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: Trade Corporations

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Chapter URL: http://www.nber.org/chapters/c4826

Chapter pages in book: (p. 93 - 102)

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TRADE CORPORATIONS

AN ANALYSIS OF CORPORATE CASH BALANCES for large trade corporations reveals some striking differences from manufacturing corporations and also some similarities. The purpose of the present chapter is to point out these differences and similarities, although the preceding analysis used for manufacturing companies will not be repeated point by point.

The samples of trade corporations, on which the following discussion is based, are small[1] and, therefore, no generalizations of the conclusions of this chapter are permissible. However, when the results obtained are similar for both trade and manufacturing corporations, the presumption seems warranted that these results are due to forces in the economic system which affect various types of enterprise in the same fashion, no matter what line of activity may be carried on by an enterprise.

INTERWAR PERIOD

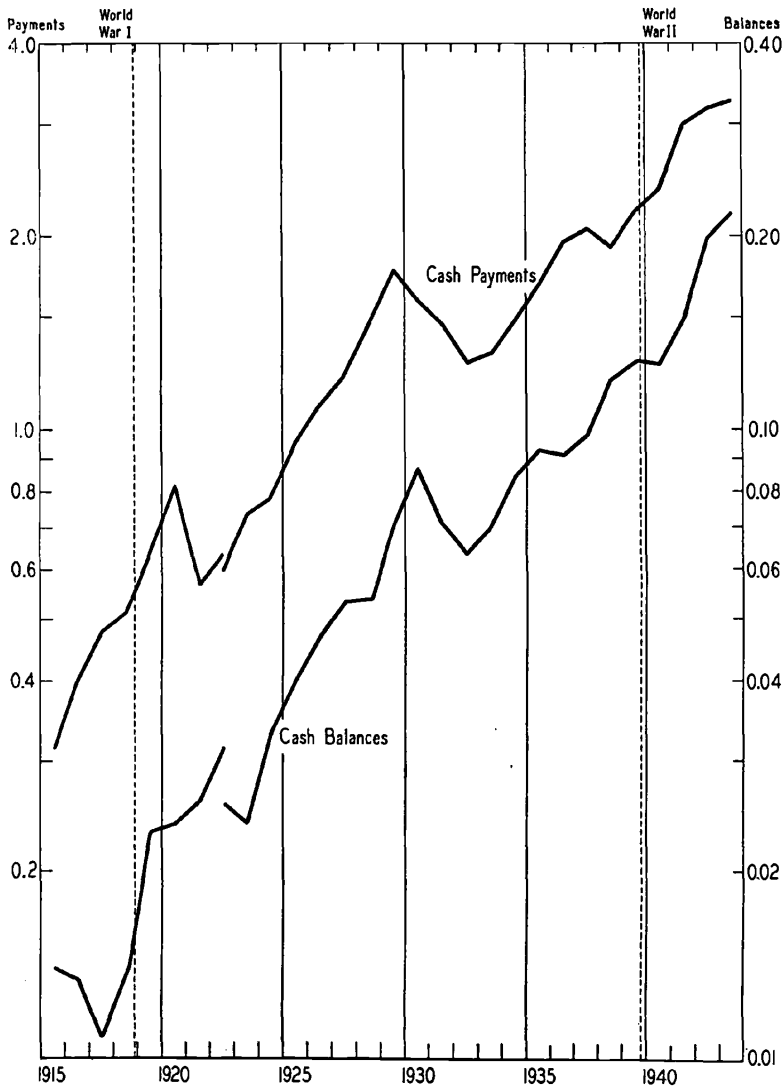
A comparison of average cash balances and payments of the samples of large trade corporations with corresponding series for samples of large manufacturing corporations reveals conspicuous differences between the two groups.

In the period between the two World Wars, the large trade corporations of our sample grew more rapidly than the large manufacturing corporations, a fact which is reflected in the trends of both cash balances and payments. The trends of these series for the trade companies rise more sharply than those for large manufacturing corporations. (Compare Chart 19 and Chart 10.)

The two curves for large trade corporations, although they do not show the same direction of movement year by year, show a greater degree of parallelism than the corresponding curves for manufacturing corporations. In particular the depression of 1930-33 is reflected in a decline not only in the payments figures of the

[1] For a description of these samples see Appendix A.

Chart 19—Estimated Annual Cash Payments and Average Cash Balances of Samples of Large Trade Corporations



The trends of both cash balances and payments indicate that large trade corporations grew more rapidly than large manufacturing corporations in the period between the two World Wars.

large trade corporations (which had begun in 1929) but also in the cash balances of these companies; the cash balances of large manufacturing corporations, on the other hand, rose somewhat above the level of 1929.

The upward trend of the cash balances of large trade corporations is steeper than that of payments; this is also true for manufacturing corporations in the interwar period but there is a marked difference of degree between the two groups in this respect. For large trade corporations the upward trend of the ratio of cash to payments is steeper than that for manufacturing companies. (See Chart 20 and Chart 11.) In the case of the latter group it may even be doubtful that one should speak of a rising trend at all (although a straight trend line fitted mathematically to the curve representing the ratio of cash to payments for large manufacturing corporations would have a positive slope), since the ratio of cash to payments in the expansion year 1937 shows a definite tendency to return to the level of the twenties. But there can be no doubt about the rising trend of the ratio of cash to payments for large trade corporations.

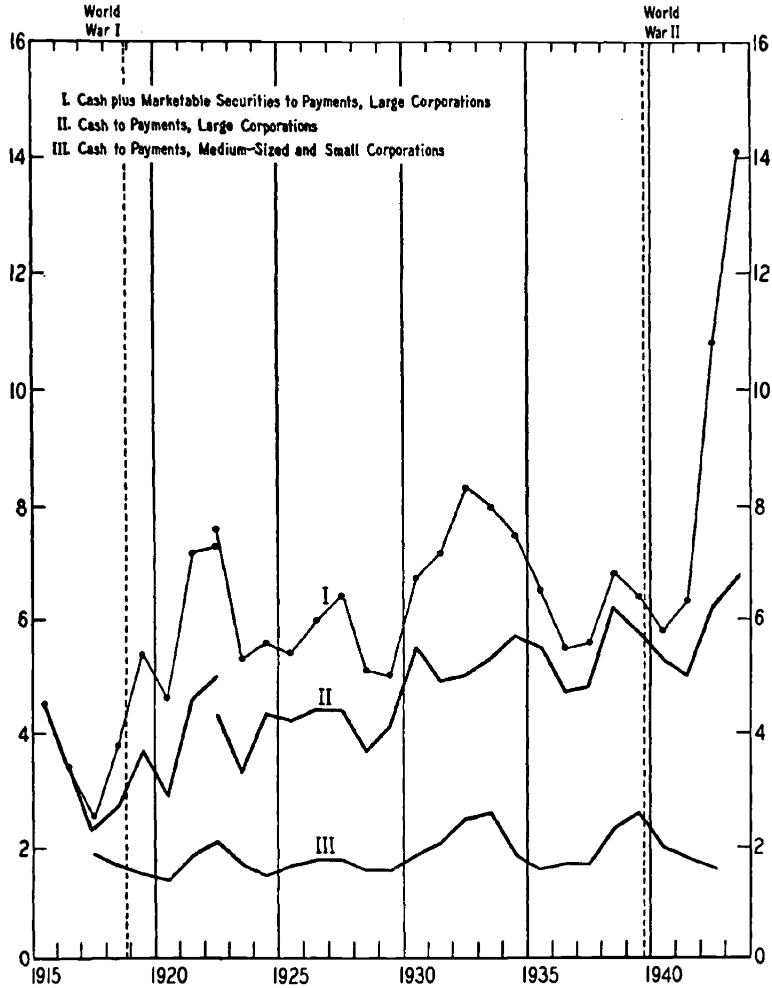
The reason for the rising trend of the ratio for large trade companies cannot be definitely established on the basis of the available material; very likely it is connected with the rapid growth of the companies included in the sample. In this connection it is significant that the ratio for our sample of small trade corporations, which did not undergo a similar rapid growth, does not display any upward trend. But why this rapid growth of large trade corporations should bring about a rising trend in the ratio of cash to payments is not self-evident. Without further information about the form in which this growth took place[2] and the changes in the habit of payments which may have accompanied it,[3] a definite answer cannot be given.

When the cyclical movement of the ratio is examined, conspicuous differences between large manufacturing and large trade cor-

[2] New chain stores, for instance, may require quite different ratios of cash to payments according to their geographical locations, e.g., whether they are located in agricultural or industrial districts.

[3] The growth of department stores may, for instance, have been accompanied by a growing habit of placing large single orders, which lead to large lump-sum payments. The latter necessitate a higher ratio of cash balances to payments of the companies concerned. (See the discussion in Chapter 4.)

Chart 20—LIQUIDITY RATIOS OF SAMPLES OF TRADE CORPORATIONS



porations are again found. The ratio for the latter group in the thirties does not show the inverse cyclical pattern displayed by manufacturing corporations; for large trade corporations the ratio does not show a marked rise after 1930. If the trend of the ratio were used as a basis for calculating "free" cash, following the method described for manufacturing companies,[4] "free" cash would appear in 1930 just as in the case of large manufacturing

[4] See Chapter 4, pp. 40-41.

corporations, but in contrast to the latter it would decline in 1931 and rise again from 1932 to 1934. From then on through 1938 the "free" cash of trade corporations would show the same movement as that of manufacturing corporations — decreasing during expansion and increasing during contraction.

If marketable securities are taken into account, these differences between large trade and large manufacturing corporations disappear, to a great extent. First of all, the trend of the ratio of cash plus marketable securities to payments of large trade corporations for the period from 1921 to 1939 is approximately horizontal; in addition, the cyclical pattern of the ratio between 1929 and 1938 is the same as that for large manufacturing corporations.[5] From these comparisons it follows that the main difference between the two groups is in the distribution of their liquid funds between cash and marketable securities. In particular, large trade corporations bought marketable securities in 1931 on a relatively larger scale[6] than the manufacturing corporations. The appearance of "free" liquid funds in 1930, their decline during the upswing after 1933, and their sharp rise in the recession year of 1938 are therefore common to both groups.

The reasons for the fluctuations in "free" funds are the same for both groups. The trade companies liquidated "operating" assets (mainly inventories) during 1930-33, and thereby increased their cash holdings or marketable securities; some of these additional liquid funds were used to pay a substantial part of their bank debts, but since the large trade corporations were not greatly indebted to banks around 1929, this outlet did not absorb all the surplus liquid funds, just as in the case of large manufacturing corporations. Nor did the excess of dividend payments over current earnings or the retirement of long-term debt amount to a large sum in the contraction years 1930-33.[7] In 1938 a relatively small liquidation of operating assets added to the liquid funds. These funds could not be used to reduce bank debts, since such debts of large trade corporations had practically disappeared at

[5] The only difference is that the lowest ratio for large trade corporations is reached in 1936 and for large manufacturing corporations in 1937.

[6] They more than doubled their holdings of marketable securities in this one year.

[7] The trade companies never experienced actual losses. Their dividend payments were somewhat greater than their current earnings in 1930 and 1932. Long-term debts were retired in 1932 and 1933 by not quite $4 million.

that time. Earnings were higher than dividend payments and there was even a small increase in long-term funds from outside. On the other hand current operating expenses declined. All this resulted in a rise in the ratio of liquid funds to payments in that year.

It should be mentioned that the depression of 1921 also brought about a sharp rise in the ratio of liquid funds to payments for large trade corporations, which was followed by an almost equally sharp decline in 1923. The year 1921 (and to a much smaller extent 1922) was a year of selling out of inventories. Although the bulk of the funds released in this way were used to reduce bank debts, the latter did not absorb all of the funds. This together with the decline in operating expenses is mainly responsible for the movement of the ratio of liquid funds to payments in the recession of 1921.

The ratio of cash to payments for medium-sized and small trade corporations shows relatively small variations in the period between the two World Wars; they are even smaller than those of the corresponding group of manufacturing corporations. "Free" cash is therefore of minor importance in the case of this size group of corporations, no matter whether they are engaged in trade or manufacturing. The reasons are similar for both groups of companies.[8]

WORLD WAR I

The percentage increase that occurred between the end of 1914 and the end of 1918 in the cash balances of the large trade corporations of sample B (see Table D-4, Appendix D) was less than that for large manufacturing corporations and for total means of payment. Since payments of large trade corporations increased at a more rapid rate than their cash balances, the ratio of average cash to payments is found to have been less at the end of the war than at the beginning (Table 6). This, in contrast to the manufacturing corporations, is also true if marketable securities are taken into account, although the companies of sample B began to buy marketable securities in 1917 and continued their

[8] Since "permanent investments" and marketable securities are not given separately in the balance sheet, the ratio of "liquid" funds to payments cannot be computed for these companies.

Table 6—Liquidity Position of Sample B of Large Trade Corporations, 1915-22[a]
(dollar figures in millions)

Year	*Average Cash*[b]	*Average Marketable Securities*[b]	*Estimated Cash Payments*	Ratio of: Cash to Payments[c]	Ratio of: Cash Plus Marketable Securities to Payments[d]
1915	$14.0	..	$311.7	4.5%	4.5%
1916	13.4	..	398.6	3.4	3.4
1917	10.8	$ 1.4	479.6	2.3	2.6
1918	13.9	5.8	514.7	2.7	3.8
1919	23.1	11.3	631.8	3.7	5.4
1920	23.9	13.8	819.1	2.9	4.6
1921	26.0	15.0	568.1	4.6	7.2
1922	31.5	15.2	634.3	5.0	7.4

[a] For a description of the sample see Appendix A.
[b] Average of two successive year-end figures.
[c] Ratio of average cash of two successive year ends to total payments in the year between the two dates.
[d] Ratio of average cash plus average marketable securities of two successive year ends to total payments in the year between the two dates.

purchases on a larger scale in 1918. The postwar inventory boom of 1920 therefore could not be financed by drawing on excess liquid funds; instead, the corporations had to rely on bank credit. Their notes payable rose in the one year, 1920, by $46.1 million or 233 percent. The ratios of cash and of cash plus marketable securities to payments which the companies maintained in the years 1916-18 were the lowest in the whole period of 1915-43.

For the medium-sized and small trade corporations (for which balance sheet figures are available only since the end of 1916) the ratio of cash to payments fell slightly between 1917 and 1918. If the item "investments" is included on the assumption that the larger part of the increase during the two last years of the war consisted of marketable securities, the ratio of liquid funds to payments is found to have risen only slightly (from 2.3 percent in 1917 to 2.9 percent in 1918). This ratio in the postwar period was never allowed to fall below 2.7 percent, which justifies the conclusion that this group of corporations also emerged from World War I without any excess liquidity.

WORLD WAR II

The liquidity position of large trade companies in World War II is different from that of large manufacturing corporations. Cash balances rose by 76 percent from 1939 to 1943, compared with an increase of 78 percent for total means of payment and a rise of 47 percent for the cash of large manufacturing corporations. Marketable securities show a much steeper increase, multiplying almost 19 times in the same period; the marketable securities of large manufacturing corporations multiplied only four and a half times. The result is that the ratio of liquid funds to payments for large trade companies reached 14.1 percent in 1943, compared with only 5.6 percent in 1937 (Table 7). Even if allowance is made for the fact that increased tax liabilities require increased liquidity, large trade companies in 1943 were much more liquid than in 1937. (The ratio of cash plus marketable securities to payments after deducting tax liabilities from both the numerator and denominator for 1943 is 8 percent.) A sources and uses of funds analysis of the sample of large trade corporations reveals that the main reason for the difference in the liquidity of large

Table 7—Liquidity Position of Sample A of Large Trade Corporations, 1937-43[a]
(*dollar figures in millions*)

				Ratio of:	
Year	*Average Cash*[b]	*Average Marketable Securities*[b]	*Estimated Cash Payments*	Cash to Payments[c]	Cash Plus Marketable Securities to Payments[d]
1937	$ 98.7	$ 15.2	$2,045.7	4.8%	5.6%
1938	119.7	11.8	1,921.0	6.2	6.8
1939	127.4	12.1	2,191.1	5.8	6.4
1940	126.1	10.6	2,376.3	5.3	5.8
1941	148.9	40.2	2,996.3	5.0	6.3
1942	197.9	145.1	3,166.9	6.2	10.8
1943	217.9	239.8	3,251.4	6.7	14.1

[a] For a description of the sample see Appendix A.
[b] Average of two successive year-end figures.
[c] Ratio of average cash of two successive year ends to total payments in the year between the two dates.
[d] Ratio of average cash plus average marketable securities of two successive year ends to total payments in the year between the two dates.

trade and large manufacturing corporations is that the trade companies, which are engaged in the distribution of consumer goods, have liquidated their receivables since 1941; in addition their equipment (including land, building, and merchandising equipment) in the years 1942 and 1943 declined, which also resulted in an inflow of cash. These factors together with others that are quantitatively less important increased the liquid funds which had to be held either as cash or in the form of marketable securities.

Although trade companies are not faced with a reconversion problem in the sense of shifting to fundamentally different activities, they will find themselves at the end of the war with inferior goods which will be difficult to sell. They will have to stock up again with "peacetime" commodities, using their excess liquid funds to finance the building up of these new inventories. In addition, equipment which was run-down during the war will have to be replaced and receivables will be built up again. No general statement can be ventured as to whether their excess funds are sufficient for these purposes or whether outside financing will be required.

Our sample of medium-sized and small trade corporations has the same defects for an analysis of the present war period as the sample for the corresponding size group of manufacturing corporations; that is, the latest figures are those for 1942, and marketable securities are not available separately but are included in the item "investments," which comprises both permanent investments and marketable securities. For this size group, however, a sample of 634 corporations is available for the period 1940-43.[9] This sample shows an increase of 171 percent in cash between the end of 1940 and the close of 1943; marketable securities in the same period multiplied 20 times. The ratio of average cash plus marketable securities to sales (which have to be taken as a substitute for payments) rose from 2.4 percent in 1941 to 5.9 percent in 1943. Even if tax liabilities are deducted from the numerator and the denominator, the ratio still shows a substantial increase. This size group, like the large trade corporations, has improved its liquidity position. The difference observed in the development of the

[9] Data compiled by the Board of Governors of the Federal Reserve System, who have courteously allowed their use in this study.

liquidity position of medium-sized and small and of large manufacturing corporations does not exist between the corresponding size groups of trade corporations.

SUMMARY

(1) In the interwar period the trend of cash balances of large trade corporations is steeper than the trend of their payments. This results in a rising trend of the ratio of cash to payments. The ratio of cash plus marketable securities to payments does not show a corresponding upward trend in this period.

(2) "Free" cash of large trade companies does not display the same movement as "free" cash of large manufacturing corporations. But in the thirties "free" liquid funds (cash plus marketable securities) show on the whole the same movement as "free" liquid funds for large manufacturing corporations, and for substantially the same reasons.

(3) At the close of World War I the large trade corporations, in contrast to manufacturing corporations, were less liquid than at the beginning of the war. Medium-sized and small corporations also emerged from World War I without any excess liquidity.

(4) In World War II the large trade companies, unlike large manufacturing companies, have built up an "excess" liquidity, mainly in the form of marketable securities. This is due primarily to the fact that they liquidated their receivables on a large scale. Medium-sized and small companies also have improved their liquidity position.