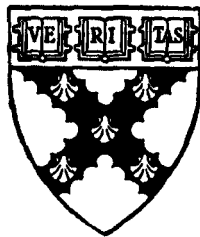


Effect
of
Federal Taxes
on
Growing
Enterprises



J. KEITH BUTTERS *and* JOHN LINTNER

Effect of Federal Taxes on Growing Enterprises

THIS study presents the final results of a pioneer research project which has been carried on for the past eighteen months at the Harvard Business School by Professor J. Keith Butters of the Business School Faculty and Mr. John Lintner of the Society of Fellows of Harvard College. Although the study is primarily concerned with the effect of federal taxation on new and growing enterprises, it also contributes to a better understanding of the problems of a particularly significant type of small business by illustrating through its case records some of the conditions which are encountered in starting and developing a new business.

A HIGH level of employment and national income can be achieved by private enterprise only if there is widespread formation of new firms and a rapid growth of existing firms. Some firms and industries are always dying. Expansion in other sections of the economy must absorb the labor and capital released by declining industries and, in addition, must make possible the productive use of new savings and labor constantly coming on the market. Thus, the implications of this study are far broader than the impact of taxes alone on the much discussed "small" business.

DIVISION OF RESEARCH
HARVARD BUSINESS SCHOOL

Soldiers Field, Boston 63, Massachusetts

**EFFECT OF FEDERAL TAXES ON
GROWING ENTERPRISES**

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GROWING ENTERPRISES**

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Assistant Professor of Financial Research

AND

JOHN LINTNER

Society of Fellows



**DIVISION OF RESEARCH
GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
HARVARD UNIVERSITY
BOSTON**

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DONALD K. DAVID, *Dean*
MELVIN T. COPELAND, *Director of Research*

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[iv]

FOREWORD

In this report on the *Effect of Federal Taxes on Growing Enterprises*, Professor Butters and Mr. Lintner present the final results of a pioneer research project. This volume supersedes the interim reports on the Lockheed Aircraft, Polaroid, and Lithomat Corporations previously published. The concept of this study originated during an informal discussion of some of the tax problems of the aircraft industry, and the costs of the project have been defrayed from funds contributed to the Harvard Business School by members of the aircraft industry for research on problems of significance to that industry.

Although of especial significance to a young and rapidly developing industry such as the aircraft industry, this volume has a far wider amplification than any single industry. The problems discussed include some of the most basic questions of economics, business, and public policy which now need to be faced in this country.

Professor Butters and Mr. Lintner present detailed analyses of several growing enterprises in various industries to illustrate different aspects of the problem. These illustrative companies were selected from the large number of such companies interviewed during the preparation of the study. The authors also present evidence drawn from numerous published sources. Thus their conclusions have a broad base.

Although the study is primarily concerned with the effect of federal taxation on growing enterprises, it also contributes to a better understanding of the problems of a particularly significant type of small business by illustrating through its case records some of the conditions which are encountered in starting and developing a new business.

As the authors state, furthermore, their conclusions, if sound, "emphasize the significance of the methods by which the savings of society are channeled to the places where these savings are needed to finance business expansion and other new private investment." The implications of this study are broad.

MELVIN T. COPELAND
Director of Research

PREFACE

This book could not have been prepared without the cooperation of many businessmen and government officials who have generously contributed their time and in many instances have supplied confidential data. In particular, we wish to acknowledge our gratitude to the managements of the companies whose experience is reported in detail in this study.

Many helpful suggestions have been made by our colleagues during the preparation of this book. Dr. Melvin T. Copeland, Director of Research, has followed the study closely at all stages. Professors C. C. Abbott, R. L. Masson, D. T. Smith, and S. F. Teele have read the final manuscript and offered suggestions for its improvement. A special debt is owed to Professors Lynn L. Bollinger and Tom Lilley for many hours of consultation and of friendly criticism. We also wish to express our appreciation to Miss Ruth Norton for careful editing of the manuscript and to Miss Virginia Jenness for able research assistance.

In view of other uses to which the material in Chapters V to VIII may be put, it seems desirable to state that the basic research and the underlying memoranda from which these chapters were written were prepared independently by Mr. Lintner.

It goes without saying that we bear full responsibility for the study and its conclusions and that we have had complete freedom in the formulation of these conclusions.

J. KEITH BUTTERS
JOHN LINTNER

Soldiers Field
Boston 63, Massachusetts
June, 1945

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CHAPTER I

Introduction and Conclusions

IMPORTANCE OF PROBLEM

A HIGH level of employment and national income can be achieved by private enterprise only if there is widespread formation of new firms and a rapid growth of existing firms. Some firms and industries are always dying. Expansion in other sections of the economy must absorb the labor and capital released by declining industries and, in addition, must make possible the productive use of new savings and labor constantly coming on the market. If this expansion does not take place in the private economy, the only alternatives are an enlargement of the activities of government or mass unemployment.

Traditionally, in this country large firms and industries have grown rapidly from very small beginnings. In recent decades, however, dramatic expansions from small beginnings have become increasingly rare. Instead, the great corporate research laboratory with its highly specialized scientists has become the symbol of industrial innovations.

Various explanations are offered for the decline in the role of small, independent enterprises in business expansion. Among them are the disappearance of the geographic frontier, the increased amounts of capital required to start successful enterprises in many industries, the restrictive policies of some large, established corporations, and high taxes.

Some of these trends may be so fundamental that they cannot be significantly altered by legislative policy. Yet the continued formation and growth of small, independent enterprises is generally recognized to be essential to the maintenance of a healthy industrial competitive structure — some would even say to the continued preservation of political stability and personal freedom. The very fact that the activities of government

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