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## Financing Working Capital

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The circulation and net change of working capital and the manner in which these transactions are financed are so familiar as to require very little discussion here. Working capital as a net asset is almost invariably the group of accounts employed by accounting authors in their treatment of the "Statement of Sources and Applications of Funds." Working capital is important from the short-term lender's point of view, for it marks a fairly liquid sum which no creditor, existing or potential, can reduce for twelve months, thus restricting the lender's risks to faults of management, bad markets, and lawsuits. So much of our business thinking, in fact, revolves around this semiliquid sum that one is forced sometimes to check himself as to whether he means cash or working capital.

### CHANNELS OF WORKING-CAPITAL FLOWS

The form in which the transactions affecting working capital are classified is given in Table 6, using company data for 1948. As in the case of cash, with working capital also it is possible to trace three main channels of flow, under the headings of operating, capital-budget, and money-market transactions. In operations, most of the goods sold by Allis-Chalmers in 1948 represented a conversion of inventory into cash and accounts receivable and, hence, added nothing to working capital. A portion of the plant, and certain of the deferred charges (the amount of which has been lost to view in this case and, therefore, is ignored), were the only previously existing noncurrent assets transferred to working capital. These and profits make up the \$29,345,000 added to working capital via operations. Cash dividends of \$5,193,000, and a tax bill for \$10,800,000 due within the year, offset the receipts, leaving \$13,352,000 as the net addition arising in operations. Nonoperating expenditures, principally for plant, absorbed \$7,387,000 of working capital. Among the

TABLE 6

TRANSACTIONS AFFECTING WORKING CAPITAL: ALLIS-CHALMERS MANUFACTURING  
COMPANY, 1948  
(thousands of dollars)

	<i>Payments</i> <i>Dr.</i>	<i>Receipts</i> <i>Cr.</i>
<i>Business transactions</i>		
Operating budget		
Net income before tax		26,242
Depreciation		3,103
Other transfers to or from noncurrent accounts, net		—
Income tax liability incurred	10,800	
Dividends declared	5,193	
Subtotals	15,993	29,345
Subtotal difference		13,352
<i>Capital budget</i>		
Investments and advances	0	
Plant expenditures	7,190	
Deferred charges	220	
Other assets		23
Subtotals	7,410	23
Subtotal difference	7,387	
Total business transactions	23,403	29,368
Difference		5,965
<i>Money-market transactions</i>		
Notes payable, long-term		10,000
Bonds		0
Preferred stock		0
Common stock		0
Subtotals	0	10,000
Subtotal difference		10,000
<i>Total payments and total receipts</i>	23,403	39,368
Effect on working capital		15,965

SOURCE: Annual reports of the company.

## *Financing Working Capital*

money-market transactions only the term loan of \$10 million is entered; neither the company's purchase of marketable securities, nor its short-term borrowing of \$15 million, altered the working capital. In all, payments of \$23,403,000, diminishing working capital, and receipts of \$39,368,000, adding to it, brought about a net increase of \$15,965,000.

### ORIGIN OF CALLS UPON THE LONG-TERM MONEY MARKET

Chart 7 (based on Table 7, given at the end of this chapter) shows the net effect of operating, nonoperating, and money-market transactions on the working capital of Allis-Chalmers annually over the period 1937-57. Since, on the money-market side, only long-term transactions affect working capital, the close correspondence between the curve for these transactions and the one showing changes in net working capital is noteworthy. It appears that funds from operations largely offset plant expenditures, etc., and that the long-term money market is employed by the company to support the fluctuations in working capital. This observation reinforces one made earlier: that the company's contact with the total money market seems influenced more by net operating payments (receipts) than by non-operating expenditures.

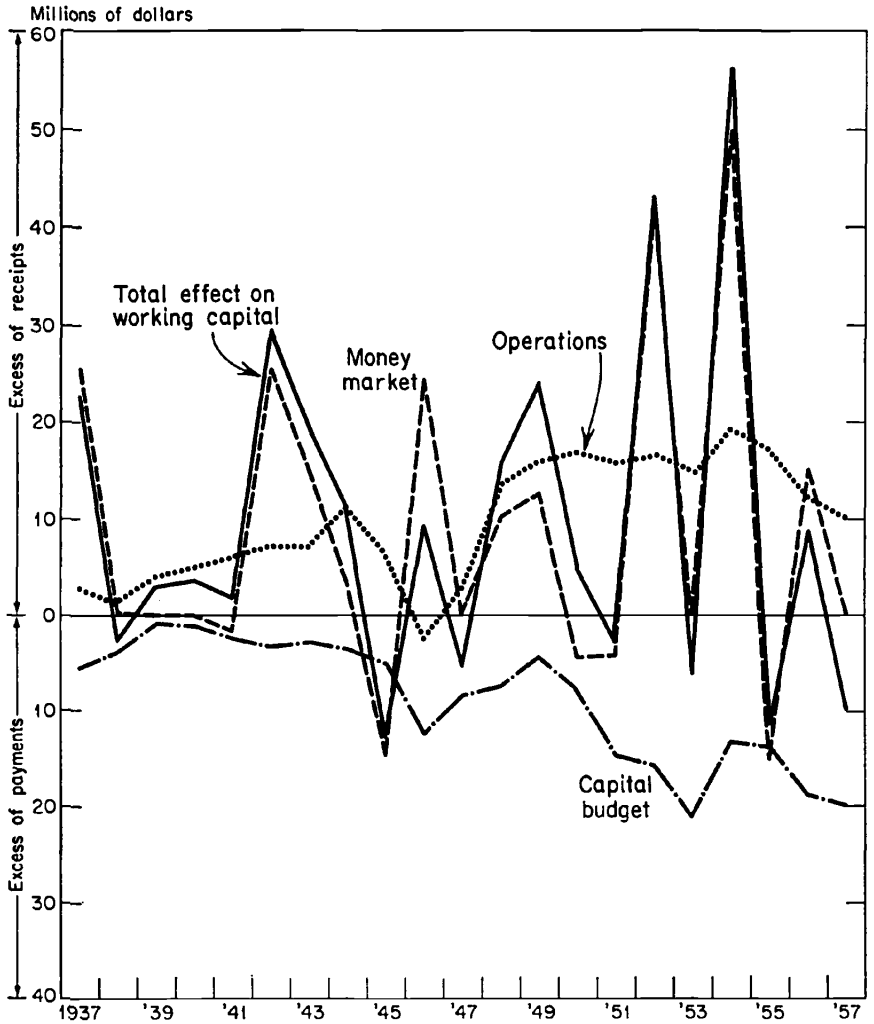
### COMPARISON OF EFFECTS OF OPERATIONS UPON WORKING CAPITAL AND UPON CASH

It is interesting to compare the effects of operations alone upon working capital and upon cash. The net payments or receipts of each in the operations of Allis-Chalmers, 1937-57, are shown in Chart 8. Working capital gained from operations alone shows an accretion in all years save 1946. In contrast, operations had a depleting effect on the cash fund in ten years of the twenty-one.

# Financing Working Capital

## CHART 7

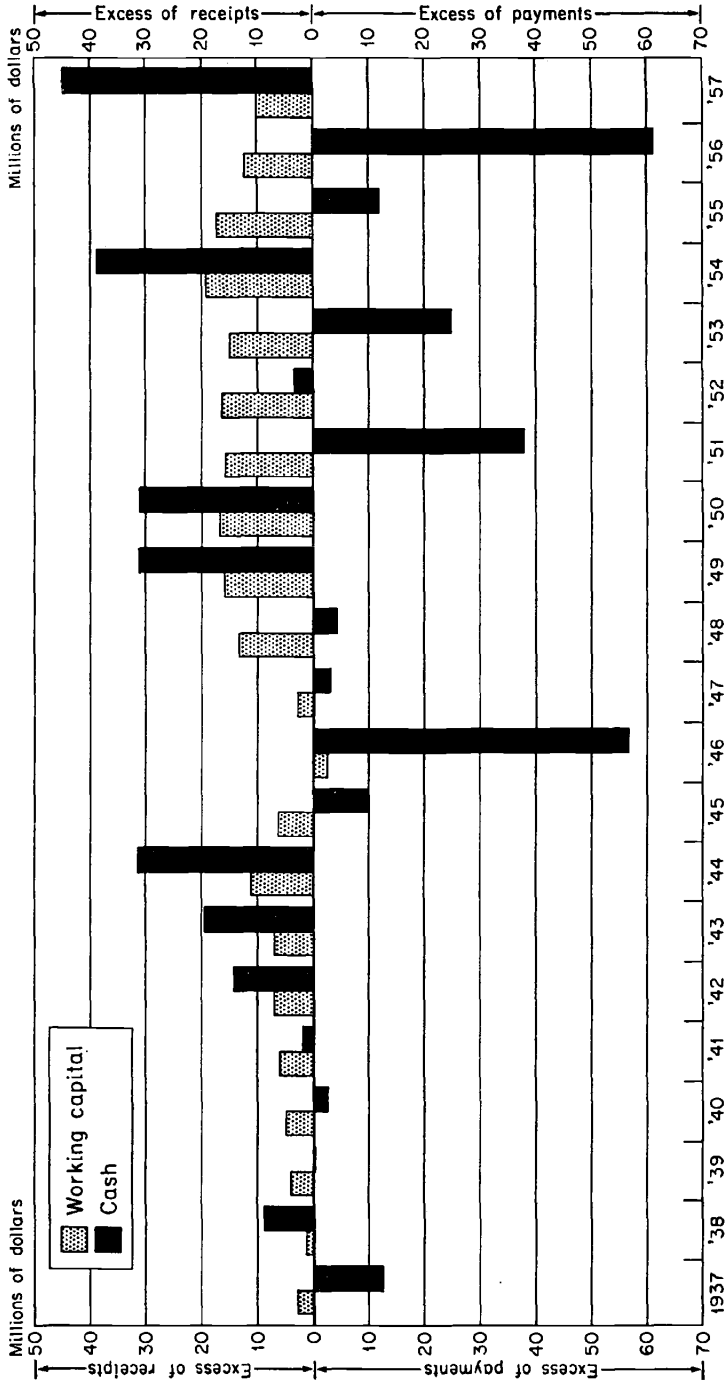
**Effect of Operations, Capital Expenditures, and Money-Market Transactions on Working Capital, Allis-Chalmers Manufacturing Company, 1937-57**



SOURCE: Table 7.

CHART 8

Effect of Operations on Working Capital and on Cash, Allis-Chalmers Manufacturing Company, 1937-57



Source: Table 3 and Table 7.

## Financing Working Capital

TABLE

PAYMENTS AND RECEIPTS OF WORKING CAPITAL,  
(thousands)

	1937		1938		1939	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
<i>Business transactions</i>						
Operating budget						
Net income before tax		10,847		3,534		5,929
Depreciation		1,032		1,261		1,272
Other transfers to or from noncurrent accounts, net		105		67		105
Income tax liability incurred	3,006		980		1,109	
Dividends declared	6,203		2,663		2,220	
Subtotal	9,209	11,984	3,643	4,862	3,329	7,306
Subtotal difference		<u>2,775</u>		<u>1,219</u>		<u>3,977</u>
Capital budget						
Investments and advances						
Plant expenditures	5,445		4,029		966	
Other assets		8		84		8
Deferred charges	93					
Subtotal	5,538	8	4,029	84	966	8
Subtotal difference	<u>5,530</u>		<u>3,945</u>		<u>958</u>	
Total business transactions	14,747	10,992	7,672	4,946	4,295	7,314
Difference	<u>3,755</u>		<u>2,726</u>		<u>3,019</u>	
<i>Money-market transactions</i>						
Notes payable, long-term						
Bonds		25,325				
Preferred stock						
Common stock		145		11		
Subtotal	0	25,470	0	11	0	0
Subtotal difference		<u>25,470</u>		<u>11</u>		<u>0</u>
Total payments and total receipts	14,747	37,462	7,672	4,957	4,295	7,314
Effect on working capital		<u>22,715</u>		<u>2,715</u>		<u>3,019</u>

## Financing Working Capital

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ALLIS-CHALMERS MANUFACTURING COMPANY, 1937-57  
of dollars)

1940		1941		1942		1943	
Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
	8,678		15,689		28,595		45,256
	1,292		1,342		1,619		2,154
	104		185		68		76
2,518		8,600		21,400		38,250	
2,664		2,664		1,776		2,220	
5,182	10,074	11,264	17,216	23,176	30,282	40,470	47,486
	<u>4,892</u>		<u>5,952</u>		<u>7,106</u>		<u>7,016</u>
1,202		2,438		3,174		2,589	
	16				116		16
2		41		294		240	
1,204	16	2,479	0	3,468	116	2,829	16
1,188		2,479		3,352		2,813	
6,386	10,090	13,743	17,216	26,644	30,398	43,299	47,502
	<u>3,704</u>		<u>3,473</u>		<u>3,754</u>		<u>4,203</u>
			9,250		25,750		15,000
		10,908					
0	0	10,908	9,250	0	25,750	0	15,000
	0	1,658			25,750		15,000
6,386	10,090	24,651	26,466	26,644	56,148	43,299	62,502
	<u>3,704</u>		<u>1,815</u>		<u>29,504</u>		<u>19,203</u>



## Financing Working Capital

TABLE 7

	1944		1945	
	Dr.	Cr.	Dr.	Cr.
<i>Business transactions</i>				
Operating budget				
Net income before tax		54,853		23,199
Depreciation		2,523		4,229
Other transfers to or from noncurrent accounts, net		242		144
Income tax liability incurred	42,667		16,757	
Dividends declared	3,697		4,340	
Subtotals	46,364	57,618	21,097	27,572
Subtotal difference		<u>11,254</u>		<u>6,475</u>
Capital budget				
Investments and advances				
Plant expenditures	3,958		4,915	
Other assets		393	149	
Deferred charges				
Subtotals	3,958	393	5,064	0
Subtotal difference	<u>3,565</u>		<u>5,064</u>	
Total business transactions	50,322	58,011	26,161	27,572
Difference		<u>7,689</u>		<u>1,411</u>
<i>Money-market transactions</i>				
Notes payable, long-term	10,000		14,428	
Bonds	15,627			
Preferred stock		28,993	13	
Common stock				
Subtotals	25,627	28,993	14,441	0
Subtotal difference		<u>3,366</u>	<u>14,441</u>	
Total payments and total receipts	75,949	87,004	40,602	27,572
Effect on working capital		<u>11,055</u>	<u>13,030</u>	

## Financing Working Capital

(Continued)

1946		1947		1948		1949	
Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
25,804			9,072		26,242		33,205
	2,168		2,620		3,103		3,472
6			27				
	25,400	3,650		10,800		14,450	
4,316		5,192		5,193		6,199	
30,126	27,568	8,842	11,719	15,993	29,345	20,649	36,677
			2,877		13,352		16,028
12,419		8,367		7,190		4,115	
53			47		23	22	
39				220		256	
12,511	0	8,367	47	7,410	23	4,393	0
12,511		8,320		7,387		4,393	
40,469	25,400	17,209	11,766	23,403	29,368	25,042	36,677
15,069		5,443			5,965		11,635
25,572					10,000	2,500	15,000
	14,962						
	17,329						
	17,678						
25,572	49,969	0	0	0	10,000	2,500	15,000
	24,397	0			10,000		12,500
		=					
66,041	75,369	17,209	11,766	23,403	39,368	27,542	51,677
	9,328	5,443			15,965		24,135

## Financing Working Capital

TABLE 7

	1950		1951	
	<i>Dr.</i>	<i>Cr.</i>	<i>Dr.</i>	<i>Cr.</i>
<i>Business transactions</i>				
Operating budget				
Net income before tax		47,020		69,917
Depreciation		3,526		3,393
Other transfers to or from noncurrent accounts, net	541			
Income tax liability incurred	23,900		47,500	
Dividends declared	9,345		10,050	
Subtotals	33,786	50,546	57,550	73,310
Subtotal difference		<u>16,760</u>		<u>15,760</u>
Capital budget				
Investments and advances			4,583	
Plant expenditures	7,477		10,004	
Other assets	22			
Deferred charges				
Subtotals	7,499	0	14,587	0
Subtotal difference	<u>7,499</u>		<u>14,587</u>	
Total business transactions	40,744	50,005	72,137	73,310
Difference		<u>9,261</u>		<u>1,173</u>
<i>Money-market transactions</i>				
Notes payable, long-term	4,500		4,500	
Bonds				
Preferred stock				
Common stock		33		235
Subtotals	4,500	33	4,500	235
Subtotal difference	<u>4,467</u>		<u>4,265</u>	
Total payments and total receipts	45,244	50,038	76,637	73,545
Effect on working capital		<u>4,794</u>		<u>3,092</u>

## Financing Working Capital

(Continued)

1952		1953		1954		1955	
Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
	65,983		43,448		50,012		50,105
	4,077		5,746		7,620		8,728
							236
41,525		21,504		23,882		25,300	
12,060		12,855		14,526		16,468	
53,585	70,060	34,359	49,194	38,408	57,632	41,768	59,069
	16,475		14,835		19,224		17,301
15,543		21,353		1,636		12,056	
			270	9,893		1,794	
137				1,781			
15,680	0	21,353	270	13,310	0	13,850	0
15,680		21,083		13,310		13,850	
69,265	70,060	55,712	49,464	51,718	57,632	55,618	59,069
	795	6,248			5,914		3,451
	42,000				14,750	15,250	
	222		104		34,885		
					243		282
0	42,222	0	104	0	49,878	15,250	282
	42,222		104		49,878	14,968	
69,265	112,282	55,712	49,568	51,718	107,510	70,868	59,351
	43,017	6,144			55,792	11,517	

## Financing Working Capital

TABLE 7 (Concluded)

	1956		1957	
	Dr.	Cr.	Dr.	Cr.
<i>Business transactions</i>				
Operating budget				
Net income before tax		42,805		35,144
Depreciation		8,596		9,050
Other transfers to or from noncurrent accounts, net				
Income tax liability incurred	22,450		17,325	
Dividends declared	16,680		16,840	
Subtotals	39,130	51,401	34,165	44,194
Subtotal difference		<u>12,271</u>		<u>10,029</u>
<i>Capital budget</i>				
Investments and advances	4,000		3,117	
Plant expenditures	14,431		16,229	
Other assets	457		545	
Deferred charges				
Subtotals	18,888	0	19,891	0
Subtotal difference	18,888		19,891	
Total business transactions	58,018	51,401	54,056	44,194
Difference	<u>6,617</u>		<u>9,862</u>	
<i>Money-market transactions</i>				
Notes payable, long-term		14,750	250	
Bonds				
Preferred stock				
Common stock		467		277
Subtotals	0	15,217	250	277
Subtotal difference		<u>15,217</u>		<u>27</u>
Total payments and total receipts	58,018	66,618	54,306	44,471
Effect on working capital		<u>8,600</u>	<u>9,835</u>	

SOURCE: Annual reports of the company. Payments are entered in debit column; receipts, in credit column.