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Volume Title: Corporate Cash Balances, 1914-43: Manufacturing and Trade

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Volume Publisher: NBER

Volume ISBN: 0-870-14136-8

Volume URL: <http://www.nber.org/books/lutz45-1>

Publication Date: 1945

Chapter Title: Relation of Cash Balances to Total Receipts and Expenditures, 1919-39

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Chapter URL: <http://www.nber.org/chapters/c4819>

Chapter pages in book: (p. 30 - 36)

RELATION OF CASH BALANCES TO TOTAL RECEIPTS AND EXPENDITURES, 1919-39

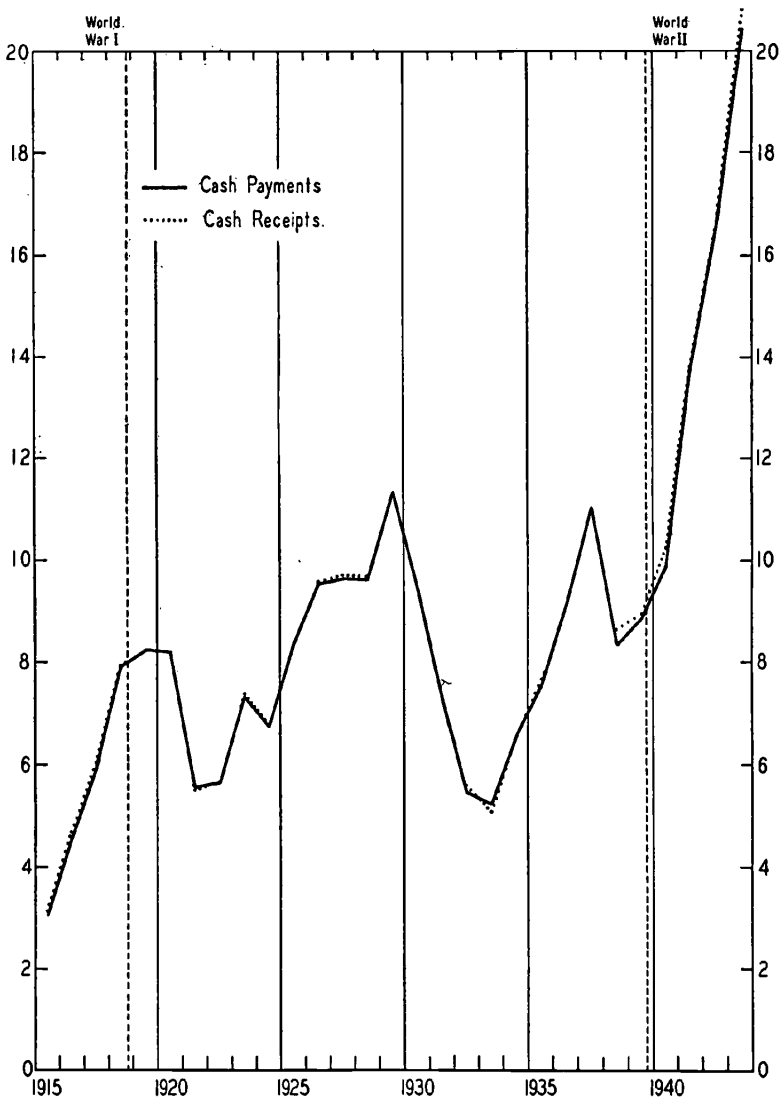
IN THE PRECEDING CHAPTER, when use was made of the sources and uses of funds analysis, only those receipts and expenditures which leave their trace in the balance sheet were considered. The present chapter is intended to supplement the analysis of Chapter 2 by taking into consideration the *whole* flow of receipts and disbursements and their major components. By this procedure the importance of changes in the cash balance, in relation to total receipts or disbursements and to their components, can be investigated.

Chart 7 presents estimates of total cash receipts and payments, annually, for our sample of large manufacturing corporations.¹ The differences between the two series are identical with increases or decreases in the cash balance. Compared with changes in either total receipts or payments, changes in the cash balance of our sample are insignificant. In the years in which part of the expenditures was financed by drawing on the cash balance, the decline of the cash balance never amounted to more than 2.7 percent (1933) of total payments; this contribution by the cash balance to the financing of total expenditures was small indeed. In the years in which receipts were greater than payments, that part of receipts which was absorbed by an increase of the cash balance never amounted to more than 3.6 percent (1938). In other words, almost all payments are financed by receipts which come in during the same year, or if receipts are greater than payments almost all receipts during the year are used in that same year to finance expenditures. Apparently, the cash balance contributes little to payments nor does it ever absorb much of the receipts.

Chart 8 shows cash receipts split up into receipts from sales and "other" receipts, and cash payments split up into operating

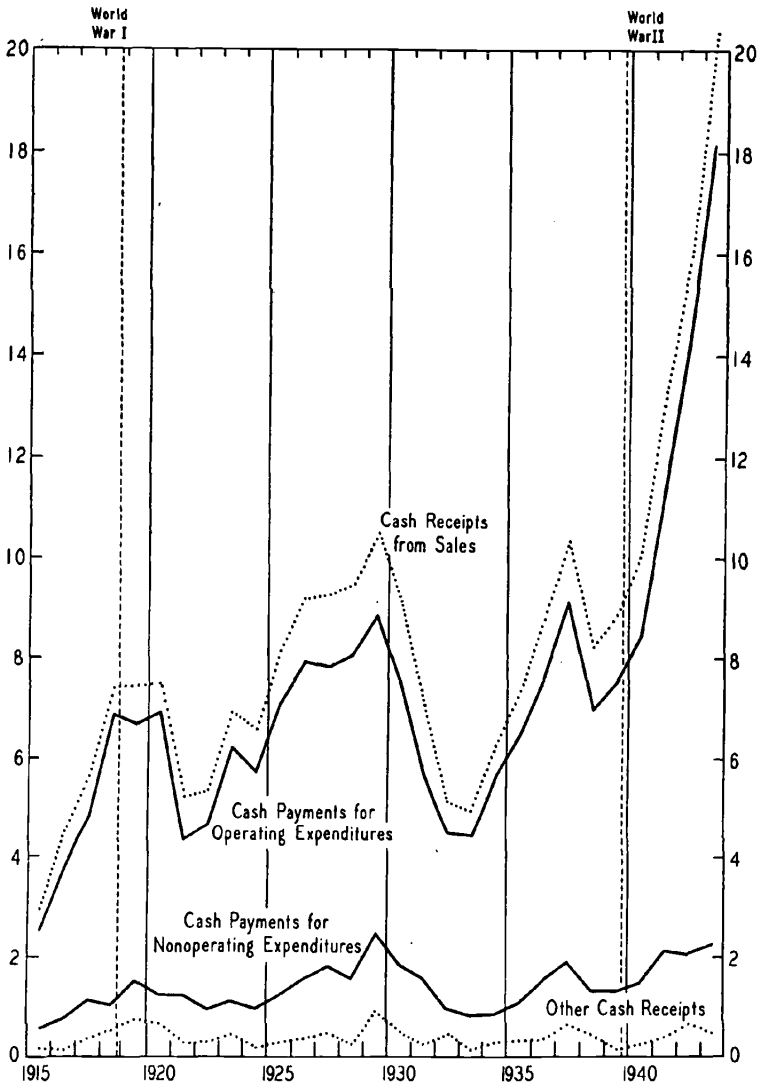
¹ For a detailed account of the method of estimating receipts and payments see Appendix C.

Chart 7—TOTAL CASH PAYMENTS AND TOTAL CASH RECEIPTS OF SAMPLE OF LARGE MANUFACTURING CORPORATIONS (SAMPLE B)



On the whole payments of large manufacturing corporations are financed by receipts during the year; the cash balance contributes little to payments and never absorbs much of the receipts.

Chart 8—MAJOR COMPONENTS OF CASH RECEIPTS AND CASH PAYMENTS OF SAMPLE OF LARGE MANUFACTURING CORPORATIONS (SAMPLE B)



There is always a net contribution to the cash balance on current account and a drain on the cash balance on noncurrent account for large manufacturing corporations.

expenditures and nonoperating expenditures. Other receipts are mainly receipts obtained through the issue of stocks and bonds and through borrowing from the banks,² and can be identified with funds from outside the corporations. It must be emphasized that they represent an inflow of funds without any deductions for an outflow which may occur over the accounting period through repayment of debts.³ Nonoperating expenditures represent mainly dividend payments and outlays on fixed property, both of which are of approximately equal quantitative importance. Operating expenditures are identical with total payments minus nonoperating expenditures. In the interwar period, other receipts never amounted to more than 9.4 percent of total receipts (1919), and they fell as low as 1.1 percent (1939); nonoperating expenditures never exceeded 22.0 percent of total payments (1921) and never fell below 13.5 percent (1934).

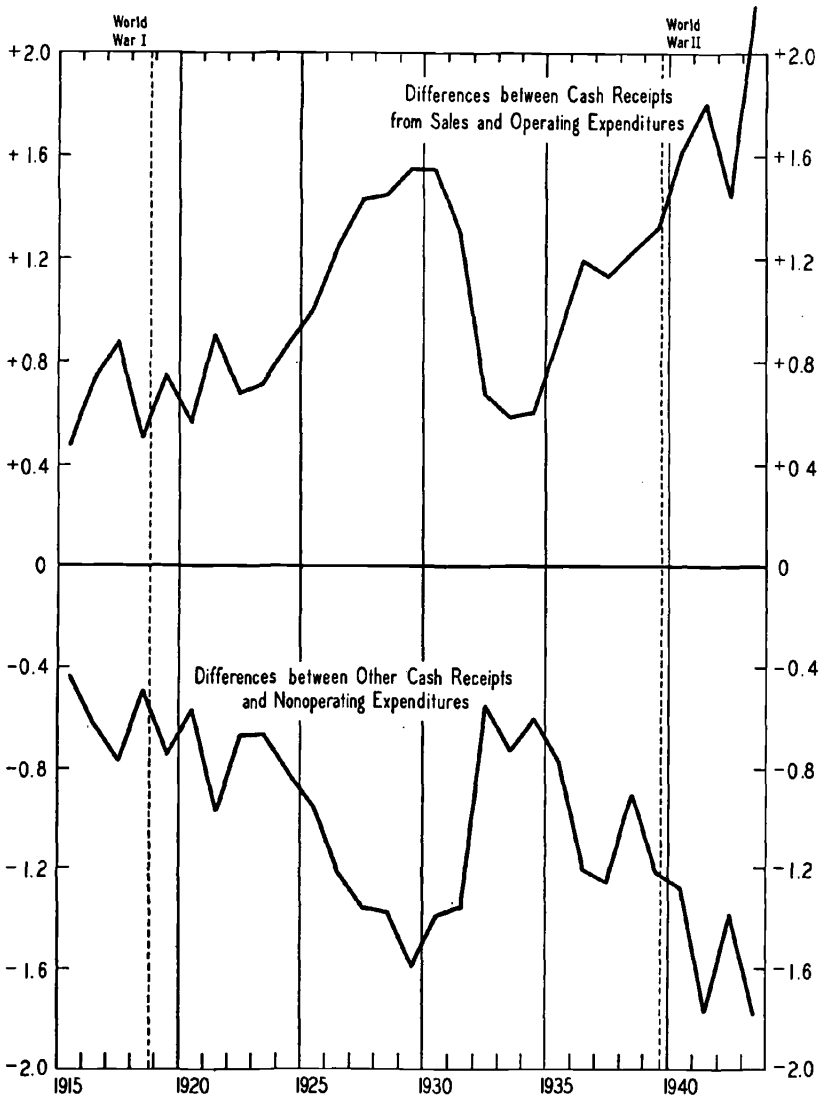
As is to be expected, current receipts (receipts from sales) are always larger than current expenditures (operating expenditures), and therefore there is always a positive contribution to the cash balance on current account. This contribution increased in the expansion of the twenties (from 1923 onward), declined in the contraction years of the early thirties, and rose again after 1933. These changes are shown clearly by the top curve on Chart 9. The excess of current receipts over current expenditures appears to follow a cyclical pattern, rising in an expansion period and falling during a period of contraction. But there are exceptions to this rule. Each of the recession years 1921 and 1938, for instance, shows an increase, and the expansion year 1937 a decrease, in the excess of current receipts over current expenditures.

These exceptions to the general movement of the excess of current cash receipts over current cash disbursements can be traced mainly to the influence that changes in inventory may have on current receipts or disbursements. As a rule, business expansion raises current receipts more than current outlays, mainly because profits from sales rise; in a depression prices fall and losses occur, with the result that the excess of current receipts over current expenditures declines. However, it may happen that inventory increases abnormally in a year of expansion (as in 1937), raising

² See Appendix C.

³ The net inflow of funds from outside is shown in Chart B-2, Appendix B.

Chart 9—DIFFERENCES BETWEEN MAJOR COMPONENTS OF CASH RECEIPTS AND CASH PAYMENTS OF SAMPLE OF LARGE MANUFACTURING CORPORATIONS (SAMPLE B)



When the surplus of receipts from sales over operating expenditures rises, companies can finance a larger volume of their nonoperating expenditures from this surplus, and vice versa when the surplus declines.

current expenditures without increasing sales by a corresponding amount. As a result the excess of current receipts over current expenditures may decline in spite of the rise in profits on sales. Contrariwise, inventory in a year of recession may show a sharp decline (1921, 1938), in which case receipts from the sale of inventory are not matched by corresponding operating expenditures incurred for the purpose of replacing the inventory. The excess of current receipts over current expenditures will then rise in spite of the decrease in profits on sales which may occur simultaneously.

While receipts from sales consistently exceed current expenditures, other receipts are consistently smaller than nonoperating expenditures (Chart 8). On noncurrent account therefore there is always a *drain* on the cash balance. But as Chart 9 shows, the drain becomes greater (i.e., the deficit on noncurrent account increases) in those years (with the exception of 1934, 1937, and 1938) in which the surplus of receipts from sales over current expenditures rises. The opposite movement of the excess on current account and the deficit on noncurrent account is, of course, causally connected: When the surplus of receipts from sales over operating expenditures rises, the companies can finance a larger volume of their nonoperating expenditures from this surplus, and vice versa when the surplus declines.

The difference between the surplus of receipts from sales and operating expenditures on the one hand and the deficit between nonoperating expenditures and other receipts on the other is identical with an increase, or decrease, of the cash balance. These increases and decreases of the cash balance do not seem to follow any definite pattern. The data in the bottom panel of Chart 5 give the impression that the residual movements of the cash balance are simply accidental. This impression, however, is misleading. The discussion in the preceding chapter has shown that if we consider the movements of the cash balance in relation to the other items of the balance sheet, they fit into a definite pattern; and the next chapter will reveal that a clear pattern emerges also if we relate the cash holdings to payments, i.e., to the work which they have to perform.

For small and medium corporations the cash balances do not increase and decrease in the same years as the cash balances of

large manufacturing corporations. Nevertheless, in all essential points the relation between cash balances and receipts and expenditures is the same for both groups of corporations.

SUMMARY

- (1) In the period 1918 to 1939 cash receipts from sales were always greater than operating expenditures. There was, therefore, a net addition to the cash balance on current account; this addition itself underwent wide fluctuations.
- (2) Nonoperating expenditures were always greater than noncurrent receipts, thus causing a drain on the cash balance. The difference between the two fluctuated widely.
- (3) The bulk of the "deficit" on noncurrent account was financed by the surplus on current account. An increase or decrease of the cash balance represented only a negligible part of either total receipts or total payments.