Less Money in the Till . . .

Will Cash Shortage Pinch Business?

American businesses are doing more business with less cash lately. Corporation treasurers and small businessmen alike are finding that the heavy expenses accompanying high business activity are putting a strain on their bank accounts. What is causing the pinch and what it will mean for the future are two increasingly important questions as the time for making plans for 1957 draws near.

Highlights on the squeeze on corporate liquidity are:

In the first six months of 1956, cash and U. S. Government securities held by all corporations fell nearly 15 percent.

Hardest hit were firms with the greatest increases in sales and spending programs.

The pinch is not confined to major national companies; even fairly small firms in the Sixth District have felt the squeeze on ready cash.

Some slack remains before the ratio of cash to current debt reaches low prewar levels for all corporations in the aggregate; individual firms are undoubtedly near their minimum.

If the result of the cash shortage is a brake on business spending, it is in line with the intent of Federal Reserve policy.

How Tight is the Squeeze?

Generally corporations count as part of their cash assets their total bank deposits, till money, and also their short-term Government securities, which can be readily sold if necessary. At the end of June 1956, American corporations (excluding banks and insurance companies) had cash of 30.7 billion dollars in their bank accounts and in their cash registers and some 18 billion dollars in Government securities. The total of some 49 billion dollars, impressive though it might sound, was puny, compared with either the volume of business being done or the amount of money corporations owed to others. Furthermore, the total of their liquid assets, or ready cash, was about one-seventh less than the sum they held just six months earlier, at the end of December 1955.

American businesses have had to stretch out their means of payment to cover the greater volume of business being done. At the end of 1954 business firms on the average had 10 cents in ready cash or easily convertible securities for every dollar of sales that they made in that year. At the end of June 1956 only 8 cents in liquid assets was available per dollar of sales on a yearly basis, so much have sales risen and liquid assets fallen.

A better way of looking at the liquidity squeeze is to compare the amount of cash assets corporations own with what they owe, excluding, of course, long-term debt, which does not have to be paid immediately. Once again, the straitened circumstances of most business firms become obvious. Right now American corporations, if necessary, could pay off only about 48 cents on the dollar of all current liabilities. At the end of the war, when corporate liquidity was the highest, American firms on the average could have paid off nearly 95 cents of every dollar of current debt.

Part of the difficulty arises because of the stage of the business cycle we are in. Changes in corporate liquidity occur in conjunction with changes in business activity. Corporate liquidity becomes relatively great when business activity has been low for some time. As business improves, heavy requirements of inventories and trade receivables tend to draw cash balances down.

Pinch Felt in District Too

Many Sixth District concerns have also experienced a shortage in cash relative to current debt. This is best seen by looking at the balance sheets of a sample of medium-size firms with headquarters in District states that publish their accounts regularly in financial manuals. These firms, all with public stock issues, now have cash equal to about 60 percent of current debt, compared with about 80 percent last December. At present their cash relative to debt is about the same as that of many large national manufacturing and trade concerns.

Both the large national firms and the medium-size District firms are considerably more liquid relative to their current debt than is the average national corporation. On the other hand, the first six months of the year saw much greater liquidity restrictions for these local and large national firms. Undoubtedly the national average is heavily weighted both by small firms and by retail establishments which presumably do not require any substantial cash positions. The cash-to-debt ratio of very small District firms apparently changed little in the first six months of 1956, according to the meager data available at the Federal Reserve Bank.

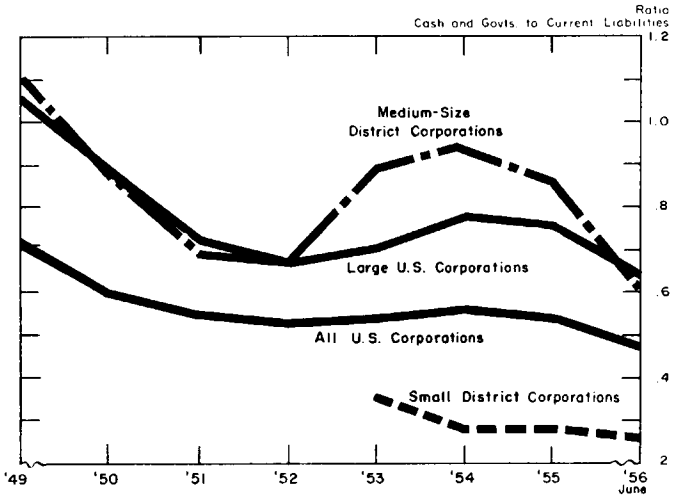
Slimming Diet Not Starvation

Part of the apparent shortage of ready cash on the part of American business has been an optical illusion: Demands have been so large that businesses have not been able to generate enough cash to keep up. In the first half of 1956, retained profits of all American corporations fell below year-earlier levels, and even though depreciation allowances were producing more funds, the cash "throw-off" of American business relative to their total uses of funds dwindled from 53 percent to 41 percent. In 1954, the cash throw-off of American corporations supplied about 95 percent of their total needs for funds.

District corporations also have expanded their use of funds far beyond their ability to generate more from their operations. In 1955, for the sample of 59 medium-size corporations with headquarters in the Sixth District and with public stock issues, 59 percent of the total funds

requirements came from retained earnings and depreciation allowances, in comparison with 86 percent in 1954. Small corporations too found their internal sources of funds insufficient for their requirements. For the sample of small District firms shown in the accompanying chart, only 49 percent of needed funds could be supplied from retained earnings and depreciation last year. On the other hand, the sample of 229 national manufacturing and trade con-

Corporation liquidity is falling.



Source: **Data for all U. S. corporations from Securities and Exchange Commission; for large U. S. corporations from *Federal Reserve Bulletin* June 1955 and 1956: sample includes approximately 250 manufacturing and trade concerns. Data for medium-size District corporations from *Moody's Industrials:* Sample includes manufacturing and trade concerns headquartered in District states; 61 such companies 1949-50 and 59 after 1950. Sample of small District corporations includes 39 manufacturing and trade concerns whose accounts are on file in the Discount Department of the Federal Reserve Bank of Atlanta.**

In all cases except that of all U. S. corporations, estimates for June 1956 were prepared from small samples used as basis for projection of relevant figures.

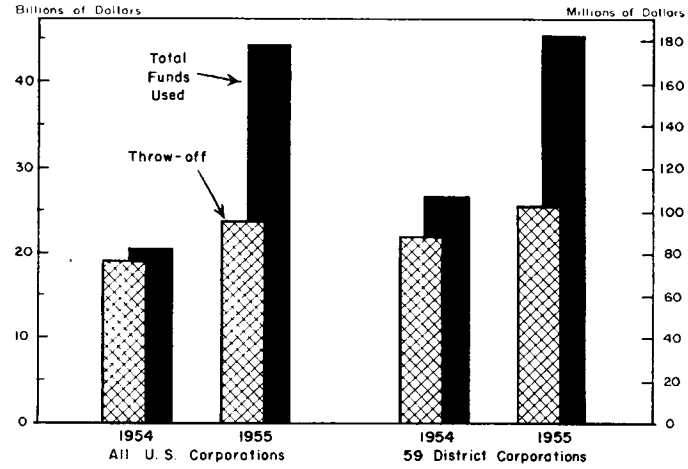
cerns (most of them quite large) showed some 70 percent of requirements could be supplied from internal sources.

The desire of businesses to spend more money has run head on into current Federal Reserve policy that is seeking to hold down the growth in the money supply. Thus, in spite of the substantial increase in loan demand throughout most of the period, the money supply expanded only about 3 percent in the year ended June 30, 1956, compared with about 5 percent for the previous year. In the first half of 1956 the money supply (deposits and currency) continued to increase very slightly.

All of this, of course, has meant the economy has been served a slimming diet rather than one of starvation. Businesses sometimes have drawn down their bank accounts when they were unable to borrow to fulfill their building programs. That corporations' cash positions have fallen in dollar figures recently in the face of a slightly expanded money supply suggests that other sectors of the economy may be increasing their cash holdings.

Business officials have found it particularly attractive to keep a minimum of money on hand because of the relatively high yields currently available on virtually risk-free, short-term investments. Alert corporate treasurers frequently calculate their immediate needs with a sharp pencil, lending out the remainder of their bank balances to other corporations or security dealers even for a few days

Gain in cash throw-off (retained earnings and depreciation) is not keeping up with rise in funds used.



in addition to purchasing short-term Treasury securities.

In part, the ability of corporations to economize on cash assets has been responsible for the increase in the relative turnover of bank deposits that has occurred during most of the year. From December 1955 to August 1956 turnover (checks drawn divided by deposits) had increased over 10 percent. This, of course, tends to offset monetary policy aimed at slowing down the growth in bank deposits: the same deposits do more work.

Will Less Money Mean Less Business?

Obviously there is no neat answer to the question of the ultimate impact of the liquidity squeeze on American business. Some tendencies, however, can be discerned. Banks often ration credit by requiring higher compensating balances when credit is tight. More important, ready cash and easily convertible securities are to nonfinancial businesses what reserve balances are to commercial banks. Although there are no legal limitations on the amount of cash and Government securities that a corporation must keep relative to its liabilities, traditional standards of management tend to keep many businesses from weakening their liquidity positions beyond a certain point. This tendency to observe liquidity standards is particularly important to banks and trade creditors who are continually faced with deciding whether or not credit should be granted.

Unlike many other financial ratios, ratios testing the adequacy of the cash account have no formal rule of thumb. There are traditional differences in liquidity standards among industries, and individual companies within an industry may have widely differing attitudes toward the amount of cash and Governments they desire to maintain. Even so, for corporations as a group, the only period when liquid assets were as small a proportion of current debt as they are today was 1939-41. Many corporations may have considerable slack before they run up against their minimum liquidity requirements; others may have reached that point already. In any case, American businesses will find their liquidity considerations of increased importance in their 1957 spending and financing plans.

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