

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

Volume Title: Financing Small Corporations in Five Manufacturing  
Industries, 1926-36

Volume Author/Editor: Charles L. Merwin

Volume Publisher: NBER

Volume ISBN: 0-870-14130-9

Volume URL: <http://www.nber.org/books/merw42-1>

Publication Date: 1942

Chapter Title: Changing Credit Needs of Small Manufacturing  
Corporations

Chapter Author: Charles L. Merwin

Chapter URL: <http://www.nber.org/chapters/c9387>

Chapter pages in book: (p. 57 - 89)

## CHANGING CREDIT NEEDS OF SMALL MANUFACTURING CORPORATIONS

The financial structure of representative groups of small businesses was described in the preceding chapter, industry by industry. From the experience of these companies over the period 1926-36 the present chapter will draw certain implications that have significance for the general problem of financing small enterprises. These eleven years encompass a period of cyclical expansion (1926-29), a period of cyclical contraction (1930-32) and another period of cyclical expansion (1933-36). <sup>1/</sup> The following pages deal only with particular samples of small enterprises that continued in existence throughout these years, but there is no reason to believe that the findings would not apply in large measure to small enterprises in general, and to both successful and unsuccessful ones.

### LONG-TERM DEBT

An important characteristic of the financial structure of small manufacturing companies, as revealed by our samples, is their small amount of long-term debt. This was apparent from the case studies in Chapter 2, but it is sufficiently important to warrant elaboration here. For each industrial sample, considered as a group, long-term debt amounted to the following proportions of total assets, at the beginning and end of the period studied. <sup>2/</sup> These figures, however, pertain to the aggregate of all surviving corporations in each sample, and thus give no indication of the fact that the great majority of the

	<u>1926</u>	<u>1936</u>
Baking	6.6%	10.7%
Men's clothing	1.2	2.8
Furniture	1.2	4.4
Stone-clay	3.4	6.7
Machine tool	4.4	7.2

companies reported no long-term debt whatever: in men's clothing 87 percent, and in the other industries from 69 to 74 percent, of the companies reported no long-term debt in 1936, and in 1926 these proportions were even higher.

For the corporations that did have such debt the figures given in the tabulation above are of course a considerable understatement. In considering these companies, long-term debt cannot be directly computed in relation to total assets but it can be calculated in relation to net land and plant. On the latter base the proportions for the reporting companies in the various industries were as follows at the beginning and end of the period: 3/

	<u>1926</u>	<u>1936</u>
Baking	30% (28% of all cos.)	36% (31% of all cos.)
Men's clothing	46 (11 " " " )	53 (13 " " " )
Furniture	30 (9 " " " )	34 (27 " " " )
Stone-clay	23 (21 " " " )	35 (30 " " " )
Machine tool	34 (14 " " " )	51 (26 " " " )

We know the ratio of the net land and plant of all the companies in the samples to their total assets, 4/ and from this ratio it is possible to compute, for the companies that reported long-term debt, rough estimates of what such debt amounted to in relation to total assets. The resulting proportions are shown herewith. These

	<u>1926</u>	<u>1936</u>
Baking	19%	22%
Men's clothing	4	5
Furniture	8	11
Stone-clay	12	18
Machine tool	15	20

estimates, crude as they are, indicate that for particular companies in these samples of small manufacturing corporations long-term debt constituted an important source of financing, a source, too, that seems to have increased in importance over the 1926-36 period. This finding is corroborated by data on the net amount of funds derived from such debt, and the net amount expended on reducing it during three periods of the decade 1927-36; 5/ a tabulation of these data is presented on the following page, with minus signs used to indicate the net reductions of long-term debt.

	<u>1927-29</u>	<u>1930-32</u>	<u>1933-36</u>
Baking	\$ 23,000	\$ 63,000	\$11,000
Men's clothing	50,000	-12,000	9,000
Furniture	481,000	-214,000	-79,000
Stone-clay	0	68,000	84,000
Machine tool	390,000	-36,000	-31,000

It appears that in the 1927-29 period long-term debt constituted a fairly sizable source of funds for the furniture and machine tool samples. But despite such indications that long-term debt was of some importance for certain of these small corporations and in certain years, the fact remains that it was not a significant source of funds for the companies in the aggregate or over the period as a whole.

What long-term debt these companies had appears to have been mortgage debt rather than unsecured bond and note issues. Federal income tax returns in the period covered by this study called for the breakdown of long-term debt into two categories: unsecured bonds and notes; and mortgages and other similarly secured debt. The reporting of these items may have been incomplete, especially since these were small companies; but at least according to the reports practically all the long-term debt consisted of mortgages and similarly secured obligations. An exception is the machine tool sample; there one-half the long-term debt was listed as unsecured bonds and notes.<sup>6/</sup>

It might be inferred that the long-term debt of these small manufacturers, since it appears to have consisted largely of mortgage obligations, was incurred mainly for the purpose of acquiring new assets. Probably more often, however, it represented a means of providing creditor relief to a financially embarrassed enterprise, through the funding of book or note credits under a mortgage indenture, or a means of making part payment, through the granting of a mortgage claim, when ownership was transferred by sale or inheritance.

The infrequency of long-term debt among the companies studied was due not only to the owners' unwillingness to jeopardize their control but also to the prospective lender's fear of loss. An investment in small enterprises has a large speculative element. The success of the business is usually dependent upon the skill of a single person, the owner-manager. The competitive situa-

tion is fraught with uncertainty, and the instability of the markets for supplies and sales makes accurate anticipation almost impossible. Therefore an investor in a small company would rather have an opportunity to share in any unusual or speculative profits, than accept a promise of a fixed but small return.<sup>7</sup> The failure rate is higher among small than among large enterprises, and as a rule the liquidation value of an unsuccessful small company is barely adequate to satisfy the claims of short-term creditors, not to mention those of long-term creditors. It is certainly true, however, that an important reason for the infrequency of long-term debt among the type of companies studied here lies with the owners themselves. Because the earning power of their business is unstable, they would naturally strive to avoid fixed charges and the accompanying danger of losing their property.

Among the five industries studied here, differences in the proportions of long-term debt can be traced to differences in the various industries' discontinuance rates, in the stability of their earnings, and in their relative investment in fixed assets. In men's clothing manufacture discontinuances were numerous and earnings were far from stable; because of these factors, and also because such companies have so little property to mortgage, the ratio of funded debt to total assets was small and there was a large proportion of companies with no long-term debt, even in comparison with the other samples of small manufacturers. In baking, on the other hand, earnings were stable, there were fewer discontinuances than in most of the other groups, and the investment in land, plant and equipment was relatively heavy; therefore the ratio of long-term debt to total assets was comparatively high and the proportion of companies with no funded debt was slightly less than in the other industries.<sup>8</sup> What long-term debt was recorded for the three durable goods industries can perhaps be traced to their extensive mechanization. Certainly the stability of their earnings would not encourage long-term lenders.

Small business enterprises cannot generally rely on the institutionalized capital market for long-term credit, because their assets and management are specialized, their salvage value is slight, and their credit needs are not subject to standardized appraisal. In these respects

the large enterprise is a direct contrast and hence its creditor-debtor relationship with the formal capital market is impersonal and standardized.<sup>9/</sup> In addition, there is the important consideration that the cost of floating small issues on the capital markets would be prohibitive, even for companies much larger than those in our samples.

The reasons put forward in explanation of the infrequency of long-term credit in the financial structure of small companies apply also to these companies' small use of preferred stock as a means of raising capital. Only in the furniture and machine tool samples were there any appreciable numbers of corporations reporting preferred shares in 1936 (21 and 17 percent, respectively), and among these establishments such shares were not particularly important; in the other industries less than a tenth of the companies reported any preferred shares in their capital structure.<sup>10/</sup> It is probable that most of the preferred shares issued by these small companies were the result of special circumstances, as in the rare cases of long-term debt, and did not represent regular issues designed for the acquisition of new assets.

#### FIXED PROPERTY EXPENDITURES

It has already been pointed out that the long-term debt of these small corporations, so far as it existed, was probably not incurred for the purpose of expanding fixed property. This is suggested by the fact that it consisted largely of mortgage obligations, and it is corroborated by an analysis of fixed property expenditures. But it should be remembered that a small amount of long-term debt does not necessarily mean that land and plant are not expanded, for fixed property outlays are not necessarily financed by long-term borrowings. They may be financed by renewed short-term borrowings, by funds from operations or from the owners, or by asset liquidation. Thus these companies might have expanded and modernized their operating facilities by making use of some of the amounts withdrawn as officers' compensation, which, as we have seen, were sizable in each of the industries throughout the period studied.

There is a serious difficulty inherent in an attempt to estimate a company's property expenditures from the fi-

nancial statements it submits to the Bureau of Internal Revenue, for financial statements rarely show such outlays as a separate item. Expenditures for maintenance and repair - which in manufacturing industries are not technically regarded as property outlays - are frequently shown separately, as a charge to the profit and loss account, but those for replacements and extensions of operating facilities are presumably capitalized. 11/ These fixed property expenditures - outlays for replacement and expansion of land, plant and equipment - must generally be derived by comparing the annual change in fixed property with the annual depreciation charge and with any asset revaluations that may have been made. Net expansion of fixed property - outlays for expansion alone 12/ - is arrived at by subtracting from fixed property expenditures the part that represents replacements, or anticipated capital consumption. 13/

Depreciation charges have been regarded as representative of the anticipated capital consumption of these companies, 14/ although there are two important reasons why the figures should not be taken too literally. In the first place, wear and tear of plant and equipment are difficult to estimate, even where an appraisal of the annual depreciation is the only purpose. In the second place, it is known that some of the concerns in these samples revalued their property account from time to time by means of a charge of credit taken directly to surplus. When an owner thought he had failed in prior years to charge off enough depreciation against plant and equipment, he wrote down the account; if he feared (or if the Internal Revenue agent decided) that he had charged off too much, he wrote up the account. Like depreciation charges, these writeups and writedowns are in the nature of rough estimates; in addition, the year in which they are entered on the books of an enterprise is not a trustworthy indication of the time when an unanticipated depreciation or appreciation occurred.

These qualifications should be borne in mind 15/ in examining the figures on the following page, which pertain to the entire period 1927-36. 16/ Those on property expansion or contraction are derived by subtracting depreciation charges from fixed property expenditures and adding the positive or negative figure on property revaluation. All figures are given in thousands of dollars.

	<u>Fixed Property Expenditures</u>	<u>Accumulated Depreciation Charges</u>	<u>Net write- up (+) or writedown (-)</u>	<u>Fixed Property Expansion (+) or Contraction (-)</u>
Baking	\$3,975	\$3,953	\$-277	\$-275
Men's clothing	275	257	- 2	+ 16
Furniture	1,263	1,468	+357	+152
Stone-clay	1,685	2,679	- 48	-842
Machine tool	3,007	3,158	- 151	-159

These figures indicate that in none of the industries except stone-clay was there a significant expansion or contraction in fixed property over the decade. And there the sizable contraction in land, plant and equipment probably represented a depletion of raw material resources rather than a failure to maintain operating plants, exclusive of clay deposits. It appears, too, that in these five industries the revaluations of plant and equipment were small, especially in comparison with depreciation charges. Over the decade as a whole only two of the industries had, in the aggregate, an important net writeup or writedown: the bakeries wrote down their plant and equipment, largely in the 1930's; and the furniture manufacturers wrote up this account, mostly in the late 1920's. <sup>17/</sup> Some of these writeups probably resulted from overdepreciation in the years before 1927, or perhaps from the optimism characteristic of 1929, but it is impossible to pin down revaluations to the precise year to which they are properly applicable without making a detailed case study of each company.

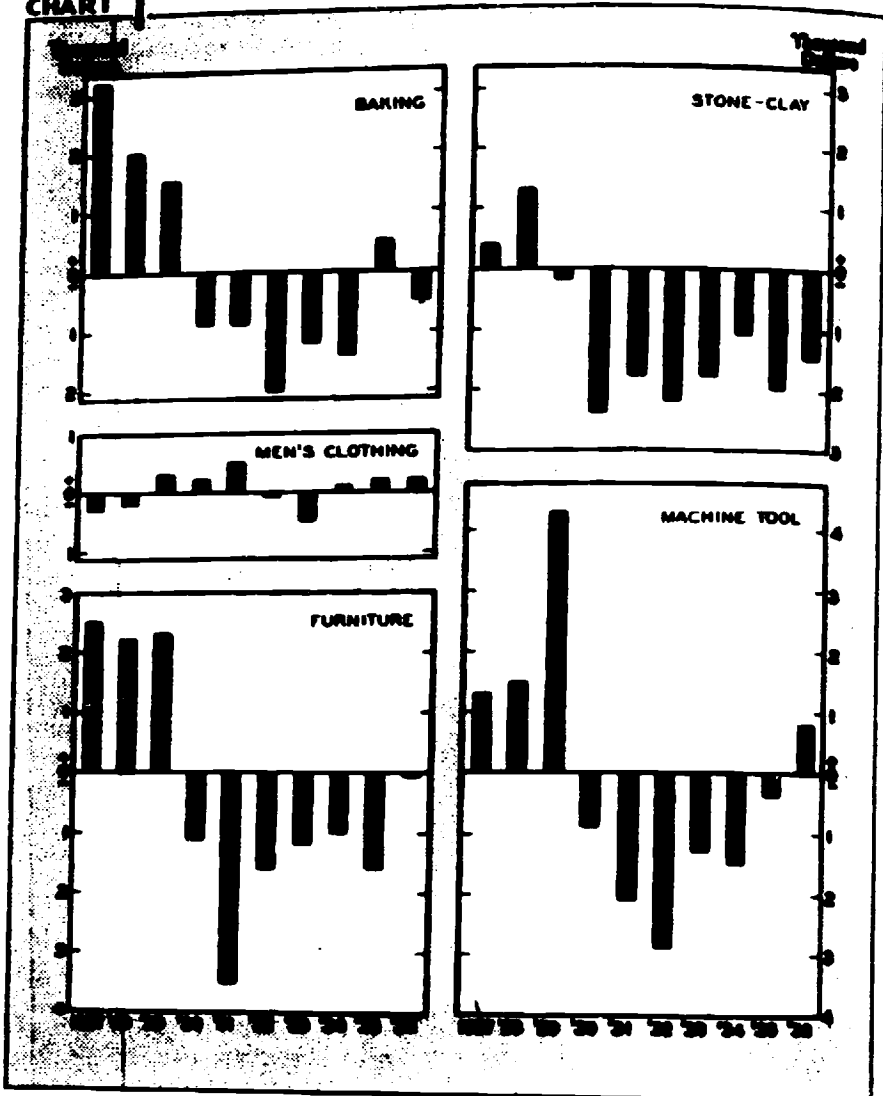
Annual estimates of the average net land and plant expenditures per company are shown in Chart 1. Because of the impossibility of precise allocation writeups and writedowns were ignored in the calculations of these estimates, and the depreciation charge alone was taken to measure the consumption of capital during the year. The figures were reduced to a per company basis in order to improve their industrial comparability, but they are still not fully comparable from one industry to another because the average size of these companies varies in the different industries. The 66 furniture companies, for example, have somewhat larger average assets than the companies in the other industries.

Chart 1 indicates that except in men's clothing, where property expenditures are generally unimportant, it was principally in the years 1930-35 that the net prop-



**SAMPLE CORPORATIONS IN FIVE INDUSTRIES**  
**Average Net Expenditures per Company on**  
**Land and Plant, 1927-36<sup>a</sup>**

CHART 1



<sup>a</sup> Based on Tables B-10 to B-14 in Data Book (see footnote 16 of Chapter 1).

erty outlays of these companies were negative.<sup>18/</sup> In the other years of the 1927-36 decade the companies somewhat expanded their plant and equipment. The stone-clay group stands out prominently in this chart because as early as 1929 it failed to maintain its plant and equipment (including clay deposits), and sustained a contraction in every succeeding year of the decade. This singular performance may not be wholly unrelated to the secular decline of the stone-clay industry, although probably a more important factor is depletion of the clay deposits.

Thus, on the whole, the available data suggest that the fixed property expenditures of these small manufacturers over the 1927-36 decade just about equaled the depreciation charged for the same period. In other words, the companies spent on land and plant little, if any, more than the funds from operations that were earmarked on the books of account for replacing worn-out plant and equipment. To be sure, the mere earmarking of such funds does not make them available for outlays on land and plant: they may become tied up in current assets or be absorbed by operating losses. But over a period of years, some of which were profitable ones, the former contingency would not be important and the latter would be only temporary. Therefore we may conclude, from the present data, that these small companies did not significantly expand their land and plant over the period studied. This means that they had little need for long-term funds, whether equity or creditor, and that credit facilities designed to provide such funds would have been largely unnecessary.

#### SHORT-TERM DEBT

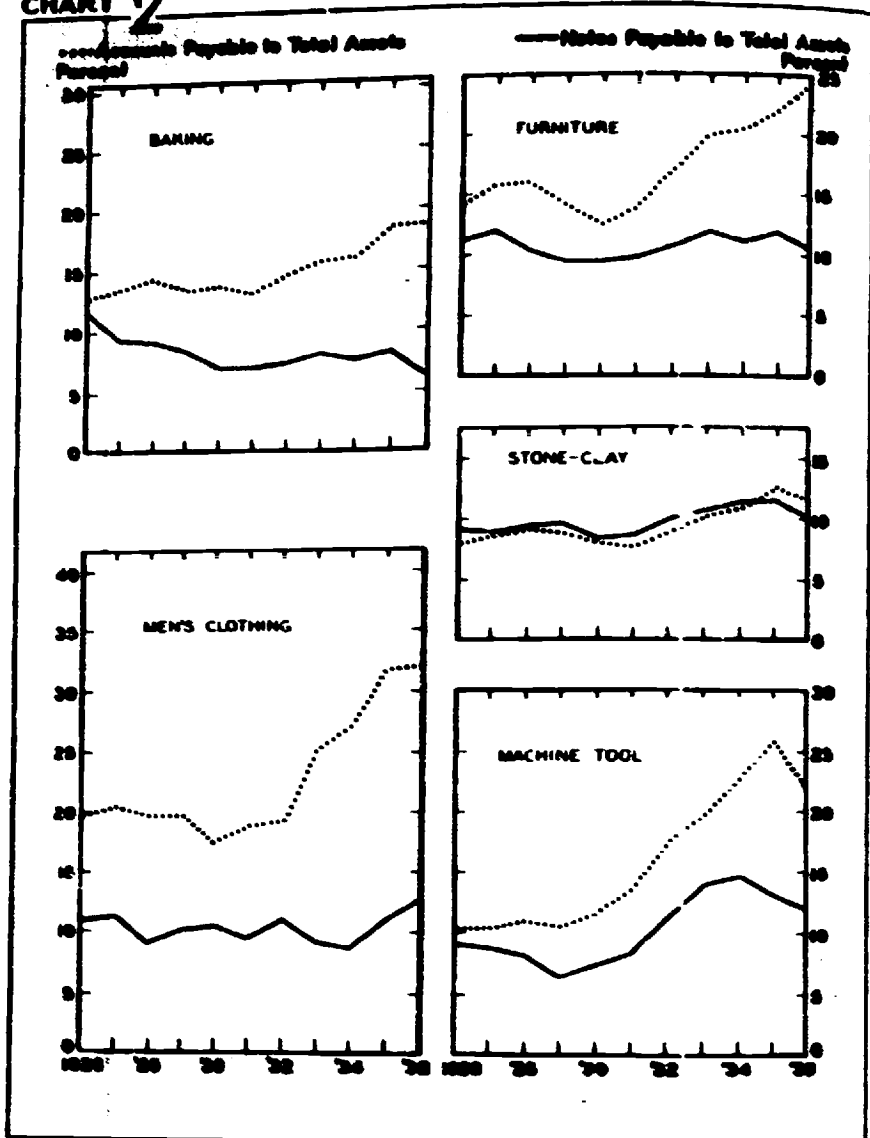
The current debt of these small manufacturers seems to have undergone notable changes over the 1926-36 period, both in regard to its distribution between accounts payable and notes payable and in regard to the importance of these two items in comparison with relevant items in current assets.

#### Distribution of Short-Term Debt

For an analysis of the comparative importance of accounts payable and notes payable we may take total assets as a basis of reckoning. Chart 2 and Table 13 indicate

**SAMPLE CORPORATIONS IN FIVE INDUSTRIES**  
 Year-End Accounts Payable and Notes Payable,  
 in Percent of Year-End Total  
 Assets, 1926-36<sup>a</sup>

CHART 2



<sup>a</sup> Based on Table B-7 in Data Book (see footnote 16 of Chapter 11).

that on this basis mercantile credit increased during 1926-36 while notes payable - which may be assumed to have consisted largely of bank credit 19/- increased less markedly, remained stable or actually declined.

As can be seen from the chart, every industry represented here showed an increase, during 1926-36, in its proportion of accounts payable. In all of the industries this increase occurred largely in the last half of the period, during the depression and early recovery years. 20/ The contrast in this respect between the beginning and end of the period is clearly evident from the figures on "all companies" in Table 13, where the average proportions for the first three years are shown in conjunction with those for the last three years. 21/ Statistically speaking, the increase between these two sets of years can be considered definitely significant (as an indication of trend not only within the sample but among all small corporations in the industry) in the baking, men's clothing and machine tool groups, less significant in stone-clay, and not significant in furniture. 22/

The relative amount of notes payable, on the other hand, decreased in the baking sample, remained approximately the same in men's clothing and furniture, and increased in the other two groups, especially in machine tool. The baking companies' decrease occurred in the first half of the period (Chart 2); in the stone-clay and machine tool samples the increase took place during the depression years. But even in these two industries, which showed increases in both items, the increase in the accounts payable proportion was more pronounced than that in the relative amount of notes payable. It cannot be determined whether any of these changes in the notes payable proportion is statistically significant; the safest conclusion to draw is that this ratio did not undergo any noteworthy change in the sum total of small corporations represented by each of these samples.

Table 13 indicates too that the increase in the proportion of accounts payable between the beginning and the end of the period was characteristic of both the larger and the smaller companies in the samples, though the greater rises were reported, on the whole, by the smaller companies; 23/ in fact, in the men's clothing and furniture samples the upward tendency in this item was pro-

**Table 13 - SAMPLE CORPORATIONS IN FIVE INDUSTRIES**  
Average Year-End Accounts Payable and Notes Payable, in Percent of Average Year-End Total Assets, by Industry and by Size and Profitability of Companies, 1926-28 and 1934-36 *a/*

Industry	Accounts Payable		Notes Payable	
	1926-28	1934-36	1926-28	1934-36
<b>Baking (81 cos.)</b>				
All companies	13.5%	17.8%	10.1%	7.5%
Larger companies	9.9	12.2	9.2	6.2
Smaller companies	17.1	23.2	11.1	8.7
More profitable companies	17.9	22.5	10.1	7.9
Less profitable companies	9.3	13.2	10.2	7.1
<b>Men's clothing (46 cos.)</b>				
All companies	20.0	30.3	10.4	10.8
Larger companies	22.2	22.0	8.8	7.8
Smaller companies	17.7	38.6	12.0	13.8
More profitable companies	22.3	39.4	11.7	15.9
Less profitable companies	17.7	20.8	9.1	5.7
<b>Furniture (66 cos.)</b>				
All companies	15.2	22.1	11.1	11.0
Larger companies	11.4	12.0	12.2	10.5
Smaller companies	19.1	32.5	9.9	11.6
More profitable companies	17.6	29.7	13.6	14.6
Less profitable companies	13.0	14.7	8.5	7.5
<b>Stone-clay (70 cos.)</b>				
All companies	8.6	11.7	9.1	11.0
Larger companies	7.2	10.9	7.8	11.1
Smaller companies	10.0	12.6	10.5	10.9
More profitable companies	9.3	11.5	9.5	12.3
Less profitable companies	8.0	12.0	8.8	9.7
<b>Machine tool (118 cos.)</b>				
All companies	10.7	23.8	8.9	13.2
Larger companies	10.3	13.9	8.8	8.4
Smaller companies	11.1	33.8	8.9	18.1
More profitable companies	12.5	32.0	6.6	16.2
Less profitable companies	8.8	15.6	11.1	13.6

*a/* Based on Tables B-7, B-8 and B-9 in Data Book (see footnote 16 of Chapter 1). In each of the two periods indicated the figures represent simple averages of the proportions for each year of that period; these annual figures, in turn, represent simple averages of the proportions for the individual companies. The dividing line between "larger" and "smaller" is, for each industrial sample, the median of the average total assets of all companies in the sample over 1926-36. The dividing line between "more profitable" and "less profitable" is, for each industrial sample, the median of the average ratios of net income (plus officers' compensation) to net worth, for all companies in the sample over 1926-36.

duced entirely by the companies of less than median asset size. The less conclusive movement in the relative amount of notes payable shows no consistency when examined from the point of view of company size. In baking the decrease in this proportion was shared by the larger and the smaller companies. In the two industries that registered increases the evidence is conflicting: the increase was produced entirely by the larger companies in the stone-clay sample, and entirely by the smaller ones in the machine tool group. Slight decreases among the larger men's clothing and furniture companies were nullified by slight increases among the smaller companies in these industries.

Similarly, the relative increase in accounts payable was experienced by both the more profitable and the less profitable of these companies that continued operations throughout the period. And in regard to the notes payable proportion, both its decrease (in baking) and its increase (in stone-clay and machine tool) seem to have been unrelated to the profitability of the companies. In men's clothing and furniture, where the notes payable proportions for "all companies" were practically the same at the end as at the beginning of the period, there were increases among the more profitable companies and equivalent decreases among the companies whose net income plus officers' compensation (in percent of net worth) was under the median level.

Thus far these two types of short-term debt have been discussed as percentages of total assets. The story they tell is not changed, however, if their behavior over the 1926-36 period is viewed in relation to other items in financial structure. 24/ When compared to volume of business, accounts payable moved upward in every group except men's clothing, where they remained about the same, and notes payable tended to decrease in every industry except stone-clay; this industry, it will be remembered, was undergoing a marked secular decline. When inventory holdings are taken as a base, accounts payable increased, while notes payable decreased in three industries - markedly in baking and furniture, slightly in men's clothing. Since the movement of this ratio is due in part to the inventory item, which also declined during these years, the indicated decrease tends to understate rather than overstate the drop in notes payable. The magnitude and industrial variation of this ratio are interesting: In

all groups (except baking in some of the years between 1926 and 1932) notes payable amounted to less than inventory holdings, and in the men's clothing, furniture and machine tool groups they seldom reached as much as half of inventory.

A final indication of the movements in accounts payable and notes payable is the dollar volume of net change in each of these two types of debt over the years 1927-36. On this the figures are as follows, with net reductions indicated by minus signs. 25/ In all groups except

	<u>Accounts Payable</u>	<u>Notes Payable</u>
Baking	\$160,000	\$-385,000
Men's clothing	99,000	- 11,000
Furniture	40,000	-286,000
Stone-clay	-43,000	- 32,000
Machine tool	379,000	- 25,000

stone-clay there was an absolute substitution of account for note credit over this decade. The significance of the exception in stone-clay, where the two types of credit decreased about the same in dollar volume, is minimized by the fact that in this industry the cost of materials purchased - the customary cause of mercantile credit - is extraordinarily small, amounting to no more than an eighth of the total value of product. In the men's clothing group the relatively modest reduction in notes payable is somewhat misleading, for in 1936 the companies in this sample sharply increased their notes payable, thereby offsetting almost all of the contraction that had occurred in the preceding years.

On the exact composition of the notes payable item of these sample companies the income tax returns give no information, and, even for corporations in general, statistical data on this point are usually meagre. Notes payable consist of bank loans, trade credits and loans from officers, directors, stockholders and employees, and it is ordinarily assumed, in financial statements analysis, that bank loans constitute the preponderant proportion. That this assumption is reasonably valid in regard to the five industries represented here is suggested by two sources of information.

The first source is Federal Trade Commission tabulations covering the principal enterprises in each of the

five industries studied here and giving a detailed breakdown of current liabilities in 1938 and 1939. 26/ These figures indicate that at least for the larger companies in these industries notes payable were composed almost exclusively of bank loans. In every group except furniture either all or 99 percent of the total notes payable to trade, banks and individuals was bank debt in those years. In furniture (represented by a group of 15 companies) bank loans constituted about half of notes payable in 1938, with the rest divided fairly evenly between the other two items, and about four-fifths in 1939, with loans to individuals accounting for practically all of the remainder.

The second source of information on this point is a special tabulation of financial statements pertaining to a sample of companies that applied for industrial advances at the Federal Reserve Bank of New York and showing notes payable to banks and to trade during 1926-33. 27/ This sample includes some companies, mostly of medium size, in each of the industries studied here, the number ranging from 5 in stone-clay through 10 to 12 in clothing, furniture and machine tool, to 30 in food. In the clothing, furniture and machine tool groups bank loans constituted about three-fourths of the notes payable to banks and to trade, and in the food and stone-clay groups they amounted to about half.

Evidence such as that provided by these two sources does not show conclusively that in our sample industries bank debt constituted the bulk of the notes payable item, but it does indicate a presumption in that direction. And thus the entire body of data presented in this section patterns into a fairly strong indication that after the depression of the early 1930's mercantile credit bore a larger share of these small manufacturers' short-term financing than it did before, and that over the period as a whole bank credit was relied on less: while mercantile credit was increasing, bank credit was declining (baking) or remaining stable (men's clothing and furniture) or increasing less markedly (stone-clay and machine tool). 28/

What may have brought about such a shift in the relative importance of these two types of credit? The question, of course, cannot be answered definitively, but certain relevant considerations may be pointed out.



In the first place, short-term debt is incurred partly for the purpose of carrying inventory, and if a smaller amount of funds is needed for inventory businessmen usually prefer to cut down bank credit first, rather than trade credit, unless there are strong factors urging the opposite course. A decline in inventory does not necessarily mean a decline in short-term financing requirements, nor does that result necessarily mean an increase in the relative importance of accounts payable. But the probabilities are that both of these consequences will follow a decline in the dollar volume of inventory holdings.

Over the 1926-36 period such a decline occurred in all of these industries except men's clothing. The net funds received from the end of 1926 to the end of 1936 through inventory liquidation were as follows, for four of the industries: 29/ baking \$76,000; furniture \$299,000; stone-clay \$329,000; machine tool \$272,000. In the men's clothing sample there was a net accumulation of inventory, amounting to \$240,000.

This evidence is at least not contradicted by the data on inventory in relation to total assets, though here the decline is not very pronounced, and again men's clothing is an exception. The following figures on inventory in percent of total assets are averages of annual proportions for the first three and the last three years of the period: 30/

	<u>1926-28</u>	<u>1934-36</u>
Baking	10.5%	9.7%
Men's clothing	32.1	37.3
Furniture	29.1	27.1
Stone-clay	15.6	15.2
Machine tool	22.8	18.5

The reason for this decline appears to have been not a reduction in the physical volume of inventory but a general fall in raw material and finished goods prices during the period covered by the data. For example, in 1936 the wholesale price of Kansas City winter straights wheat flour was 75 percent of its average in 1926; the wholesale price of brick and tile was more than 10 percent lower in 1936 than in 1926; a composite wholesale price of furniture was down more than 20 percent. 31/ And these examples could easily be multiplied.

The assumption that it was a price fall rather than a decline in volume that produced the decrease in dollar volume of inventory is supported by data on inventory in relation to sales. On this basis inventory holdings do not appear to have moved decisively either upward or downward. It is true that they decreased slightly in baking and machine tool, but they increased fairly sharply in stone-clay, and remained stable in the other two industries. This may be observed from the following figures, which represent, again, averages of annual proportions (inventory to sales) for the first three and the last three years of the period: 32/

	<u>1926-28</u>	<u>1934-36</u>
Baking	4.4%	4.0%
Men's clothing	12.9	13.1
Furniture	20.2	21.7
Stone-clay	14.0	25.7
Machine tool	17.5	15.7

Thus it appears that one of the causes for the relatively greater importance of mercantile credit in the financing of these small manufacturers over the 1926-36 period was a decline in the dollar volume of inventory holdings. And there are indications that this, in turn, was due to the decline in prices that occurred during those years. 33/

Other factors may have worked more directly to increase the relative importance of mercantile credit, by increasing its supply. Competition, perhaps sharpened by the depression, among the raw material and equipment suppliers may have led them to seek more business from these small manufacturers by offering more trade credit. There is a strong presumption that at least the large suppliers were able to capitalize on cheap money rates, and thereby found themselves in a position to grant more credit to their customers. If the capital market did serve thus as a source of funds for the raw material suppliers, the paradox results that sizable resources not directly available to small businesses were used nevertheless to finance such enterprises indirectly. And the suppliers may, of course, have obtained additional funds for the financing of small manufacturers from sources other than the capital market, for instance from a reduction of their own inventory and receivables resulting from the decline in business.

But though there may have been an increase in credit granted, there is no evidence that credit was offered on more attractive terms. 34/ In fact, persons familiar with credit conditions in these industries report that trade credits in the middle 1930's were extended either on the same or on less liberal terms than they were in the 1920's. In general, the tightening of these terms came with the advent of the NRA. There may have been some competitive liberalization of trade credits in the early 1930's, or even in the late 1920's; but for the last three years of 1926-36 trade credits were offered on less liberal terms than at any other time during the period, a fact that would hardly be expected to encourage an expansion of mercantile credit on the part of these small manufacturers. Therefore any expansion that occurred must have been in spite of, rather than because of, the terms of purchase.

The tightening of credit terms occurred particularly in the men's clothing and furniture industries. In the late 1920's the selling terms of a prominent woolen manufacturer supplying the men's clothing trade were 10/10, 8/60 or 7/4, with season's dating as of December 1 or June 1 for the 7/4 terms. 35/ These were, obviously, very liberal terms, enabling the men's clothing manufacturer to get well along, if not through, his productive process before he was called upon for repayment of his mercantile credits. But since the NRA days terms of sale for woollens and worsteds have been fairly uniform at 1/10, n/60, the former being elected primarily by the large buyers, the latter by the small manufacturers, such as those that constitute the samples studied here; moreover, the practice of season's dating is no longer current. Before the depression of the 1930's suit linings were sold on the basis of net 60 days from the end of the month for the small buyers, and on 4 months e.o.m. for the large buyers. During the middle 1930's they were sold on 60 e.o.m. for all buyers, though today a few are again obtaining terms of 4 e.o.m. 36/

Manufacturers of upholstered furniture buy their piece goods, such as mohair and other fabrics, on terms of 2/10, n/70. These terms were established in 1933, and before that year had been 6/10 plus 60 extra, which is equivalent to terms of 6/70, or 7/10 because of the privilege of anticipating discounts to gain an annual rate

of 6 percent interest. In dollar volume the bulk of the raw material and supplies purchases by upholstered furniture manufacturers is for piece goods, with purchases of frames relatively insignificant. Some manufacturers make their own frames; others buy them, usually for cash. In fact, furniture manufacturers may even have to advance money to the frame manufacturers because the latter are frequently small backwoods shops with little, if any, working capital.

Flour purchases, particularly by the small bakeries, are largely on a cash basis. Sometimes terms of n/30 are allowed, but on the other hand bakers with poor financial ratings frequently have to buy their flour on a C.O.D. basis. There is no evidence that these terms changed markedly over the 1926-36 period, but there are indications that the flour millers have been tending to supply the bakers directly rather than through jobbers or wholesale grocers. The latter, it appears, found the credit risk too large for the profit margin involved in the transaction. 37/

Similarly, the machine tool manufacturers' purchases of raw steel, such as foundry billets and pig, are on the same terms now as in the 1920's:  $\frac{1}{2}/10$ , n/30. Parts for machine tools, such as gears and cutting tools, are and have been bought on terms of 1/10, n/30, or, if the supplier happens to be a manufacturer of parts for the automobile industry, on the slightly more liberal terms of 1/10 and 25. 38/ For manufacturers of stone-clay products raw material purchases, as was mentioned in the preceding chapter, are relatively unimportant, and therefore in regard to this industry the question of trade terms of purchase is largely irrelevant. Moreover, among the five industries that are studied here, this group gave the least indication of a shifting from notes payable to accounts payable.

A final reason for the relative increase in mercantile credit may have been the general tightening of bank credit during the depression. The fact, revealed by Chart 2 above, that these companies experienced their relative increase in accounts payable mainly in the second half of the 1926-36 period lends support to this hypothesis, but the question is one on which we can do no more than speculate, in the present instance.

Creditor-Debtor Relationships

Small manufacturers are creditors as well as debtors of the banks, and over the period 1926-36 the relationship between their credit balance and their debit balance became increasingly favorable to them. This was true of all the industries studied here except stone-clay, as is indicated by the following averages, for the first three and last three years of the period, of annual figures on cash in percent of notes payable: 39/

	<u>1926-28</u>	<u>1934-36</u>
Baking	70%	99%
Men's clothing	71	91
Furniture	57	97
Stone-clay	81	63
Machine tool	57	101

In this relationship the change is more marked than in those discussed above, and it shows clearly that in the aggregate these sample companies came to have practically as much cash on hand and in the banks as they had obligations due on notes (most of which were presumably to the banks). The notes payable item, moreover, was the active agent in this shift; cash holdings remained fairly stable. Because these figures refer to each sample as a whole, because not all the notes payable are due to banks, and because some companies in these samples reported no notes payable, the proportions given here are not necessarily illustrative of the creditor-debtor relationship existing between the ordinary small business and its bank. They do, however, indicate that after the depression the creditor position of these concerns taken as a group was about the same as their debtor position, as far as the banks were concerned, whereas before the depression this group of companies had been net debtors of the banks. Practically all of this change in creditor-debtor position can be attributed to a decrease in the use of bank credit.

In trade accounts, however, the relationship between current assets and current debt was quite different. The trade credits owed by these small manufacturers were, except in the baking sample, considerably less than their outstanding receivables, but the margin tended to shrink during the period studied. This is evident from the following tabulation, which shows, for the earlier and the

	<u>1926-28</u>	<u>1934-36</u>
Baking	90%	87%
Men's clothing	199	150
Furniture	245	217
Stone-clay	266	178
Machine tool	183	149

later years of the period, averages of annual figures on receivables in percent of accounts payable.<sup>40/</sup> Even with the narrowing margin between the outstanding credit extensions of these companies and the outstanding credit granted them by their suppliers, their receivables still exceeded their accounts payable by 50 to 120 percent at the end of the period, except in baking. In that industry the equality between outstanding mercantile credit granted and received is explained by the relative rarity of credit sales; most bakers, especially the small concerns, sell their product on a cash basis.

What may be called the creditor relief obtained by these companies - the narrowing of the differential between outstanding customer credit granted and mercantile credit received - is strikingly indicated by the dollar figures. The following tabulation, which refers again to the period before and the period after the depression, shows for each industry the average of annual differences between year-end outstandings in receivables and accounts payable; <sup>41/</sup> the figures for baking, marked with a minus sign, represent an excess of accounts payable over receivables.

	<u>1926-28</u>	<u>1934-36</u>
Baking	\$-65,000	\$-94,000
Men's clothing	789,000	338,000
Furniture	1,397,000	815,000
Stone-clay	945,000	362,000
Machine tool	642,000	461,000

In any analysis of the receivables item in the financial statements of these companies, an important qualification is necessitated by the practice of receivables factoring. It is known that in some of the industries, particularly men's clothing, receivables are frequently sold to financing agencies. Factoring of this sort would lead to an understatement of receivables, since factored receivables and the contra-liability (if any) are not generally shown on the balance sheet.<sup>42/</sup> There is no way of knowing how prevalent this practice was among the compa-

nies in the samples. <sup>43/</sup> Whatever its extent, however, it would only increase, not contradict, the observed difference between receivables and accounts payable; thus, while it might modify the decrease in that margin between the beginning and the end of the period, it is scarcely likely that it would account for the entire decrease.

The terms on which these companies sold their products, while they probably did not cause the relative decline in outstanding receivables, <sup>44/</sup> at least do not appear to have interfered with it. In most of these five industries selling terms at the end of the period studied here were no more liberal than in the middle 1920's; when a change occurred it was in the direction of less liberal selling terms.

The terms on which the manufacturers of men's clothing sold their product in the middle and late 1920's were in the neighborhood of 9/10, 7/70. Since the depression of the early 1930's they have rarely been more than 2/10, net 60 or 70, and today they are frequently straight net 60 or 70, with no discount. Manufacturers of upholstered furniture customarily sell their product on terms of 2/30, n/60, or sometimes straight 2/30. When the time consumed in transportation is an important factor (as in sales of an eastern manufacturer to a western buyer) terms of 2/30, n/90 are frequently offered. Persons familiar with this industry declare that these terms have not changed materially since the 1920's. The baking industry sells its product largely on a cash basis.

For machine tools the terms of sale are relatively unimportant and not particularly uniform. For complete machine tools, such as lathes and borers, regular terms are and have been n/30. A few companies are reported to have offered 1 percent for payment 10 days after date of invoice, but this practice has been quite generally abandoned since the depression of the early 1930's. Terms of sale for machine tool accessories vary widely, and depend on the prevailing terms in the industry to which they are sold. Cutting tools have customarily sold on terms of 2/10, n/30. The most important change in the selling practices of machine tool companies has been a tendency since the early 1930's toward increased instalment sales. This appears to have been brought about through the buyer rather than the seller, the sales finance companies tak-

ing an important part in the negotiations. Most of the instalment paper arising from these transactions is of 12- to 24-month maturity, with a 25 percent down payment, though a few of the contracts run for 36 months. When the instalment purchase of a machine tool is financed by a sales finance company the transaction appears as a cash sale on the books of the machine tool manufacturer. Therefore the increase of instalment purchases of machine tools has not affected the outstanding receivables and accounts payable of this industry.

Selling terms in the brick and tile industry are relatively short. Common brick frequently sells at a discount of 50 cents per thousand brick, and face brick at a \$1 discount, for payment in 30 days. On tile the discount ranges from 2/30 to 5/30, though sometimes the discount date is the 25th of the month for invoices dated from the 1st to the 15th, and the 10th of the following month for invoices dated from the 16th to the 31st. These terms vary from company to company as well as from area to area, and it is difficult to ascertain whether there has been a marked change from the middle 1920's to the middle 1930's. It has been declared that selling terms before the depression were frequently 2 percent discount for cash in 30 days for all the various brick and tile products. If this is true the discount today is more attractive than it was in the 1920's, but the discount period is no longer.

### CYCLICAL BEHAVIOR

During the course of the strong business fluctuations of 1926-36 the small companies in the samples behaved in much the same way as their larger counterparts, except that their reaction was in some respects sharper. The large companies, with their strong liquidity position, were able to resist the forces of deflation more effectively than the small enterprises, as is indicated by the financial structure and discontinuance rate of the companies under review. But despite differences in magnitude, the cyclical changes in the financial structure of large and small concerns were of a similar pattern.

Economists have long recognized that that part of the economy which caters to the demands of consumers is more stable cyclically than that which serves the pro-



ducers, a difference due mainly to the fact that producer goods are usually more durable than consumer goods. This generalization is substantiated by indices of the volume of business done by our samples of small companies over the period 1926-36 (presented below in Chart 4). During the post-1929 depression the index of sales volume fell more sharply in the industries producing durable goods than in those manufacturing non-durable goods,<sup>45/</sup> while in the prosperous years it rose to greater heights. These indices are based on sales at current prices, and since the prices of consumer goods fluctuated more sharply than those of producer goods, the curves in the chart tend to understate the difference between the two groups.

Similar variations between producer and consumer goods industries, and between durable and non-durable goods industries, are reflected in the profit ratios presented in Table 14. The losses suffered by these indus-

Table 14 - SAMPLE CORPORATIONS IN FIVE INDUSTRIES  
Profit or Loss in Percent of Sales, 1926-36 <sup>a/</sup>

Year	Cyclical Turns in General Business <sup>b/</sup>	81 Baking Corps.	46 Men's Clothing Corps.	66 Fur- niture Corps.	70 Stone- Clay Corps.	116 Machi- nery Corps.
1926	Peak	2.7%	2.6%	3.3%	6.4%	3.4%
1927	Trough	3.9	1.4	2.6	4.9	1.8
1928		2.1	1.8	2.1	6.2	4.4
1929	Peak	3.4	1.1	1.8	1.4	8.0
1930		2.0	-1.5	-3.4	-1.8	-2.8
1931		0.7	-4.1	-4.5	-9.5	-7.6
1932	Trough	-2.6	-7.4	-17.3	-32.3	-19.1
1933		-0.4	0.5	-2.4	-18.4	-5.2
1934		-0.6	c/	-2.9	-7.0	-0.2
1935		-0.2	0.8	-1.1	0.6	3.3
1936		1.0	1.2	2.2	5.9	3.7
1937	Peak	d/	d/	d/	d/	d/

<sup>a/</sup> Based on TMEC Monograph 15 (previously cited) Tables 1-A to 1-E in Appendix F. Profit or loss is net income after income taxes and exclusive of capital gains and losses.

<sup>b/</sup> Calendar-year dates, as determined by W. C. Mitchell and A. F. Burns of the National Bureau of Economic Research.

<sup>c/</sup> Less than 0.05 percent.

<sup>d/</sup> Data for the sample companies terminate with 1936.

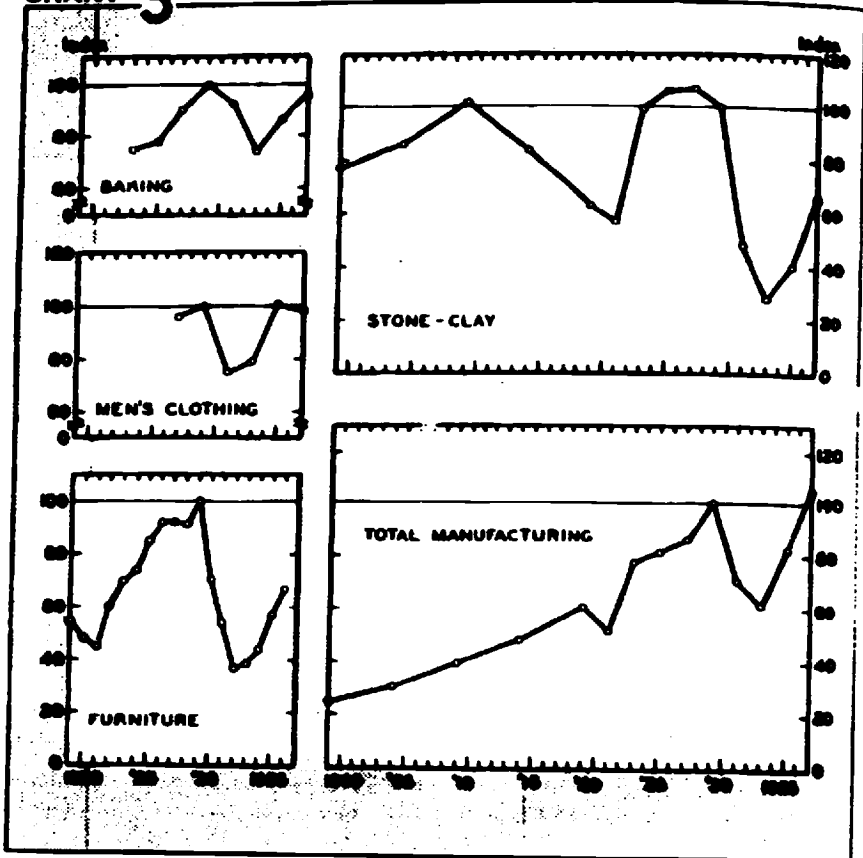
tries in the early 1930's were so large that they stand out much more prominently than the profits made in the late 1920's and middle 1930's. It was in the durable goods groups, however, that losses were most severe. In stone-clay, to take the extreme case, net losses averaged a third of sales in 1932, whereas in baking, to take the other extreme, they never amounted to more than 3 percent. In the durable goods industries, on the other hand, experienced higher profit rates in the prosperous years.

Another economic theorem which is substantiated by the cyclical behavior of these samples is the observation that a growing industry tends to react earlier than others during expansion and to lag during contraction, whereas a declining industry tends to behave in the opposite manner. Of the five groups studied here, stone-clay is a declining industry, and machine tool an expanding one; the others are fairly stable. This is evident from Chart 3, which shows the physical volume of output of all the establishments in four of these industries, 46/ and in all manufacturing industries throughout the country, for periods as far back as the data are available. The secular decline in the stone-clay industry over the period 1899-1937 stands in sharp contrast to the secular increase over the same period in total manufacturing. For the other industries represented in Chart 3 the data cover a much shorter period, and therefore it is more difficult to detect a secular movement. Baking and men's clothing appear to have been relatively stable, for their trends closely follow that of total manufacturing; certainly there is no evidence of a long-time decline. Probably the same is true of furniture manufacture, though here the picture is influenced by the lag in the closely-correlated construction industry. As for the output of the machine tool industry, some notion of its long-run trends is afforded by data on value added by the manufacturing process. From 1899 to 1937 the value added by manufacture in the foundry and machine shop products industry (which includes machine tools) rose 548 percent, an increase 13 percent greater than the corresponding rise for all manufacturing industries combined. 47/

Here too - in regard to secular growth and decline - sales data may be taken as indicators of cyclical differences among the sample industries. In the declining stone-clay industry, as can be seen from Chart 4, our

FOUR MANUFACTURING INDUSTRIES AND TOTAL MANUFACTURING: Indices of Physical Output, 1899-1937 (1929 = 100)<sup>a</sup>

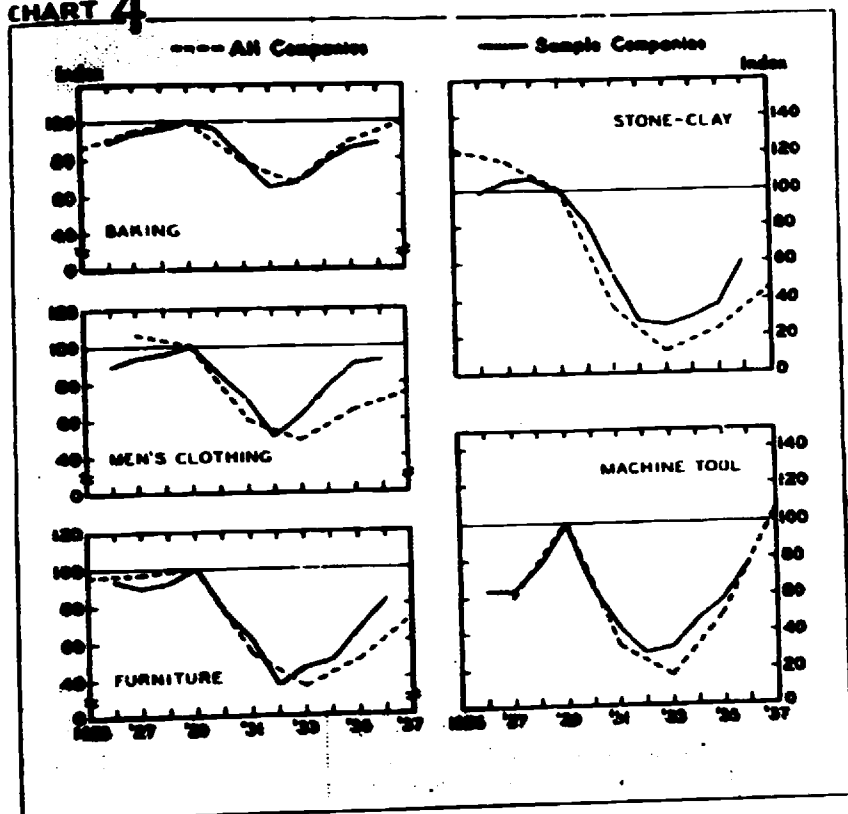
CHART 3



<sup>a</sup> Data for furniture from National Research Project, *Production, Employment and Productivity*, by Harry Magdoff, Irving H. Siegel and Milton B. Davis (Philadelphia 1939) Pt. 2, p. 80. Data for other three industries, and for total manufacturing, from National Bureau of Economic Research, *The Output of Manufacturing Industries, 1899-1937*, by Solomon Fabricant (New York 1940) pp. 384, 423, 522, 525, 602.

FIVE MANUFACTURING INDUSTRIES: Indices of Sales for Sample Corporations, and of Total Value of Products for All Companies, 1925-37 (1929 = 100) <sup>a</sup>

CHART 4



<sup>a</sup> Sales data are annual, and are based on TNEC Monograph 15 (previously cited) Tables I-A to I-E in Appendix F. Value-of-products data are biennial, and for baking, men's clothing and stone-clay are based on National Bureau of Economic Research, *The Output of Manufacturing Industries, 1899-1937*, by Solomon Fabricant (New York 1940) pp. 384, 423-24, 522-26; value-of-products data for furniture and machine tool are based on the Census of Manufactures.

sample of successful companies reached their sales peak in 1928, a year before the cyclical turn in general business, whereas in the other four industries the sample companies' sales peaks conformed with the reference cycle; and the stone-clay sample did not reach its subsequent trough until 1933, a year later than the others. The converse lag in contraction and lead in expansion that is to be expected in the expanding machine tool industry cannot be detected from these annual data, but Chart 4 does provide further evidence that this industry was experiencing a secular rise in volume of business, for its sales volume in 1936 was considerably higher than it had been in 1926. The sales of the baking and men's clothing groups were about the same at the end as at the beginning of the period, while those of furniture were somewhat lower and those of stone-clay were much lower. This divergency indicates again the secular decline in stone-clay, and suggests that the furniture industry was suffering from the effects of the lag in housing.

The volume of business done by the small manufacturers studied here seems to have followed much the same course during 1926-36 as that of all establishments in these particular lines of business. This is evident from a comparison of the sales index of the sample companies with the value-of-products index of all companies, also presented in Chart 4. 48 Only in baking was the drop after 1929 more pronounced for the sample companies than for all companies in the industry. And during the subsequent recovery period the sample companies (except in the baking group) appear to have expanded their sales somewhat more sharply than did all establishments in the respective fields. In other words, the samples, composed of companies that continued in existence from 1926 through 1936, slightly increased their proportionate share of the business that was handled by all the enterprises in these industries.

These observations, however, are for the most part only confirmation of widely recognized economic facts. A more specific question on which the present data can throw some light is how the financial structure of these small corporations responded to the strong fluctuations that characterized the period under review. How did the companies utilize their profits in good years, and how did they finance their operations in unprofitable years?

<u>Sources of Funds</u>		<u>Uses of Funds</u>	
Funds from operations (net income of \$1,902 plus depreciation of \$1,112)	\$3,014	Gross outlay on land and plant	\$1,957
Long-term borrowings	390	Cash dividends	679
Mercantile borrowings	240	Accumulation of cash and government bonds	483
Equity funds	174	Increase of receivables	321
Increase in other cur- rent liabilities	200	Reduction of notes payable	204
Sundry	24	Purchase of investments	193
		Accumulation of inventory	175
		Sundry	30
<b>TOTAL</b>	<b>4,042</b>	<b>TOTAL</b>	<b>4,042</b>

During prosperity the companies in these samples, on the whole, used their net income, supplemented by borrowings, for land and plant expansion, cash dividend disbursements and the accumulation of current assets. The foregoing figures for the 118 machine tool companies may be regarded as roughly illustrative; the figures are in thousands of dollars, and pertain to the sum of operations for the three years 1927-29. <sup>49/</sup> The reduction of notes payable does not conform to the general pattern of financial adjustments during a prosperity period, but it offers further evidence of the declining importance of bank as compared with mercantile credit. It should be mentioned, however, that this bank debt reduction by the machine tool sample was concentrated in 1929, and was offset to some extent by modest increases in bank borrowings in the early 1930's.

For unprofitable years the picture is in general the reverse of that shown above. In such periods these small corporations financed their operations by liquidating their assets, both fixed and current. Here the figures for the 70 companies in the stone-clay group - presented below - may be regarded as more or less typical of the

<u>Sources of Funds</u>		<u>Uses of Funds</u>	
Liquidation of re- ceivables	\$594	Gross outlay on land and plant	\$434
Liquidation of in- ventory	294	Cash dividends	348
Drafts on cash and sales of govern- ment bonds	165	Net operating losses (net loss of \$1,186 minus de- preciation of \$886)	300
Sundry	206	Reduction of accounts payable	105
		Reduction of notes payable	52
		Sundry	20
<b>TOTAL</b>	<b>1,259</b>	<b>TOTAL</b>	<b>1,259</b>

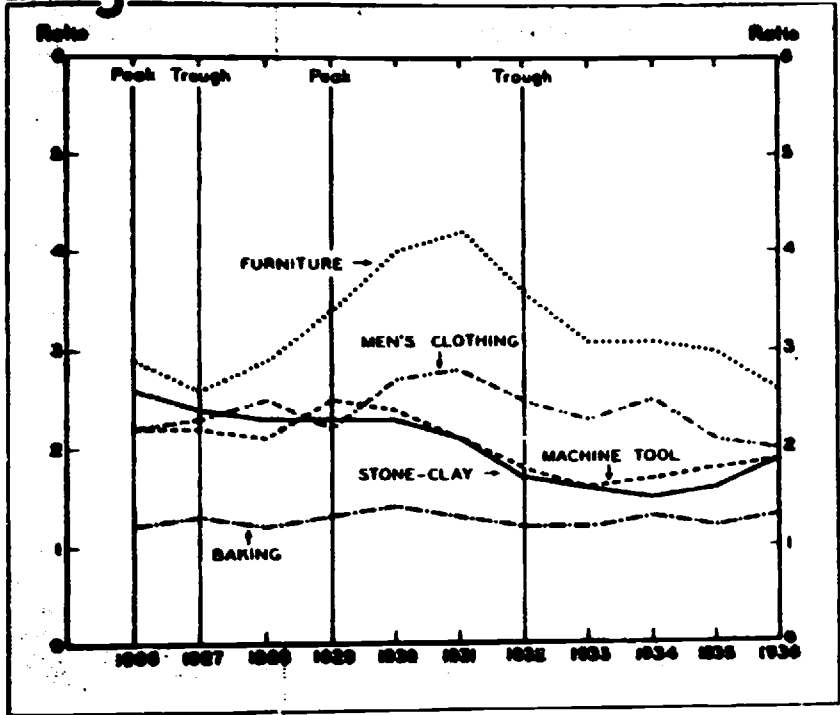
manner in which all five of the samples financed their depression losses and dividend disbursements; the data, again in thousands of dollars, refer to the sum of operations for the three years 1930-32. <sup>50/</sup> Land and plant outlays were less than half the depreciation accruals, implying that considerable amounts of fixed property were used up without being replaced. <sup>51/</sup> Cash dividends were even larger than the net operating losses that had to be financed, but it should be remembered that these figures are aggregates for a group of 70 companies, not all of which paid dividends.

These two sets of figures reveal that during fluctuations in business the brunt of the necessary financial adjustments is borne by the current items. In times of cyclical expansion inventory is accumulated and receivables are increased, and the funds needed for these purposes are obtained from short-term credits as well as from profits. During cyclical contraction a sharp liquidation of inventory and of receivables is necessary, in order to obtain funds for paying off short-term debts and for financing operating losses, and sometimes for disbursing dividends. Thus the credit structure of the companies in our samples is considerably more flexible than their capital structure. For example, during 1927-29 and 1933-36, both periods of cyclical expansion, the mercantile credits of these small manufacturers increased in dollar volume (from the beginning to the end of the period), and in some instances their bank borrowings also expanded. These credits helped to provide the funds needed for the accumulation of inventory and the financing of credit sales. During the years of cyclical decline, 1930-32, when funds were needed for a reduction in the amount of current debt, there was liquidation of current assets. In these years, however, the funds obtained through current asset liquidation (through cash and government bonds as well as through liquidation of inventory and receivables) greatly exceeded the funds required for current debt reduction, as is evident from the following figures on the opera-

	<u>Current Asset Liquidation</u>	<u>Current Debt Reduction</u>
Baking	\$ 411,000	\$292,000
Men's clothing	1,724,000	853,000
Furniture	2,645,000	811,000
Stone-clay	1,053,000	125,000
Machine tool	1,590,000	160,000

**SAMPLE CORPORATIONS IN FIVE INDUSTRIES**  
**Ratio of Current Assets to Current Liabilities, 1926-36<sup>a</sup>**

**CHART 5**



<sup>a</sup> Based on TNEC Monograph 15 (previously cited) Tables I-A to I-E in Appendix F. The vertical lines indicate cyclical turning points in general business (calendar-year dates), as determined by W. C. Mitchell and A. F. Burns of the National Bureau of Economic Research.



tions of these three years, 1930-32, combined. <sup>52/</sup> The excess provided a cushion to finance other operating adjustments and in some cases to pay unearned dividends.

The concomitant reduction in current assets and current debt resulted in a fairly stable ratio of current assets to current liabilities, as can be seen from Chart 5. The cyclical movement observable here in the current ratio is much less marked than that found in the ratio of profits to sales (Table 14) or even in such ratios as current assets or current liabilities to total assets. Chart 5 reveals that in the three consumer goods industries, particularly in men's clothing and furniture, there was some evidence of a current ratio movement contrary to the course of general business, that is, of an upward movement in depression and a downward one in prosperity. In the two producer goods industries there is indication of a directly cyclical movement, but here the downward tendency in the ratio over the entire period tends to obscure its cyclical variation.

#### CONCLUSION

The foregoing analysis indicates that the financing requirements of small manufacturers, as typified by the present samples of companies in five different industries, run largely in terms of short-term credits and equity capital. Moreover, the proportion of short-term credits obtained from mercantile sources appears to have increased over the 1926-36 period, in relation to the proportion obtained through banking channels. But the terms of purchase in these industries were not liberalized over this period, and the greater part of the relative increase in mercantile credits occurred during and after the depression of the early 1930's. Therefore the permanency of this observed shift in the relative importance of bank and trade credit may be open to question. The 1936 increase in the dollar amount of bank debt shown by these small manufacturers suggests that the years of cyclical expansion subsequent to 1936 may have obliterated most of the tendency toward a relatively greater reliance on mercantile credit. We have no proof, however, that this reversion has taken place, and for the machine tool sample there is positive evidence that the increased share of accounts payable in the short-term financing of these

companies not only was maintained through 1939, but was augmented still further.

It is difficult to ascertain from the present analysis what types of financing, not already available, are needed by such companies as these. There are strong grounds - instability of earnings, high rate of discontinuance and the like - for believing that long-term credits would not serve their purposes. Their needs run, rather, in terms of equity capital and short-term credits. But equity capital from outside sources is probably one of the last things small entrepreneurs want; their sense of individuality and free private enterprise is strong, and they react quickly against any scheme that might jeopardize their control over their property. It appears, therefore, that what these small manufacturers need is equity capital from inside sources, and short-term credits from banks, other financing agencies and trade suppliers.

Equity capital from inside sources must, in most instances, come from retention of earnings in the business during profitable years, and from a minimizing of fund withdrawals during unprofitable years. These effects could be achieved by maintaining a close watch on ownership withdrawals, both officers' compensation and cash dividends. Such wariness demands, however, a longer range point of view than that exhibited by many small manufacturers. Thus it appears that unless something can be done to broaden entrepreneurial perspective the financing of small businesses will continue to be a pressing problem, particularly during and after periods of extended cyclical contraction, and that the most practicable avenue for relief is short-term, and possibly also medium-term, credits. 53/