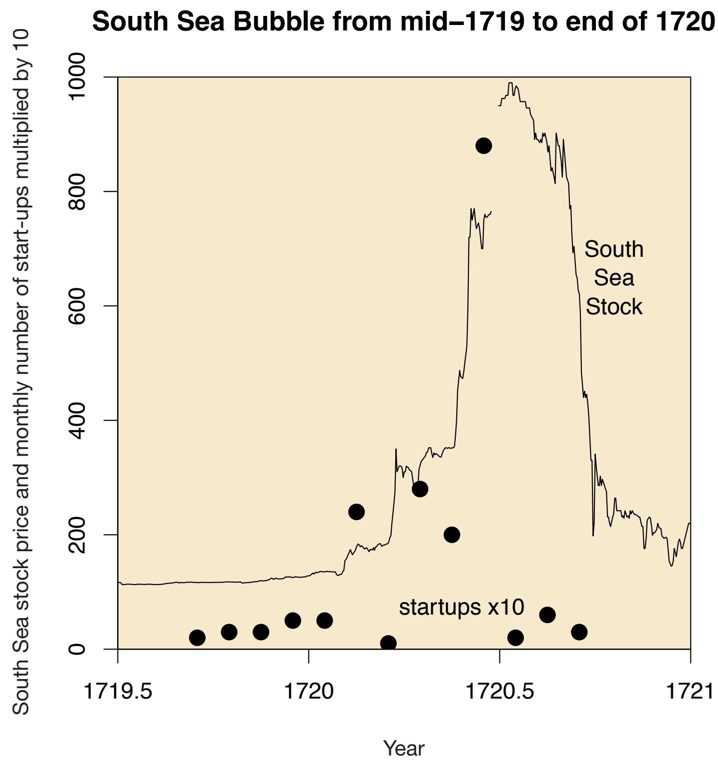


Figure 1. South Sea stock price and the number of new projects announced in London each month from July 1719 to December 1720. The scatter plot shows 10 times the number of start-ups each month, so that the one for June 1720 corresponds to the 88 ventures that, according to one count, were announced that month.

and investors' "animal spirits" were stirring. The ebullient atmosphere of 1719 offered new opportunities to promoters, and they began soliciting money from investors. Figure 1 shows, in the scatter plot, the number of new projects announced each month, but multiplied by 10, so that the 88 projects of June 1720 correspond to 880 in the figure. These numbers are taken from William Scott's *The Constitution and Finance of English, Scottish and Irish Joint-stock Companies to 1720*. As can be seen, out of the almost 200 projects that Scott tabulated, only 13 were started in 1719. But they were noticed by many observers. Also noticed was what seemed to many skeptics to be the inordinate credulity of the public that was eager to get involved. This led to the first of the events that likely inspired the "undertaking of great advantage, but nobody to know what it is" fable.

Starting on Friday, December 18, 1719, the *Daily Post* carried for several days an ad for an "extraordinary scheme for a new insurance company to be proposed, (whereof publick notice will speedily be given in this paper)," with "permits to subscribe" offered for £0.05 each. No names of projectors, nor details of the scheme were cited. The sale of the "permits" took place on Thursday, December 24. Two days later, this same paper had an ad which offered refunds for the "several hundred" of those permits that had been sold and explained that the whole thing was a hoax designed to show how easy it was to "impose upon a credulous multitude." The ad mentioned that the person who had collected the money was unknown to anyone in the crowd, and signed receipts with a name made up from the initials of the six people who concocted the scheme.

While this spoof did show that British investors were "a credulous multitude," it was far less extreme than the Oldmixon/Mackay fable. Even if all 1,000 permits were sold, the total take was only £50, not the £2,000 of the fable. Furthermore, for an individual buying a single permit, the price of £0.05 was only the cost of a dozen cups of coffee. So the "credulous multitude" were not risking very much individually. Furthermore, they were not putting their money into an "undertaking …nobody to know what it is," but into an insurance scheme. Actuarial science was in its infancy, so insurance was underdeveloped, and there were some sound reasons for expecting growth in that area.

The "permit" process visible in the *Daily Post* ads was indeed how promotions of that period were started. Investors would put down very minor amounts for a permit, often the £0.05 of the ads. This permit would entitle them to become shareholders later. It was only at that later subscription stage, typically weeks afterwards, that the more substantial amounts, such as the £2 per £100 share of the Oldmixon/Mackay fable, were asked for. That stage, reached by very few of the South Sea Bubble projects, made them more concrete. It involved shareholder meetings, elections of management, and participation of known bankers as collectors and custodians of the money being invested.

A week after the nature of the spoof was unveiled—on January 2, 1720—another paper, the *Weekly Packet,* carried a paragraph about it. It treated the event as a humorous and praiseworthy joke, expressing the hope it would "prove a means of preventing many innocent people being gulled of their money for the future." A week later, Mist's *Weekly Journal* had a much more detailed account. But this article also seemed to embellish the story, perhaps part of the common trend by which the fable grew and acquired its more colorful aspects as time went on.

In spite of the ads that revealed the nature of the joke, and the publicity in the *Weekly Packet* and Mist's *Weekly Journal*, speculative excitement continued growing, and many investors were "gulled of their money." It should be said that the British press during the South Sea Bubble was somewhat split in its coverage of the South Sea scheme itself, where the really big money went. However, this press was almost uniformly scornful of the myriad new projects, the "bubbles" in the language of the time. With a few exceptions, they were presented as frauds, designed just to fleece the public. But such publicity did not have much effect. Ads similar to the hoax from December 1719 proliferated as the Bubble was inflating in early 1720. Almost all were for well-defined purposes, even if those seemed to skeptical minds to be chimerical. But several featured elements of the "nobody to know what it is" mystery. For example, the May 21, 1720 issue of the *Daily Post* carried an ad for raising £6 million (so comparable, relative to GDP, to

Image courtesy of the English Broadside Ballad Archive.

"The Bubblers bubbled, or the Devil take the hindmost." This cartoon was printed in June 1720, at the height of the South Sea Bubble.

£200 billion for the UK, and $2 trillion for the U.S. today). It was "carry on a design of more general advantage to Great- Britain and Ireland, &c. and of more certain profit to the encouragers thereof, than any undertaking yet set on foot: Of which further notice will be given in this paper." Soon the atmosphere became even more frenzied, largely because of the impending passage of the Bubble Act, which outlawed most new companies. For example, on June 8, the *Daily Post* had an ad for a company "for carrying on a thing that will turn to the advantage of the concerned" with no indications what that "thing" was. But we should note that this was just the newspaper ad, and it is quite possible that when prospective investors showed up in the indicated place for purchasing "permits," they did receive at least some outlines of a business plan. If so, it would be similar to modern venture capital funds, where investors typically are told in advance that it is to concentrate in the biomedical area, say.

It is possible that there was even a project that did advertise itself literally as "an undertaking of great advantage, but nobody to know what it is," since *Mercurius Politicus* for June 1720 listed it, and *Political State of Great Britain* for July 1720 reprinted that listing.

There were also contemporary reports of promoters simply absconding with investors' initial payments, as in the other element of the anecdote. For example, the *London Journal* of June 11, 1720, the day that the Bubble Act became law, noted:

> About the middle of this week two or three of our famous projectors took care to put themselves out of the reach of the new Act of Parliament for suppressing of bubbles; for having got their subscriptions full, they closed their books, shut up their offices, and fairly marched off with five or six hundred pounds a-piece in their pockets, in order to secure to themselves the sole benefit of such laudable undertakings.

We don't have any statistics on how frequent such occurrences were. This might be partly because, in Oldmixon's words cited before, in the atmosphere at the peak of the Bubble, when "people were [not] in their senses," such events were "only a matter of laughter."

A likely reason that it was "only a matter of laughter" when some promoters made off with initial deposits is that much greater sums were being abstracted from investors' pockets by more elaborate maneuvers. A venture that proved popular would see the value of the permits soar, and any held back by the promoters in the initial stage could be sold at high prices. If the project went to actual subscription phase, more money would go through promoters' hands, and if prices of the shares rose, there were more chances for astute operators to fleece investors. Of course, not all promoters were astute, and many were ruined themselves. That's how it is in all investment manias. Unfortunately, we simply don't have any systematic data on what happened with the new projects of the South Sea Bubble era.

The main issue in investing is the degree of plausibility of new ventures that should be demanded. After all, there was some plausibility to the stories told by the various people who "sold" the Brooklyn Bridge. And there is some plausibility in the emails telling us about a forgotten inheritance, of which we can get a large chunk by assisting the senders of the spam. And there was even greater plausibility in the stories that Adam Neumann told in building up WeWork. The key issue is human judgment of what is sensible.

At the peak of a mania, it is often difficult to tell the difference between satire and reality. As just one example from our era, consider WeWork's stated mission to "elevate the world's consciousness." Several compilations of South Sea Bubble projects list three for building or emptying toilets. Carswell in his book says ads for those ventures were "inserted as pure jokes, which have imposed only on historians" (p. 117). But they may not have been jokes, as they were treated seriously by most contemporaries (cf. Mist's *Weekly Journal,* February 27, 1720). And then there is the South Sea scheme itself, the centerpiece of the South Sea Bubble. That is where the main money flows were concentrated, and by some measures it was the most preposterous of all financial proposals of that era. But we don't treat it here.

Some of the seemingly preposterous small projects of the South Sea Bubble are not all that farcical when considered in the context of that era. Alchemy was still being taken seriously, and even Isaac Newton had devoted some years to it a couple of decades earlier. So extracting silver out of lead was not as absurd then as it is now. Similarly, perpetual motion was far more respectable then, and patents for it continued to be granted in Britain into the early 19th century. Thus, simply looking at the stated aims of various bubbles from 1720 is rather misleading. And the vast majority of the projects were for relatively mundane businesses, such as trade or insurance, which were developing rapidly.

Thus, there is some ground for considering the many minor bubbles of the South Sea Bubble as outgrowths of the exuberant optimism of that era. And they are not necessarily more absurd than many examples from the dot-com era, like eToys or Webvan, or the more recent WeWork fiasco. Even the fact that most of the South Sea projects were dishonest in design is not unusual, as widespread fraud has been typical of investment manias. One study in early 2018 characterized over 80% of the ICOs as "outright scams" (Kharif). Further, while bubbles have a very negative image, they have made positive contributions to society, by spurring development of new technologies and new business models.

Yet, to twist the famous quote of Mae West, "too much of a good thing" is not always "wonderful." In investments, excessive credulity all too often leads to panics and crashes. And those are sometimes followed by costly and painful recessions or depressions. So can we use history to help develop guidelines for detecting dangerous bubbles? The task is certainly not easy, and it seems unlikely that a foolproof method can be found. But one approach is to try to develop a gullibility index. One element of it might be the susceptibility of people to those spam emails or phone calls that offer a share in some forgotten inheritance. Another might be the expectations of profits that passive corporate investments can achieve, which tend to soar during bubbles, with the 100% annual return promised in the Oldmixon/Mackay tale not unusual. Yet another might be derived from the nature of the new projects being offered to the public. What we find in the South Sea Bubble as well as in other manias is a myriad of imitative ventures without any innovative contribution, concocted out of nothing by promoters with no successes in their records. (Think of the hundreds of ICOs, for a modern example.)

Many standard approaches to detecting bubbles rely on looking for dangerous levels of leverage in the financial system. However, leverage is not easy to measure, since it can show up in various ways and in unexpected places (largely in the "shadow banking system" prior to the Global Financial Crisis of 2007–2008). A gullibility index might be useful, since it is the rise in investors' hopes that leads to extensions of credit, which is what leverage is about. Thus, there might be ways to use historical knowledge to help us prepare for the future. Credulity is basic to human nature, and likely essential to stimulating progress. But we could benefit from being able to rein it in. The famous "undertaking of great advantage, but nobody to know what it is" likely never existed. But this memorable phrase is a nice way to keep reminding the public about excessive gullibility. $

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