Volume Title: A Program of Financial Research Vol 1: Report of the Exploratory Committee on Financial Research

Volume Author/Editor: Exploratory Committee on Financial Research

Volume Publisher: UMI

Volume ISBN: 0-870-14458-8

Volume URL: http://www.nber.org/books/expl37-1

Publication Date: 1937

Chapter Title: Changes in the Capital Requirements of Business Enterprise and the Decline of the Commercial Loan

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Chapter URL: http://www.nber.org/chapters/c0625

Chapter pages in book: (p. 43 - 46)

Section A

Projects Related to the Committee's Research Recommendations

CHANGES IN THE CAPITAL REQUIREMENTS OF BUSINESS ENTERPRISE AND THE DECLINE OF THE COMMERCIAL LOAN

General Background

With the rapid growth of corporate cash balances and liquid assets during the 1920's, business borrowing from banks declined relatively to other types of borrowing. Business loans apparently comprised between 50 and 60 per cent of bank portfolios in 1920; by 1929 they had declined to less than 40 per cent of earning assets; today they apparently constitute less than 20 per cent. Widely commented on by experts and viewed with concern and apprehension by active bankers, this manifest atrophy of business demands for banking accommodation has been variously explained from time to time. At first, emphasis was placed upon business reaction to the financial difficulties accompanying the post-War liquidation, the emergence of hand to mouth buying, improved inventory controls, self-finance, etc. When the relative decline persisted, authorities pointed to the easy capital market conditions and the speculative boom. With the advent of depression and widespread financial crisis, banking difficulties arising out of an inflexible and reputedly illiquid asset structure of banking institutions are said to have caused a shortage of bank credit to business and forced a liquidation of many outstanding business loans. More recently, the continued relative decline of business loans has been ascribed to the monetary and fiscal policies of the Federal government in conjunction with its widespread relief and recovery program as the primary short run explanation, while technological advances in methods of production and distribution, reducing the turnover period of business working capital, have been assigned as the underlying long run influences.

Whatever the merits of these various explanations of the relative decline of business loans from commercial banks, the theoretical and practical implications for the institutional structure and behavior of our financial system are far reaching indeed. What has been, for example, the change in the character of capital demands of business enterprise in the last two decades? On what other types of earning assets have commercial banks come to depend? Can our banking and credit system adapt itself to rely chiefly upon these other types of earning assets? To what technological and other economic forces may the decline in business demands for bank credit be attributed? Has the average turnover period for business working capital been materially shortened in many industries or has the shift to independence from short term debt been dictated by broader considerations rooted in the risks of large scale investment and the various influences affecting the continuity of corporate existence under shifting economic conditions? In what measure have special financing institutions operating with invested funds obviated the necessity that business enterprises finance through banks? To what extent have corporate enterprises with large cash balances assumed increasingly the burden of financing business customers, entering thereby into active competition with commercial banks in supplying working capital for the system at large? Finally, have alterations since 1933 in banking and financial laws governing the operations of banking institutions adequately taken into account changes in the character of demands for borrowed funds by business?

Specific Problems

Intimately related to the study of the behavior of corporate liquid funds, 1929–36, a separate investigation is proposed to deal with the progressive decline of commercial lending by banking institutions. As a specific point of attack, the financial statements of several hundred larger corporations reported in investment manuals would be intensively examined from 1920 to 1936, and analyzed with respect to the relationship of current assets to total assets, notes payable to current assets, inventories and current liabilities, cash and other liquid assets to current and total assets. These data should be classified by industry, size of corporation and in other meaningful ways. Supplementary quantitative data that reflect changes in the working capital and trends in commercial debt of medium and smaller size enterprises having a continuous existence for at least ten years could doubtless be obtained from the credit files of the Federal Reserve banks, the larger city banks, and various credit-rating agencies. In this phase of the inquiry the analyses by Lauchlin Currie and various investment agencies of tendencies in corporate financial practices would be useful.[1]

These facts assembled, the emphasis of the investigation would be shifted to technological changes, internal and external, affecting the working capital requirements of various industries. In this part of the study, among other things, capital turnover, including both total and working capital, would be estimated for those enterprises and industries for which data are adequate. Finally, the inquiry would: (1) study special finance companies, the sources of their capital and manner of operation, with a view to ascertaining how and in what degree their activities have contributed to the declining importance of the commercial loan; (2) examine changing techniques of financing current productive and distributive activities by large and highly integrated enterprises.

Procedure

This research should be conducted by a person versed in corporate accounting methods, experienced in corporate balance sheet and income account analysis, and acquainted with various statistical methods suited to an investigation of this type. Three main sources of data would be used: (1) the financial and investment manuals and files of investment services; (2) the credit files of the Federal Reserve banks and large city banks; (3) the credit files and related records of leading credit-reporting agencies. It would be necessary, therefore, to obtain the sympathetic interest and cooperative support of these institutions. Other raw materials for the study would have to be provided in large part directly by finance and treasury departments of the larger enterprises with whose executives friendly relations had been established.

[1] Lauchlin Currie, 'The Decline of the Commercial Loan', *Quarterly Journal of Economics*, August 1931, pp. 698–709.