

A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1952 February



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Stocks in bounds

Business inventories are fairly well in line with sales except for special lines and particular firms. Retail holdings of nonmetal products can rise if demand warrants.

AS 1952 GOT UNDERWAY the fear of general overstocking which had haunted business managers last spring and summer had ceased to cause widespread concern. Partly, this is a result of good Christmas sales, but most inflated inventories have been worked down fairly well.

Some large District retailers would like to reduce over-all holdings somewhat further. Most of the interest in reducing stocks is concentrated in particular lines, however. Despite a considerably reduced level of output after mid-1951 manufacturers have large numbers of refrigerators, TV sets, and washing machines on hand. Soft goods producers are attempting to cut holdings of textile and leather products. Unfortunately, many dealers find themselves oversupplied with the same things.

For isolated firms the outlook is serious. Inventory holdings of some small manufacturers who were intemperate in their grab for goods during the buying rush are still badly unbalanced. Complaints are also heard from retailers who are not well diversified, and some independent dealers are experiencing such difficulties that they are considering closing their doors. The really sore spots are special cases. Holdings generally are not far from the quantities necessary to satisfy projected sales.

Scare selling avoided

In the last half of 1951 businessmen extricated themselves from what could have been a serious predicament, both for them and the nation as a whole. Retail inventories reached a peak of 20.6 billion dollars last spring, almost three months after the peak of consumer buying had passed. The final addi-

tions to this total, which was one-third above the level of June 1950, were involuntary. Merchants faced with receding sales found themselves inundated by deliveries on buying orders placed hopefully long before.

Business observers have gradually come to recognize the full significance of the part played by such changes in inventory policy in forcing fluctuations in total business activity. Certain studies have indicated that in recent decades inventory changes have been considerably more important than changes in business capital expenditures in causing or intensifying booms and busts, especially in the short-run. When stocks are building, income is created but the goods involved are not helping to satisfy consumer demand. On the downswing the reverse is true. Goods are sold, but no one is paid for producing them.

The magnitude of the effort towards inventory readjustment in 1951 might have brought serious repercussions in normal times. But 1951 was not a normal year. Rising Government expenditures and crisis-induced capital spending on a grand scale offset the depressing effects of cutbacks in consumer goods inventories and prevented a general downturn. Continued high individual income and announcements of future production cutbacks gave assurance that most retail inventories could be sold if they were held long enough. Evidence that the readjustment was carried through without severe strain is provided by the falling trend of business failures in the District during 1951.

Mixed trends since Korea

Immediately following June 1950 all classes of business—manufacturers, wholesalers, and

retailers—attempted to increase stocks in anticipation of shortages and higher prices. Much of the inventory building was based on what subsequently proved to be a miscalculation, but it tended, for a time at least, to create the very conditions that businessmen were trying to guard against.

In late 1950 and early 1951 consumer durables moved swiftly from manufacturer to dealer. Many distributors financed the operation by taking advantage of book credit offered them by their suppliers. More recently, trade firms have been reluctant to take on additional holdings. As a result, inventories of finished goods rather than receivables mounted on manufacturers' books.

For the past seven or eight months the book value of total business inventories, seasonally adjusted, has remained remarkably stable at or near the record amount of 70 billion dollars. The calm surface hides divergent trends, however. Trade stocks are down 10 per cent from their peak of last May, but manufacturers' holdings have risen sufficiently to keep up the total. Here again the aggregate is deceiving because inventories of soft goods manu-

facturers have been declining moderately in recent months while the durable goods group, buttressed by defense work, has continued to add to holdings.

About two-thirds of the post-Korea rise in total business inventories has been accounted for by the durable goods categories—principally items made of metal. Firms involved include makers and sellers of automobiles and appliances, tools and machinery, and tanks and planes.

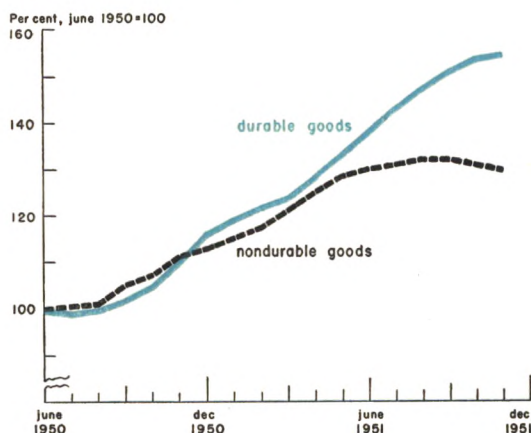
Cutbacks and confusion

With output of most consumer durables down and deliveries of armaments still at a moderate rate, many businessmen are asking where the large output of the CMP metals—steel, copper, and aluminum—is going. Part of the answer lies in the defense initiated program of industrial expansion which is far from completed. Manufacturers of transportation equipment, machine tools, and electrical and other machinery have greatly increased their “in-process” stocks.

Holders of contracts for war materials are also tying up a steadily rising share of available metals. Partly, this is a result of the accumulation of parts and raw materials which is necessary as production expands or moves through the “make ready” stage. In certain cases, however, inventories rose more or less involuntarily because particular components were lacking and stocks of materials or semi-finished goods became unbalanced. In addition, specification changes and delayed deliveries of machine tools have prevented materials from being used as rapidly as anticipated.

Outside of the Government stockpiles there is little evidence of “hoarding” of unused materials. The fact that the grey market and conversion deals for steel have declined in importance is largely traceable to restrictions placed on nonferrous metals used in connection with steel by many producers. Steel warehouses in this area have some surplus of cold rolled strips and certain types of stainless steel,

Inventories of hard goods manufacturers stimulated by defense but stocks of soft goods falter



but the great bulk of new steel is quickly sent through channels to users.

The if and when of future shortages

The initial impact of the enlarged needs of the armed services for textiles, leather products, and food has been met and absorbed. Most of the contemplated increase in numbers of personnel under arms has already occurred. From now on, the effect of rearmament will be concentrated increasingly in additional needs for metals.

If consumers wish to increase their buying of clothes, leather goods, rubber products, foods, and similar goods, the demand can be met with relative ease. The relative abundance of supplies of raw materials used in the manufacture of soft goods is evidenced by the fact that many types of foods, fibers, chemicals and the like are selling below OPS ceilings.

Should buying of consumer hard goods increase or even remain at present levels inventories of these items will probably decline significantly later in the year. Defense mobilizers have warned that the pinch on metals will tighten and that complete relief cannot be expected for at least another year.

Present plans call for only 800 to 930,000 passenger cars in the April-June quarter. Producers of many other consumer durables will receive only 35 per cent or less of the aluminum and copper that they used in the pre-Korea base period.

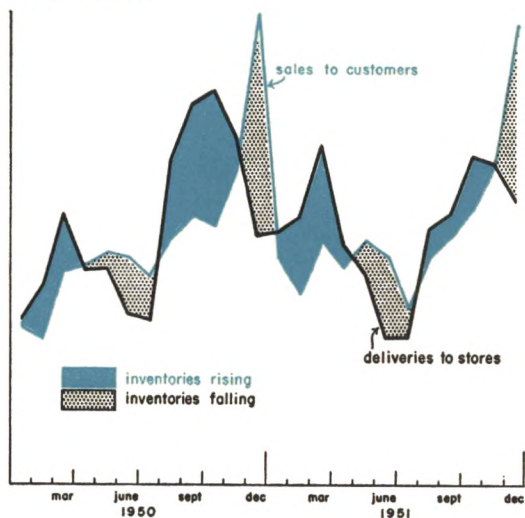
Existing stocks of most types of appliances would blunt the edge of any new consumer buying spree which might develop. Present holdings cannot be counted on too heavily, however, because a pick-up of buying at the retail level could light the fires of inventory accumulation once again. In addition, a special problem exists in the case of newer products such as clothes dryers, garbage disposal units, and dish washers. Makers of these items are tapping a vast market for original equipment. Conservation and substitution of scarce materials may help hold up the quantity of durable

consumer goods produced, but, in general, numbers as well as quality can be expected to decline.

Aside from general supply and demand conditions, special factors will influence business investment in inventories in the months ahead. Acquisitions by firms which are not engaged in essential activities will be influenced by tight working capital positions. Mainly, this has resulted from higher tax rates and the acceleration of the corporate tax payments. In addition, financing will be hampered by the cost price squeeze on profits, and the lessened availability of credit.

Other businessmen unaffected by financial stringency will be careful not to over-extend inventory positions in the near future. They are aware that the economy rests heavily on rising defense outlays and the rate of private capital investment. Whether justified or not, uncertainty as to business prospects breeds conservative inventory policies which will help to minimize the contribution of inventory changes to future business fluctuations.

Pre-Christmas inventory build-up small in District stores in '51



The poultry boom

Specialization keynotes larger chicken and egg supplies but increases credit needs.

POULTRY AND EGG PRODUCTION expanded sharply in the past decade. It far more than matched a rapid population growth, as per capita consumption rates were up from 30 to 50 per cent. The consumption of eggs in 1951 averaged over 400 per person, compared with about 300 prewar. Chicken meat consumed increased about one-half, to 30 pounds per capita. Turkey consumption, at 5.5 pounds per person in 1951, increased even more sharply.

The output of poultry and eggs has expanded more rapidly than that of other livestock products due largely to such production economies as faster growing birds, better feeds, reduced death losses, more eggs per hen, increased mechanization, and improved marketing practices. An indication of the effect of these economies is the feed requirement per egg produced; it has been declining steadily and is now about one-sixth less than twenty years ago. Rapid progress has been made also in the production of poultry meat but the major improvements in this respect probably have been more closely associated with the development of specialized broiler and turkey production.

Midwest poultry and eggs important

Poultry and eggs provide a billion dollars a year to farmers in eight Midwest states, roughly 10 per cent of their cash farm income. About two-fifths of the nation's eggs, nearly 30 per cent of its chicken meat, and one-third of its turkeys are produced in this area. Although found on 85 per cent of Midwest farms, poultry, nevertheless, is a minor enterprise on most of them.

Iowa, although more widely known for other farm products, had more chickens on farms

January 1, 1951, than any other state. Minnesota was a close second, and Missouri, Indiana, Illinois, and Ohio were all among the first 10 states. Iowa also led in the number of chickens raised in farm flocks, and in egg production.

Eggs provide more income by far than do sales of either chickens or turkeys. In many instances, however, the quality of eggs marketed leaves much to be desired. Improper handling and storage on farms probably is the chief cause, but inefficient marketing facilities and outmoded handling practices are also contributing factors.

Turkeys are produced on less than 7 per cent of the Midwest farms. Minnesota, however, is second in turkey meat production and Iowa is fourth. A recent development of importance is the popularity of the small Beltsville White which attains a convenient size for broiling, frying, or roasting when only 12 to 16 weeks old. About one-sixth of the turkeys produced in the U.S. in the past year were of this type and a further large increase is in prospect for 1952.

The production of broilers—young chickens raised specifically for meat and usually marketed when 8 to 12 weeks old, weighing 2 to 4 pounds—is less important in the Midwest than in several other areas. Virtually unknown a decade ago, they now account for one-half of all chicken meat produced in the U.S. and constitute over one-fourth of all chickens raised in the Midwest.

Broiler production expands rapidly

About 800 million broilers were produced in 1951. A further increase of possibly 10 per cent is indicated for 1952. Until recent years,

broilers were mainly by-product cockerels resulting from the rearing of replacements for farm laying flocks. The major supply now comes from poultrymen who specialize in the production of young chickens for meat, commonly on a year-round basis.

With modern equipment one man can handle about 15,000 broilers at a time and may produce as many as four batches a year with the same facilities. Broilers make efficient use of feed, a pound of gain for each three pounds consumed being a standard performance under good management. Large scale, specialized production has resulted in very efficient use of feed and labor and the production of a uniform high quality product. But small producers are still in the game. Under capable management the production of broilers on a small scale, as a sideline to other activities, has given very satisfactory results.

The rapid increase in broiler production in the past decade prevented chicken prices from rising as much as those of beef cattle and hogs. Thus, the benefits of the lower production costs were passed along to consumers and, no doubt, were an important factor in the stepped-up consumption of chicken meat.

More specialization needed?

Much of the progress made in the poultry industry in the past decade has been closely associated with the trend toward specialization. Although the number of poultry farms has declined along with all other types of farms, the proportion to the total has increased.

Some of the more effective management techniques cannot be readily applied to small units. Furthermore, the income from very small flocks, even when the enterprise is profitable, is too small to command much attention in competition with other farm jobs. Progress in the Midwest poultry industry, therefore, probably will continue to be gauged very largely by the number of farmers who expand their poultry enterprise to a point where it provides an important part of their total farm income.

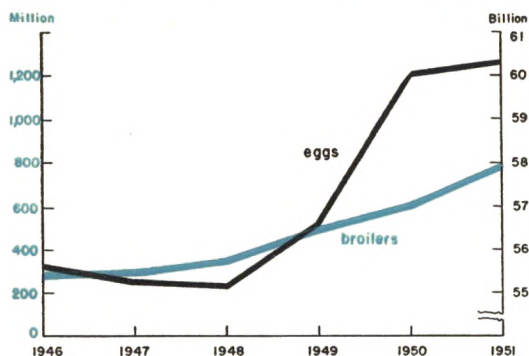
Poultry financing field open

Largely because of its sideline nature on most farms, commercial banks in the Midwest have had only limited experience in financing poultry production. However, with continued expansion by specialized producers and a growing use of purchased feed, the demand for credit to be used specifically for poultry production is increasing. Most of the credit used by poultry producers thus far has been provided by business firms which supply chicks, feed, or other materials used in production, or by firms which process and market poultry products. The rapid development of specialized poultry production in some areas has been explained largely by the ready availability of this type of credit.

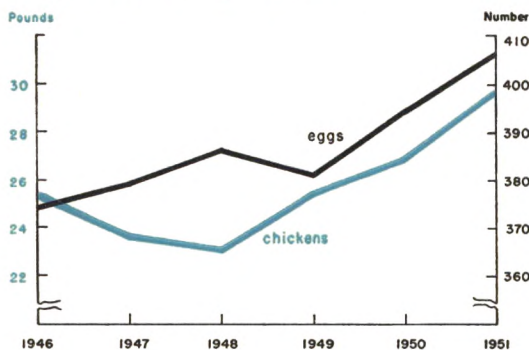
Many types of financing arrangements are used. Some farmers, of course, are in a position to provide their own financing, and others, after providing some cash, obtain the necessary additional funds by borrowing from banks or other established lending agencies. Also, where poultry production is a small part of the total farm business, the necessary funds frequently are obtained through a general line of credit without being specifically earmarked.

When financed by a dealer, growers frequently are furnished supplies, possibly including the chicks, but sign a conditional sales agreement and promissory note which leaves title to the poultry with the dealer. No specific interest charge is made on such loans but supplies ordinarily are obtained at higher prices than if purchased for cash. In some instances the grower's only contribution to the production operation is the provision of labor, site, and buildings. The agreement in these circumstances usually stipulates that any surplus above costs be divided between grower and dealer at the time the poultry is sold. The share going to the grower normally varies from two-thirds to three-fourths. In case the proceeds of the sale do not cover the costs, the dealer absorbs the loss and the grower receives no return for

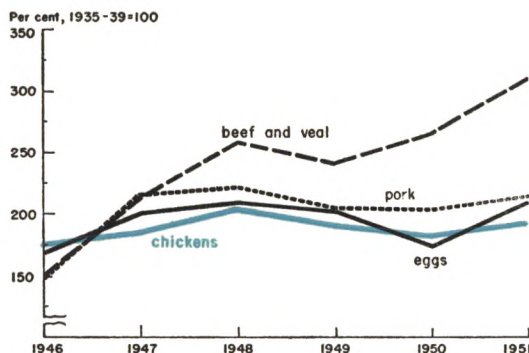
Production has increased sharply . . .



. . . permitting a big rise in per capita consumption . . .



. . . with smaller price increase than for beef or pork



his labor or the use of his land and buildings.

In a variant of this plan the financing agent agrees to make a labor payment to the grower, usually a specified amount per thousand birds sold. Any excess above costs is divided between the grower and the financing agent. Another arrangement provides for both a labor and rental payment with the financier retaining all profits. In this case, the grower is essentially a hired man.

Specialized broiler and turkey production, similar to cattle feeding, commonly involves large amounts of credit. There is an important difference, however. Credit for cattle feeding usually is extended to purchase the livestock, the borrower providing all feed, labor, and equipment. For specialized poultry production the credit more commonly is to provide feed but may also include the cost of the chicks or poults and other current production materials. Since these "out of pocket" costs average about 90 per cent of the total production expenses, the margin of security to lenders is very thin unless the borrower provides part of the funds, or collateral in addition to the poultry. Furthermore, poultry is subject to higher death losses than are some other classes of livestock. On the other hand, a crop of broilers can be produced every 90 days and eggs may be marketed daily, tending to lessen the risk of temporarily depressed markets.

Most banks which have developed a sizable volume of poultry financing rely heavily on chattel mortgages on additional property for security or upon the endorsement of a responsible feed dealer or other business firm. The latter method frequently also involves supervisory service to assure that the growers are carrying on their production activity in accordance with approved methods. Those banks which have devoted considerable attention to poultry financing generally have reported satisfactory results. As the industry develops further, its credit needs will grow. In fact, the availability of credit may be an important factor governing its growth.

Review of previews

Roundup of business forecasts for 1952 indicates wide area of agreement — few expect radical changes in any direction.

JANUARY IS FORECAST TIME in the financial press. Last month was no exception: a large and diverse group of economists and financial writers tried their hand at making informed guesses as to "what's ahead for business in '52." This year's predictions reveal a surprising degree of uniformity, a uniformity which seems independent of the affiliations of the prognosticators. Few if any expect significant weakening of demand with consequent inventory pile-ups and serious unemployment. On the other hand, there is apparently little strong fear of a general inflationary surge like that of the last half of 1950. What diversity there is ranges from uneasiness about insufficient consumer demand toward the end of the year to anxiety over rising consumer demand in the face of lowered output of consumer goods.

Among the mild "bears" is *Fortune* magazine which, in its January issue, suggested that:

- Prices will hold fairly stable, except as moderate wage boosts force up a few industrial ceilings.
 - Savings will stay high, at least well into the New Year.
 - Hard-goods supplies will increase slightly late in 1952, substantially in 1953.
 - Capital expenditures will start to decline as major defense expansions pass their peak.
 - Soft-goods production will turn up in 1952, and perhaps sales a bit, too.
 - Incomes will rise, improving buying power, but at a relatively moderate rate.
 - Production will also advance moderately, but less than capacity would allow. . . .
- . . . before the year is out, U. S. business generally may find that its No. 1 problem once again has become the task of selling the American consumer.¹

Apparently the diversity among forecasters

is to a large extent a product of different assumptions as to how consumers will behave. The low batting average of forecasters in 1951 indicates the difficulty of pinpointing consumer behavior. Some observers have expressed this attitude:

. . . it seems likely that consumers will continue to exercise restraint in their attitude toward spending. The principal reasons are: first, relatively high inventories of durable goods in consumers' hands; second, progressive elimination of deferred demand; third, the continued effect of credit controls; and, fourth, anticipation of newer models, better quality and lower prices.²

With rising incomes and accumulations of liquid savings at very high rates, some, like *Business Week*, are concerned about the possible impact of shortages of consumer hard goods:

Rising consumer income will encounter a dwindling supply of goods; the inflation potential of this, plus the unusually large volume of saving over the last nine months, is clear. Spending patterns will change. There will be fewer autos, TV sets, and refrigerators; soft goods, notably foods, will be the gainers.³

Defense spending and deficits

Another critical factor is the size of the rise in defense spending over the next year and the extent to which deficit financing will be necessary. Administration leaders think these magnitudes will be large. Thus, Defense Mobilizer Charles E. Wilson feels that inflation control will be more difficult in 1952:

We cannot assume that the stability of the past year will continue during the coming months without strenuous efforts by the Government to maintain it. The factors making for inflation will in all probability grow

stronger, making the task of stabilization more difficult.

Federal expenditures for national security will increase during the next 12 months to an annual rate about \$20 billion higher than at present. . . . we will have to cope with the inflationary impact of a growing cash deficit unless adequate amounts of new taxes are enacted.⁴

The President, in his Economic Report, stated that:

For the fiscal year 1952, the total of Federal expenditures is estimated at approximately seventy-one billion dollars, and receipts at about sixty-three billion. . . .with expenditures for security programs rising sharply, a dangerously large deficit of close to twice that size is estimated for the fiscal year 1953, if there is no additional taxation.

Even with the additional taxes that I am recommending, the deficit will remain large, until the security program has passed its peak and tapers off. . . .⁵

On the other hand, *Fortune* thinks that:

- The fiscal 1953 budget will show at most a small deficit.
- Defense spending will rise moderately in 1952 and then flatten out in 1953 and start to taper off.⁶

Prices and production

On the basis of divergent expectations with regard to consumer behavior and Federal spending, differences have been expressed regarding price and output trends. *Fortune*, as noted earlier, is somewhat bearish. But this view is not universal:

. . . it is likely that the year ahead would bring:

- a moderate increase in total industrial production with military output up sharply and civilian goods production down moderately; . . .
- automobile production of about 4,000,000 units, housing starts numbering about 800,000, a new all-time high in steel production, sharply expanded machine-tool output, new highs in chemical production and a revival in the "soft" lines; . . . and
- no major inflation or deflation in the price level but with much talk and some fear of both.⁷

. . . the rise in the value of the gross national product between the beginning of 1952 and the end of 1952 will be between 8 and 10%, about half of which would be accounted for by physical increase and the other half by price increase.⁸

Mild price inflation is in prospect for the United States for the coming year, and very likely for the next two years. . . .The general price level may advance as much as 3 to 5% a year in the next couple of years. . . .⁹

Business capital expenditures . . .

will decline later in 1952, most observers are agreed:

The prospect is that the rate of private investment will decline during the calendar year 1952. Construction will fall off during 1952 below its volume for 1951. . . . Investment in inventory will be negative, for the reason that businesses in general will seek to reduce their currently high inventories. Plant expansion in non-defense industries has already passed its peak and will fall off further during 1952. . . . An offsetting factor will be the continued high rate of expenditure for new plants in industries vital to defense and war. . . .¹⁰

. . . plant and equipment expenditures (will be) not greatly changed in the first six months but drifting downward in the second half of the year. . . .¹¹

1, 6—*Fortune*, January 1952, page 26.

2, 8, 10—Neil H. Jacoby, Dean, College of Business Administration, UCLA, *The Commercial and Financial Chronicle*, December 13, 1951.

3—*Business Week*, December 29, 1951, page 21.

4—Charles E. Wilson, *The Battle for Production*, Fourth Quarterly Report to the President, January 1, 1952, page 35.

5—*The Economic Report of the President*, January 16, 1952, pages 12-13.

7, 11—Murray Shields, Vice President and Economist, Bank of the Manhattan Company, *The Commercial and Financial Chronicle*, January 3, 1952.

9—Earl L. Butz, Department of Agricultural Economics, Purdue University, *The Commercial and Financial Chronicle*, December 6, 1951.

Instalment credit nears record

Increases in outstandings followed easing of Regulation W terms last summer, but the rise is likely to be short-lived.

CONSUMER INSTALMENT CREDIT has been on the upswing in recent months. Outstandings increased in August, September, October, and November by a total of 350 million dollars, and a further substantial Christmas increase probably occurred in December. As a result, instalment debt at year-end was close to the all-time high of 13,460 million dollars reached a year earlier.

The rise was small in comparison with those of other postwar fall seasons, but was significant in that it differed from the experience of immediately preceding months. In the first four months of 1951, instalment credit declined by more than 550 million dollars. Moreover, outstandings continued at this reduced level from May through July, the period of usual peak seasonal expansion. This contrasts sharply with the first seven months of 1950, when outstandings increased by a total of 1,700 million dollars.

It seems likely, however, that instalment credit will again turn downward in the months ahead. Buying—both cash and credit—is usually at a low ebb in the first few months of the year as consumers recover from the Christmas season. In addition, the volume of monthly repayments has risen substantially over the past year, reflecting the large amount of credit outstanding and the shorter repayment period permitted under Regulation W. Because of this, the volume of new credit granted would have to be at a level close to the peak rate of 1950 in order to offset repayments and maintain the amount outstanding.

The longer-run picture for credit buying is clouded by the sharp reductions in output of consumers' durable goods required by Govern-

ment metal allocations. At present there appear to be relatively ample inventories of automobiles, appliances, furniture, and other durable goods upon which instalment credit is typically extended. These are likely to be worked down gradually even at the current rate of buying, however, and could support a level of consumer demand comparable to that of 1950 only for a relatively short period of time. Nevertheless, the rise in instalment credit in recent months does indicate a strengthening in credit buying which may work to offset in part these other downward forces.

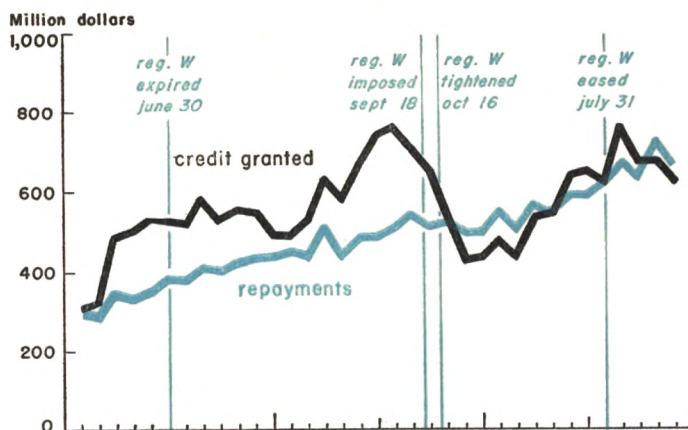
Easier terms a stimulus

One major factor accounting for the renewed strength of instalment credit is the easing of restrictions on credit terms under Regulation W which occurred at the end of July. As a result of Congressional action, permissible contract maturities were lengthened, in effect reducing the size of required monthly repayments by about one-sixth. Down payments were cut by two-fifths on instalment sales of television sets and major household appliances, and permission was granted to count trade-ins as part or all of the required down payment on all types of instalment purchases. These relaxations have the effect of reducing sharply the amount of cash required as a down payment on credit purchases, especially where the dealer is willing to grant a liberal trade-in and shade his profit margin accordingly.

The direct effect of this easing in terms has been an increase in the volume of instalment credit granted. New credit extended from August through November was 14 per cent greater than in the preceding four months and

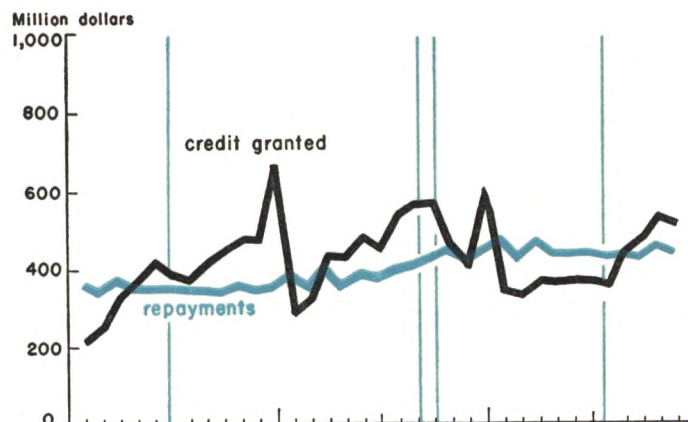
Credit granted for purchase of automobiles

dropped sharply from record summer highs following imposition of Regulation W in the fall of 1950. A steady rise from the winter low brought the amount granted last year close to the record 1950 total. Repayments about equalled new credit extensions, however, with the result that total debt declined slightly from the 5,350 million dollars outstanding at the end of 1950.

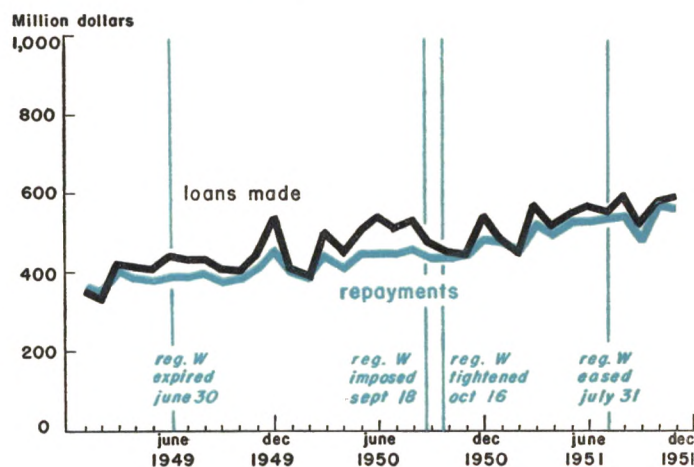


Credit extended for purchase of "other" goods

mostly consumer durables—sagged unseasonably late in 1950, and fell well below repayments through the summer of 1951. Extensions spurted upward beginning in August, however, reflecting in part the easing in credit terms at the end of July. This use boosted outstandings at year-end to about 3,400 million dollars, compared with the peak of 3,800 million a year earlier.



Instalment cash loans apparently have not been affected greatly by Regulation W as they are made for a wide variety of purposes. Since only a portion is specifically for purchase of goods, down payment requirements do not apply in many cases. Outstandings at year-end were over 3,600 million dollars—a rise of almost 10 per cent during 1951—as new loans made continued to exceed repayments.

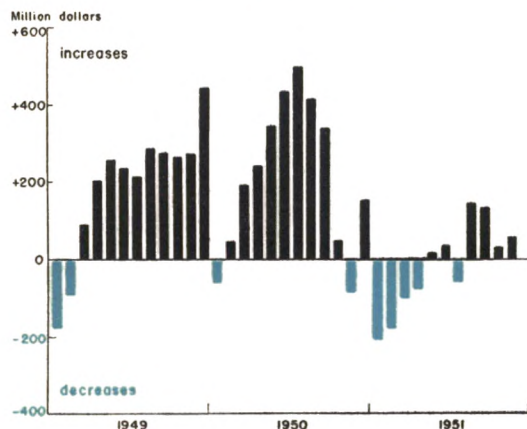


12 per cent larger than in the fall of 1950.

More basically, the relaxation of terms has substantially expanded the credit market for consumers' goods. In all major lines, the volume of credit extended has increased relatively more than total sales since last July. Sales of automobile dealers, for example, were 4 per cent lower from August through October than in the preceding three months, but credit extended for purchase of automobiles increased 10 per cent. New credit granted by appliance and furniture stores jumped 38 per cent, while total sales advanced only 11 per cent.

During the past few months, the stronger credit demand resulting from easier credit terms has helped work down burdensome inventories of durable goods. In many lines, however, these stocks cannot be replaced because of output restrictions. Looking forward to the time when inventories are further reduced and the demand for durable goods exceeds the available supply, the Council of Economic Advisors has recommended that "there should be restored to administrative authority a more flexible discretion in the formulation of selective credit regulations."

Decreases about offset increases in instalment credit outstanding during 1951, unlike earlier years



Hard times for small business?

Broad changes in business activity, not special difficulties in obtaining funds, present the main problems for the "little fellow."

SMALL BUSINESS has always occupied a special place in the hearts of the American people. Partly, this attitude springs from a sympathy for the "smalls" versus the "biggs" in all realms of human endeavor. In addition, however, it is widely believed that the perpetuation of small business is an important factor in maintaining a competitive, free-enterprise economy.

Certainly, the small business tradition has helped motivate the anti-trust policy which has, in general, kept this nation free of European style cartels. In attempting to strengthen and encourage small business, however, it is necessary to avoid policies which tend to "bottle-feed" firms which otherwise would be weeded out by the process of natural selection.

The widespread interest in the problems of the little firm is influenced by the fact that the great majority of businesses in the country are quite small. On the basis of 1948 distribution, 98 per cent of the 4 million businesses in operation have less than 50 employees, and 87 per cent have seven or fewer. In all business classifications, small firms loom large in number.

	Number of businesses (thousands)	Per cent with less than 50 employees
Retail trade	1,677	99.5
Service industries	857	99.1
Construction	372	98.3
Manufacturing	307	89.1
All others	794	98.0

Who needs money?

Much of the "do something for small business" talk is directed towards liberalizing the availability of capital and credit. Partly, this is because a firm's distress appears most dramatically in a deterioration of its working capital position. An infusion of cash is a surefire, temporary solution. In many cases, however, additional funds merely serve to conceal the underlying problems much as a snowfall blots out flaws in the landscape. In a recent study of the causes of business failures issued by Dun and Bradstreet over 90 per cent were charged to managerial shortcomings including inadequate knowledge and general incompetence. Difficulties in obtaining capital and credit were not even listed separately as causes of failure.

Between 1943 and 1951 the number of business firms operating in the United States increased by one million, or about one-third. By 1948, only three years after the war, the business population had assumed about the same relation to human population that had existed in previous decades. The entrepreneurs who started these postwar firms were able to obtain the necessary funds from savings, their own or those of relatives and friends, or from an "angel" whom they were able to interest in their proposition. Once the nucleus of initial funds was put to work, the firm was ready to prove its economic worth in competition with other establishments.

Certainly, an adequate flow of funds is vital to any business firm. The point is: Do small firms have access to sufficient capital and credit to permit the vigorous growth which is essential to a healthy, free-enterprise economy? Such a question cannot be answered categorically. Available data concerning loans granted or securities floated are of limited usefulness because they describe successful applicants for funds. Little is known about the firms who failed in their quest.

Small businessmen earnestly seeking credit

which they cannot obtain from usual sources are likely to turn to special lending or loan guarantee agencies such as the RFC, or the Federal Reserve Banks. Many prospective borrowers applying to these agencies are found to be in a precarious financial position as a result of mismanagement or an overambitious expansion program. In other cases the risk is of a marginal nature which a private bank is willing to undertake if part of the risk of the loan can be shifted through a commitment or guarantee. Few applications submitted to these lenders of last resort suggest the possibility of a "sound," bankable loan.

It is often maintained that the principal financial problem of small business is the difficulty of obtaining risk or venture capital which is permanently invested in the firm. This point of view has been characterized by the term "equity capital problem." Are there a large number of suitable investment opportunities going begging in the United States?

A number of "venture capital" companies have been formed with the object of locating desirable investments in small new firms. Although none of these companies have been established in the Seventh District on a formal basis, this area has several private research groups sponsored by persons of substantial means. Organizations of this type report that only a very small proportion, perhaps one in a hundred of the inquiries they receive eventually result in actual investments. Doubtless there will always be deserving small firms who lack capital funds, but they will continue to be outnumbered by those whose grandiose plans cannot find justification in the eyes of analysts.

Small business and the banks

When a firm's assets grow rapidly, either for seasonal reasons or because of a permanent expansion of activity, the banking system is usually called upon to meet these needs. Most banks are anxious to grant business loans which promise reasonable assurance of repayment.

A borrower cannot expect to look to the

banking system for "easy" credit, however, since the loan officer's first responsibility is to the bank's depositors. A new or expanding firm must expect to spend some time building up its credit rating and banking contacts so that when a need for credit appears it can be satisfied. Many banks are willing to give special consideration to the needs of small firms which show promise of future growth which will make them more valuable customers.

Tapping the capital markets

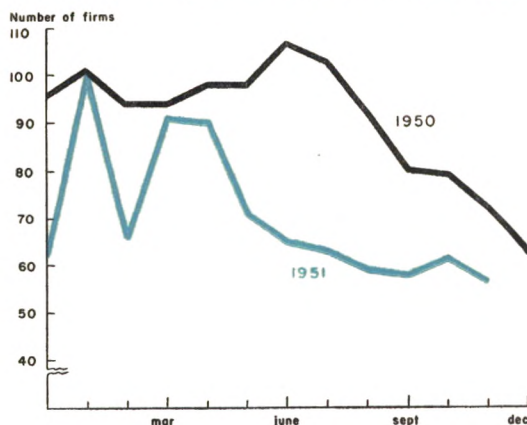
Smaller firms probably had an easier task selling their securities twenty-five years ago than they do today. This is true for both stocks and bonds, but since stock financing has never been a major source of funds for small business, the changing character of the bond market is of particular importance.

In the 'twenties individuals purchased substantial quantities of corporate bonds for their personal investment portfolios, or for trust funds. Often the bonds were obligations of relatively small firms which floated their securities with the aid of investment banking affiliates of local commercial banks. Today, life insurance companies and pension trusts buy almost all of the new corporate bonds which are offered, often through private sales. In large part, the "institutional" market is geared to handle economically only medium to large issues of substantial firms.

Some life insurance companies have made an effort to seek out smaller businesses with sound futures which can utilize funds made available in the form of term loans. This type of financing, often arranged in cooperation with commercial banks, has helped supplant bond financing for smaller firms.

It is doubtful that changes in stock market activity over the years have had much adverse effect on small business finance. Very small firms have never sold stock in appreciable amounts. Partly, this is because of a lack of investor interest, but in many cases there is no desire to float equity issues. Ordinarily,

Fewer firms fail in Seventh District



small to medium sized firms are able to sell their shares only at considerable expense—perhaps as much as 20 per cent of the selling price. In addition, small proprietors are often reluctant to share ownership and management with outsiders.

The greater reliance placed upon retained earnings and depreciation reserves by business, generally, as opposed to outside sources of funds can hardly be tagged as an unfavorable development. The fact that a firm is able to earn the money with which to expand is in itself a justification for that expansion. On the other hand, the ability of a new or relatively small firm to sell stock to the public is often a reflection of high-powered merchandising rather than an indication of the economic worth of the enterprise.

Despite high rates on individuals and corporations the postwar tax structure has tended to encourage the accumulation of equity capital in small, incorporated businesses. This is because of the differential between the capital gains tax of 25 per cent and the high marginal rates on large personal incomes. Keeping the earnings in the business, shields them from the individual tax. Many wealthy individuals have invested money in small firms in recent years without ever intending to receive dividend in-

come. They expect to sell out at some future date after the growth of the firm has enhanced the value of the stock.

In war and peace

On the basis of failures, the postwar period has been kind to business firms, large or small. In recent years, the failure rate for the nation has been only 34 per year per 10,000 firms, about one-half the prewar rate and about one-third of the rate in the 'twenties.

More small businesses fail in proportion to total numbers than is the case with their larger competitors. This is mainly because most of the bankruptcy cases involve new firms; two-thirds of the firms which failed in 1950 were five years old or less. A business, like an individual, is reasonably certain of a long life if it can survive its early years without mishap.

The onslaught of great economic disruptions such as depression or war increases business mortality. From 1941 to 1943 the business population fell by 400,000 or 12 per cent. The great majority of these "discontinuances" involved very small firms. Few were failures in the technical sense. Establishments declined in number as their proprietors were taken into the armed services or the commodities they handled or processed became scarce.

A partial solution to this situation will be found in greater ingenuity on the part of managers to fit their establishment into a war or semi-war environment. In this endeavor they can count on help from Government agencies connected with the mobilization program.

In the year ending June 30, 1951, one-fifth of the dollar value of all prime contracts for defense work went to firms employing less than 500 employees. This is not a meagre proportion when the importance in total awards of heavy goods which can be handled only by large firms is considered. The place of small business firms in this type of defense work will always lie in their role as subcontractors or sellers of parts or supplies.

A Small Defense Plants Administration has

been authorized by Congress. It is the function of this agency to negotiate the letting of defense contracts to small firms, to recommend small business defense loans to the RFC, and to help with technical and managerial aid. Small business can also seek assistance from the field offices of the armed services and the Department of Commerce.

Aside from direct defense contract awards, encouragement is being given to other small businesses engaged in less essential activities. Defense Mobilizer Wilson has directed the DPA to give preference to small firms in granting certificates of necessity which permit rapid amortization of new facilities. In addition, the NPA has been empowered to offer special help in normal business operations. Small firms are being permitted greater flexibility in their use of scarce materials and in their pricing policies than is permitted to business generally.

In conclusion

For the duration of the international emergency restrictions upon nonessential credit extensions and allocations of materials will serve to limit expansion opportunities for all types of business not directly involved in the rearmament effort. Moreover, sales and production by firms which are not engaged in defense-related activity may have to be reduced from present levels. In the years immediately ahead, these problems will far outweigh the difficulties which the small businessman will encounter in his search for funds to do business as usual.

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Christmas trade

*Disappointing to retailers,
but good by most standards.*

CUSTOMERS OF DISTRICT DEPARTMENT STORES shopped and spent at near-record rates during the 1951 Christmas season. Retailers were disappointed, however, by the level of sales which during the four weeks between Thanksgiving and Christmas were about 3 per cent below those of the corresponding period of 1950. Since prices were higher, the physical volume of goods taken home by customers declined even more than is indicated by the dollar sales figures. Nevertheless, it approximated the 1948 volume which, except for 1950, was the largest on record. Stocks continued to be worked down but were still large enough to result in intensive post-Christmas selling efforts. The season was disappointing only in terms of the exceptionally high pre-season expectations and the subsequent unfavorable comparisons with 1950, a period dominated by fears of shortages and price rises.

City sales patterns differ

There was considerable divergence among sales volumes of large cities in the District. Sales in Chicago dipped 4 per cent from year ago levels, while those of Detroit fell 6 per cent. The decline in the Motor City was the largest for any major District city and no doubt was due primarily to unemployment caused by production cutbacks in the automobile industry. In contrast to these declines, Milwaukee sales were unchanged from the previous year and those of Indianapolis increased 2 per cent. Sales in other cities in the District were down slightly on the average.

The Christmas season decline in District department store sales, while similar to the experience of stores in the New York, Philadelphia, and Minneapolis Districts, was some-

what more than for the nation as a whole. In other areas the dollar volume of sales was larger than a year ago, the greatest increases occurring in the Cleveland and Dallas Districts. Of the major cities in the United States, however, San Francisco experienced the greatest increase over year ago levels with sales about 8 per cent higher than in 1950.

Durables sales fall most

As might have been expected, durable goods sales made the poorest showing when compared with the year earlier volume. Sales of major household appliances dropped about 40 per cent and those of furniture and domestic floor coverings fell 15 and 20 per cent respectively. In evaluating such measures, however, consideration must be given to the 1950 dollar volume with which 1951 sales are compared. Due to the "scare" buying of durables which was in full swing at that time, sales were exceptionally high. Furthermore, the large consumer-held inventories resulting from the heavy buying wave a year ago lessened the Christmas demand for such goods this winter.

Sales of women's and misses' clothes and accessories dropped considerably less than those of men's clothing, probably indicating that consumers had done more advance buying of the latter.

Increased consumer resistance to high prices was commonly reported in trade circles and was evidenced by purchases of less expensive goods and by the fact that sales of basement stores declined less than those of main stores.

Over-all, 1951 Christmas sales at department stores were at a high level and there was a consistent tone of strong consumer demand in the week-by-week sales. While there fortunately was no eruption of "scare" buying such as marked the 1950 season, there were indications that consumers are able and willing to purchase goods which they are accustomed to use and in at least the usual volume. But they were in no great rush to exchange dollars for goods. They shopped for values.