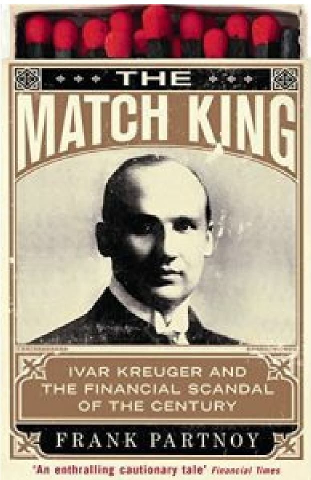

Book The Match King

Ivar Kreuger and the Financial Scandal of the Century

Frank Partnoy
Profile Books, 2010
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Recommendation

Readers who love fascinating stories with unforgettable characters will thank professor and market expert Frank Partnoy for his book on 1920s business icon Ivar Kreuger. This remarkable figure was a global financier, Greta Garbo's close companion, and an adviser to prime ministers, kings and a U.S. president. Though he was one of the world's greatest con men, he has somehow slipped, all but forgotten, from popular history. Partnoy resurrects Kreuger in all his tragic glory: a successful, well-known entrepreneur whose abrupt fall from grace and apparent suicide – by a bullet through the heart – coincided with the Great Depression. Kreuger's financial chicanery led to comprehensive U.S. securities reform in the early 1930s. *BooksInShort* considers this business biography a rollicking good tale. It holds particular lessons for those looking to make sense of recent financial history: how a brilliant businessman made some innovative – and eerily familiar – promises to greedy, willfully ignorant investors.

Take-Aways

- In the 1920s, business genius Ivar Kreuger, "the Match King," controlled a financial empire, including the largest safety match manufacturer in the world.
- One of Europe's richest men, he could quickly win the trust of anyone he met.
- He also was a consummate con man, organizing elaborate Ponzi schemes to secure new capital to pay earlier investors.
- In 1922, Kreuger traveled to America to raise funds for his newest business plan.
- He hoped to lend money to national governments at attractive rates in return for the match-selling monopolies in their countries.
- Kreuger dazzled U.S. investors, Wall Street and the press with his inventive capital raising and consistently high returns, supposedly based on the humble match.
- In an ironic twist, he successfully established match-selling monopolies in many countries, all the while manipulating his companies and accounts.
- His fraudulent financial house of cards collapsed after the 1929 stock market crash.
- In 1932, when Kreuger died – an apparent suicide – his investors panicked.
- Partly due to Kreuger's fraud, the U.S. government instituted new securities laws.

Summary

Across the Ocean to Get Money

In 1922, Ivar Kreuger traveled on the German cruise ship *Berengaria* from Southampton to New York City – the destination for entrepreneurs seeking money. In the Roaring '20s, everyone wanted to get rich on the next big deal. A hugely successful Swedish businessman, the 42-year-old Kreuger quickly impressed his fellow passengers with his wit, charm and business acumen. He carefully planned every conversation with these wealthy voyagers, striving to create the perfect impression. He would need their goodwill, admiration and, later, their money.

> "He must surely have been the best-liked crook that ever lived." (Frederic Whyte)

Kreuger's holding company, Kreuger & Toll, routinely paid 25% dividends based on its investments in Swedish filmmaking, real estate and banking, and in Kreuger's primary business, the Swedish Match Corporation, which produced two-thirds of the world's safety matches. His new plan: raise money in the U.S. to lend to governments in return for rights to sell his matches exclusively in their countries.

"Lee Higg"

At the time, Lee Higginson & Co., known as Lee Higg, was one of New York's leading investment banks. Kreuger cleverly maneuvered to meet Donald Durant, head of its "syndicate department." He detailed his monopoly plan to Durant, who arranged for him to meet the firm's partners for lunch at its offices near Wall Street. Kreuger was an instant hit with the bankers, who agreed to help secure financing for his new venture. They viewed the impressive Kreuger, with his perfect manners, cosmopolitan air and confident demeanor as "the whitest of the white shoes." Plus, they believed that he might give them the opportunity to overtake their primary rival, the mighty J.P. Morgan & Co.

> "Everything in life is founded on confidence." (Ivar Kreuger)

Kreuger and Durant soon embarked on capital-raising road shows. They set up a new company, the International Match Corporation, in tax-advantageous Delaware. The initial shareholders were Swedish Match and a number of Swedish banks. The new firm issued convertible gold debentures, or bonds redeemable in either cash or gold. Lee Higg quickly sold $15 million worth of the innovative paper, "one of the largest security issues of the year." Kreuger sent his brother, Torsten, to act as his emissary in proposing the monopolies to governments in Latin America and Europe, starting with Poland. Kreuger's scheme was off and running, but he had one major problem: getting his newly raised funds out of America.

> "Investors would give cash to Ivar, and trust him to use it to generate yet more cash."

In New York, Kreuger dispatched his new hire, Swiss-American Ernst August Hoffman, to Zurich to investigate its tax and financial regulations. Since Switzerland lived up to its reputation as a "banking and tax haven," Kreuger established a secret conduit company there, the Continental Investment Corporation, to use to move funds from the U.S. to Europe. Kreuger had Hoffman – the only other person who knew about the company – reregister it in Liechtenstein to avoid U.S. taxes on International Match's earnings.

The "Black Hole"

Spinning an intricate web of subsidiaries, affiliates and shell companies, Kreuger created a black hole that would prove impenetrable to U.S. auditors looking into his stateside business. Kreuger went to such convoluted lengths because he was desperate for money. He had to keep paying the double-digit returns he promised his investors. His legitimate companies couldn't earn enough to pay those dividends, so – without informing his partners at Lee Higg – he erected an elaborate Ponzi scheme, using funds from new investors to pay current backers. But unlike Charles Ponzi, Kreuger owned real businesses, including the successful Swedish Match. He used complicated, inventive, "off-balance sheet financing" to hide his debts. A Swedish accountant described Kreuger's financial empire as "the Greatest Speculation Venture in Sweden." By 1922, Kreuger's estimated net worth of "at least 25 million kronor" placed him among Europe's richest people.

> "Ivar believed that if he kept raising cash to pay earlier debts his businesses would grow fast enough to survive, even if they continued to pay high dividends."

Oblivious to Kreuger's financial chicanery in Europe, Durant continued to trust him. Besides, he believed Kreuger's handpicked American auditing firm, Ernst & Ernst, would relay any discrepancies in Kreuger's accounts to Lee Higg. A.D. Berning, a junior Ernst & Ernst auditor, worked on the International Match account, but not on the accounts of its affiliates. Needing Berning's acquiescence to his inventive bookkeeping, Kreuger tucked the auditor snugly in his back pocket by underwriting extravagant trips for the young man and his wife.

> "The message from Ernst & Ernst was that if Ivar decided he didn't like some numbers, they easily could be changed."

By late 1924, "International Match was a strange looking operation," with only two financial documents: a "Statement of Assets and Liabilities" (which "could easily fit in a wallet") and a handwritten "Consolidated Profit and Loss Account." Oddly, though established only in 1923, the company showed income for 1921 and 1922. But the Lee Higg partners didn't worry about such details. Kreuger was a visionary; they were sure they would profit greatly from him. And they did: In 1924, they sold additional International Match securities, "participating preferred shares," that paid off the gold debenture investors 19 years early and with 5% more than promised.

Poland and France Board the Kreuger Express

Poland's government was the first to agree to the monopoly deal in return for a $6 million loan from International Match at 7%. Kreuger trumpeted his Polish deal in America to secure a new round of backers. He invented "B Shares," each with only "1/1000 of a vote." In this way, he could raise money without ceding power to his investors. Lee Higg raised 90 million kronor from "the sale of 900,000 Swedish Match B Shares." Kreuger also asked Durant to find investors for more preferred shares for International Match.

> "According to one source, by early 1929 investments in Kreuger & Toll were the most widely distributed securities in the world."

In 1925, Kreuger set up the new firm Garanta in Amsterdam to "take over the entire match industry in Poland." To honor his agreement with the Poles, Kreuger had to secure $17 million quickly, so he sold more high-dividend preferred shares. He also hired a different auditor for Garanta. Karl Lange, who had been fired from a Stockholm bank for "arranging a secret loan to himself," was just the kind of man Kreuger needed to audit his clandestine company. He had Lange transfer $17 million from Garanta directly to him.

> “As is the case for many business people, Ivar walked a line between sharp business practices and maintaining an ethical reputation.”

With such complex arrangements, Kreuger’s monies in and out were impossible for anyone to trace. Yet, by 1926, International Match was “one of the most widely held stocks in the U.S.” In 1927, Kreuger arranged to lend France $70 million for a match monopoly. He raised the money by creating the innovative (read: complicated) “convertible debenture derivative.” Once again, manic investors threw their cash at Kreuger. With the French agreement, Kreuger had outpaced J.P. Morgan & Co. to become “the superman of finance.” He built his famous “125-room Match Palace in Stockholm,” reserving “the Silence Room” for only himself. He and his associates traveled extensively, concluding match monopolies with a dozen countries. By the late summer of 1929, Kreuger was at the peak of his success, hobnobbing with movie star Greta Garbo and U.S. President Herbert Hoover, and appearing on the cover of *The Saturday Evening Post* and *TIME*. Then, beginning in September, stocks began to fall, slowly at first, then faster.

$125 Million for Germany

In October 1929 – ever the gambler – Kreuger promised to lend Germany $125 million. Again, he would have to get it from American investors, a challenge, considering the severe market drop. Lee Higg and its consortium could have been left holding the new securities, Kreuger & Toll “American Certificates.” So, to boost confidence in the issue, Kreuger announced he would buy back any unsold securities, in one year’s time, “at cost.”

> “If everyone saw Ivar as a shining beacon of confidence, his securities would maintain their value, even if the rest of the market crashed.”

Kreuger could have backed out of his agreement with the German government, but his ego would not let him. The timing of his greatest deal, on October 28 and 29, coincided with “the most spectacular two-day decline in the history of financial markets.” Suddenly, Wall Street wanted an inside look at Kreuger’s finances. As usual, Kreuger not only didn’t panic, but, in a show of bravado, increased the International Match dividend. By now, his bankers and competitors had become more suspicious. According to Kreuger’s reported earnings, his profit margins were an astounding 20% on matches, a product priced at a halfpenny a box. It didn’t compute.

Forged Certificates

With his back to the wall, Kreuger sloppily counterfeited “42 Italian government bills” and forged a match monopoly agreement with Italy. Kreuger stored the documents in his safe at the Match Palace. In December 1930, some banks took Kreuger up on his offer to buy back almost $4.4 million in unsold American Certificates. Convincing a reluctant Lee Higg to issue $50 million in gold debentures, Kreuger quickly moved the funds to Liechtenstein.

> “The world now saw an epic betrayal: a villain, not a hero; a schemer, not a planner; a destroyer, not a builder. Ivar became the Judas of the financial markets.”

By this time, rumors swirled about deficits at Kreuger & Toll. Kreuger sent Durant and his fellow bankers a memorandum listing the firm’s assets. Though they could not verify the list, they still agreed to a final loan to Kreuger. In 1931, the value of his companies’ securities precipitously dropped; bankers and analysts speculated that he had to be in serious financial trouble. The usually abstemious Kreuger began drinking and smoking heavily; he disappeared for months at a time, shunning “all human contact.”

> “Ivar’s primary company, Swedish Match, survived the scandal and maintained a substantial share of the global match market.”

At the end of the year, Kreuger returned to the U.S., meeting with President Hoover and delivering upbeat speeches across the country. In New York, Durant held firm: He could raise no more money for International Match. To boost his company’s share price artificially, Kreuger used Lange as an intermediary to buy his own stock, but the ruse did not work. Price Waterhouse sent an auditing team to investigate one of Kreuger’s firms, Ericsson, a phone company. Kreuger owed IT&T some $11 million on an Ericsson deal. At the same time, Swedish Match had a $2 million loan payment due. Further expensive interest payments waited just around the corner.

> “Few of the people Ivar touched had happy endings. The list of his 15,000-plus creditors ran for 200 pages and included such mainstays as Harvard College and the Chase Securities Corporation.”

The growing demands for cash took their toll: In February 1932, Kreuger physically collapsed and began alternating between “mania and depression.” Two of Kreuger’s associates searched the Match Palace for collateral. They came across the forged Italian bills, supposedly worth $100 million. Swedish authorities used search warrants to collect Kreuger’s business documents and made inquiries into the phony Italian bills.

> “Greta Garbo had remained Ivar’s friend until the end...Even after Garbo became a star, Ivar had remained her personal and business advisor.”

Kreuger sailed to Paris and, on March 11, 1932, bought a 9 mm pistol. The next day, when he didn’t turn up for a meeting, his associates discovered his body in his apartment; it appeared he had shot himself through the heart. When investors learned of Kreuger’s death, they panicked – the New York Stock Exchange “recorded the largest single trade in the history of the markets: a sale of 673,800 American Certificates of Kreuger & Toll.” Their value at day’s end? Pennies.

A Mixed Legacy

The investing public had revered Ivar Kreuger and made him one of the world’s most famous and admired men. But as word of his “financial manipulations” became public, investors quickly pulled out of his many companies. Lee Higg soon went out of business. With the news of the forged Italian bills, Kreuger, once a bright symbol of the exuberant 1920s, became known as “the greatest swindler in all history.”

> “He was not merely the greatest financial fraudster of the century. He was a builder, as well as a destroyer. He was a victim, as well as a perpetrator. He was a hero, as well as a villain.”

The U.S. Congress called Durant and Berning to testify at its hearings about the scandal, and soon "securities reform" became the rage in America. President Franklin D. Roosevelt invoked Kreuger's name when pressing for stiff new regulations. The Securities Act of 1933 called for "Generally Accepted Accounting Principles," and a year later, the Securities Exchange Act established the Securities and Exchange Commission (SEC). Both laws passed because of Ivar Kreuger, the infamous "Match King." While Kreuger's reputation was destroyed, he was not just a massive Ponzi operator. He created real and lasting value in the businesses he founded: Swedish Match today has 12,000 workers in 11 countries. In addition, at the time of his death, he owned viable banks, mines, railroads, film companies and real estate. And whether current Wall Street wizards know it or not, Kreuger was the progenitor of many of Wall Street's dizzyingly complex financial products and markets.

About the Author

Frank Partnoy, former investment banker and corporate lawyer, wrote *F.I.A.S.C.O.: Blood in the Water on Wall Street*. He is a professor at the University of San Diego.