This PDF is a selection from an out-of-print volume from the National Bureau of Economic Research

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: Origin, Location and Movement of Corporate Cash Balances, 1929-1936

Chapter Author: Winfield W. Riefier, Chairman, David Friday, Walter Lichtenstein, J. H. Riddle

Chapter URL: http://www.nber.org/chapters/c0628

Chapter pages in book: (p. 53 - 56)

ing in the call money market. If, on the contrary, there was no depletion of consumers' balances, the investigation would show: (1) a distribution of deposits essentially unchanged as to ownership during the period, (2) a transfer in the ownership of securities from individuals in debt to brokers at the beginning of the period to those who had been lending funds to brokers. Since all these phenomena were probably happening simultaneously, the aim of the investigation should be to determine their relative importance.

Procedure

The investigation should be conducted by someone thoroughly acquainted with and having access to three sources of data: (1) banking statistics (available largely through the Board of Governors of the Federal Reserve System), (2) the financial statements of corporations that maintain large cash balances and presumably were the principal non-banking lenders of funds to brokers, (3) the balance sheets of brokers (obtainable through the New York Stock Exchange). The study would require the cordial collaboration of the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, and the New York Stock Exchange.

ORIGIN, LOCATION AND MOVEMENT OF CORPORATE CASH BALANCES, 1929–1936

General Background

The appearance during the 1920's of great bodies of free funds at the disposition of corporate management has given rise to new problems in banking and credit (the theoretical implications of which are relatively unexplored). Our basic theory of banking and credit was worked out at a time when the aggregate of capital funds at the disposal of business enterprise was commonly insufficient to finance full operating demands, and the deficiency was borrowed as a matter of course from banks on the basis of short term commercial loans. Under these conditions, fluctuations in the aggregate volume of business deposits closely reflected actual needs for working balances, and the specific banks in which these balances were located were determined by the necessity of maintaining close credit relationships with lending banks as well as by needs for convenient points of disbursement. Since the middle 1920's this picture has become progressively less characteristic of many large and dominant business enterprises.

Smarting under the memory of the difficulties that arose during the commodity price decline in 1920–21, American business managements in many cases decided to maintain themselves in the future as free from current short term commercial debt as possible, and, during the prosperity that followed, succeeded not only in eliminating in large part their current debt, but in addition, in piling up huge floating cash balances greatly in excess of current needs. As a result, during 1929 at a time when business transactions exceeded in volume anything previously experienced, American business was able not only to finance these huge totals without great increase in its commercial borrowing, but in addition to spare a further huge volume of funds for loans in the call market. In 1931, 1932 and 1933 many of these balances were still in existence despite the heavy losses of the depression, and by their large, sudden and erratic movements from bank to bank in search of safety, contributed considerably to the general insecurity of the banks in the period prior to the bank holiday. Data recently disclosed indicate that cash and other liquid assets of business corporations are again increasing and stand today only slightly below their pre-depression peak.

Specific Problem

Study of this problem may begin with the origin and subsequent movement of that body of funds generally known as 'Loans to Brokers for the Account of Others'. It is proposed that a group of the more important corporate lenders of funds on the Stock Exchange in 1929 be studied intensively.[1] From the point of view of their corporate ownership, it would be necessary to determine the business setting out of which the possession of large free balances arose. This would entail analysis of their earnings record, dividend practices, capital securities flotations, and their depreciation reserve policies. The appearance of the balances having been accounted for in their historical setting, it would next be necessary to study their behavior year by year, including the extent to which they were invested in other securities, the conditions under which they were loaned on the call market, and the extent to which and conditions under which they were deposited in banks. It would be especially illuminating to ascertain to what extent they were placed on time deposit in 1930 when returns on open market money rates fell below the time deposit rate, and to what extent their transfer from interior banks to urban centers contributed to the wave of bank failures that accompanied the departure of Great Britain from the gold standard in September 1931. Lastly, it would be pertinent to follow closely the behavior of these corporate cash balances and associated liquid assets during the recovery.

1 Without, of course, disclosing names.

Procedure

The person selected to conduct this study should be well acquainted with corporate accounting, have access to corporate records and be familiar with statistical techniques in grouping corporate accounts for analytical purposes. The material for parts of the study would have to be provided directly by the corporations involved whose close cooperation would be essential. Data in the hands of the Securities and Exchange Commission should be extremely useful in the analysis of cash and liquid assets for recent years. In addition, the study of large deposits as of 1933 and 1935, recently completed by the Board of Governors of the Federal Reserve System, and its WPA study of deposits in closed banks from 1928 to 1932, should provide much relevant internal banking evidence for this investigation. Access to these sources would of course depend upon the cooperation of the agencies concerned.