

MAINTENANCE OF WORKING
CAPITAL OF INDUSTRIAL CORPORATIONS
BY CONVERSION OF
FIXED ASSETS.

BY

Arthur H. Winakor.

UNIVERSITY OF ILLINOIS BULLETIN

ISSUED WEEKLY

VOL. XXXI

JANUARY 23, 1934

No. 21

[Entered as second-class matter December 11, 1912, at the post office at Urbana, Illinois, under the Act of August 24, 1912. Acceptance for mailing at the special rate of postage provided for in section 1103, Act of October 3, 1917, authorized July 31, 1918.]

BUREAU OF BUSINESS RESEARCH
COLLEGE OF COMMERCE AND BUSINESS
ADMINISTRATION

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BULLETIN No. 49

PUBLISHED BY THE UNIVERSITY OF ILLINOIS, URBANA
1934

It is the purpose of the Bureau of Business Research of the University of Illinois—

- (1) to study and as far as possible to explain economic and industrial conditions within the State;
- (2) to direct attention to experience-tested practices of good business management; and,
- (3) to investigate methods for securing the best executive control of business.

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1800—1-34—5021

UNIVERSITY
OF ILLINOIS
IN PRESS 11

PREFACE

During the past few years it was a common experience to read in the newspapers that large companies had dismantled their inefficient plants, or even abandoned them, and had concentrated their work in fewer and more favorably located, more efficient, and newer plants. The financial press was full of the news of losses incurred by corporations, and numerous instances of reduction or stoppage of dividends. From these reports it has been a common inference that many companies, in their efforts to bolster earnings statements, had failed to provide reasonable and necessary amounts of depreciation. And many companies have been, and no doubt are, foregoing what under more prosperous circumstances would be considered needed maintenance of physical assets.

Many writers currently suggest that the capital assets of corporations are rapidly becoming obsolete, and that instead of providing only "normal" depreciation or "normal" maintenance, exceptional charge-offs and rehabilitation of facilities should be made.

These changes, which have drastically affected the physical plant and book values of fixed capital, raise the question as to what the effects of such problems have been upon the working capital. Has the working capital of corporations been maintained, has it been reduced commensurately with changes in fixed assets and present economic needs, or has it been depleted?

The purpose of this study is to shed some light on a few of the problems relating to fixed assets and working capital, although all these problems are intimately related and pertinent to the subject. It is intended to show the extent to which corporations have maintained their working capital position through the operation of a simple economic principle. This principle may be briefly stated as follows: When there is promise of an "adequate" return on the investment, the flow of funds will go to expand capital assets; when economic conditions in any industry are such that an "adequate" return is not forthcoming, new capital will not venture into permanent forms, and if conditions are severe enough, capital in fixed assets will be allowed to revert gradually to a liquid form wherever possible.

The operations of this principle will be related in the following pages primarily to one factor which affects both fixed assets and working capital, namely, the "depreciation fund." Although it is recognized that the same principles apply to several other kinds of "prepaid assets," e.g., prepaid insurance, rent, leasehold, etc., the analysis is not extended to these, partly because the same principles apply to them, and also because they are of lesser importance. In addition, it is in-

tended to restate and emphasize some generalizations as to the relationship of the "depreciation fund" to fixed assets and to working capital, and possibly to suggest what types of concerns have greater "survival" power, or resistance to the onslaughts of depression.

The study is based on the years 1927 to 1932 inclusive, thus covering both "prosperity" and "depression." Although considerable space and emphasis are given to the facts as produced in depression years, this should not be construed as indicating that the principles and generalizations apply only to depression. In fact, they are of universal applicability either in prosperity or in depression. The "depression" period has merely accentuated their operations and made it easier to analyze and see the facts involved.

Grateful acknowledgment is made to Dr. Daniel Borth for helpful suggestions at the inception of the study, to Professor A. C. Littleton for constructive criticism throughout the course of the investigation, and to Professor P. H. Brown for reading the completed manuscript.

Members of the Bureau staff, particularly Joseph Cerny, R. C. Parmelee, and C. F. Dunham, assisted in the assembling and preparation of the material.

ARTHUR H. WINAKOR

January, 1934.

TABLE OF CONTENTS

	PAGE
I. PREMISES OF THE PROBLEM	7
II. CHANGES IN AMOUNTS AND RELATIONSHIPS OF FIXED ASSETS, DEPRECIATION, AND WORKING CAPITAL . .	20
A. Changes in Value of Capital Assets and Depreciation Policies	21
B. Depreciation Earned, Recovered, and Fixed Assets Converted into Working Capital	26
C. Analysis of Working Capital	31
III. CONCLUSION	39