CORPORATION PROFITS

LAURENCE H. SLOAN

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A Study of their Size, Variation, Use, and Distribution in a Period of Prosperity

By

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INSCRIPTION

This is hardly the kind of a volume that one dedicates to a friend. The subject matter is rather too stern. If it were appropriate material for dedication, it would be faithfully inscribed to a wise, generous and inspiring counselor in matters economic

L. L. B.

ACKNOWLEDGMENT

THE following study has proved an arduous and exacting task. Lacking the extensive facilities, the invaluables files and the coöperation of the members of the staff of the Standard Statistics Company, it would have been so much greater than it actually turned out to be, as to have rendered its accomplishment well-nigh impossible. The writer is especially indebted to Mr. Harold G. Parker, whose long experience with corporation statements and astounding knowledge of corporation accounting practice have been ruthlessly and frequently drawn upon; to Mr. Clayton A. Penhale for many helpful suggestions and for an abiding sympathy; to Mr. Charles A. Schmutz and Mr. Stanley N. Shaw, whose familiarity with current industrial conditions has proved a source both of great value and of decided convenience; and to Mr. R. Bruce Brownlee, Mr. Ivan S. Dobson, Mr. Carleton I. Washing, and Mr. John Raiteri, who found the spark of life in dull columns of figures and who bravely and painstakingly worked through the tens of thousands of calculations which were preliminary to the announcement of aggregate results.

The illustration on the jacket is reproduced by the kindness of *Nation's Business* and the artist, Mr. Wilfred Jones.

In somewhat—but not greatly—different form, this study was originally published as a series of special supplements to Standard Trade and Securities Service, where it carried the title: "Beneath the Surface of Corporation Statements."

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CHAPTER I

A BEGINNING

THIS book in considerable measure deals with accounting, but in a rather strange fashion.

It is about accounting, but is not a book on accounting. It examines the *results* of accounting: takes up the work of the professional accountant where he himself leaves off, seeks to determine the meaning of what his figures report, so far as possible, and seeks likewise to differentiate between meaning and confusion.

The viewpoint, then, is not that of the accountant, but of the average business man, banker, or financial executive who must make decisions, wholly or partially, on the basis of the information which the accounts give him. More precisely, it is the viewpoint of those who must make decisions *relative to security values,* based either wholly or partially upon the facts set forth by accountancy.

The financial statements (*i.e.*, income accounts and balance sheets) of about 550 leading American industrial concerns, operating in virtually all important lines of business except the public-utility and railroad fields, have been selected for study. The term "industrial concern" is here used in the stock market sense, which for convenience divides the corporation world into three broad groups—rails, utilities, and industrials—and includes in the industrial group every kind of business enterprise which may not properly be assigned either to the rail or to the utility group.

An idea of the adequacy of the material with which we propose to deal is suggested by the fact that the group of corporations which it has been found possible to study intensively and on a comparable basis had, in 1927, an aggregate net profit amounting to about 2½ billion dollars. The total net profit returned in that year by all corporations in the United States probably amounted to around 7 billions. Our data, therefore, probably represents fully one-third of the corporation data for the entire country.

The corporations on our list paid nearly 2 billion dollars to their bond and stockholders last year, and evaluated their property at more than 17½ billions.

Purposes of the Study.—The purpose of such a study are so obvious that they need not be stated in detail. Among the outstanding objectives are the following:

(1) To provide a unit of comparison which will be of at least some value to those who are constantly under the necessity of analyzing corporation statements, and of formulating, as a result of such analysis, an opinion which becomes the basis for future business decisions.

Admittedly, such a unit of comparison will not constitute an exact yardstick. It must be tentative and relative. The fact that the invested capital of the average industrial concern is, say, 25 per cent in bonds and preferred stock, 50 per cent in common stock, and 25 per cent in surplus, does not in itself signify that the individual corporation which has only 10 per cent in bonds and preferred stocks has a stronger capital situation than the average, or that the individual corporation which has as much as 50 per cent in these preferred classes of securities has a weaker situation than the average.

But having available a mathematical record of the average situation, one likewise has therewith at least a pivot for subsequent analysis of individual situations. Radical deviations from the average will, if they do nothing more, suggest the advisability of closer analysis (a) to explain the radical deviation and (b) to determine whether it is justified by peculiar conditions.

(2) To provide the basis and the incentive for explaining and analyzing radical individual deviations from the average is, indeed, one of the primary purposes of this series of studies. We know that it will be possible to establish the average, and we believe that it will be possible to suggest methods by which the average data can be used, in practical business and financial work, in appraising the significance of radical individual deviations.

(3) Moreover, it is our purpose, wherever possible, to carry the study somewhat beyond the realm of aggregates only, and at least to suggest standards which are applicable to important lines of business activity—automobiles, coal, copper, building, food products, machinery, etc.

(4) And it will likewise be possible, we believe, to make at least some headway in the task of explaining why financial situations in different lines of business differ so widely one from the other, and in determining to what extent such differences are sound, or to what extent they are dangerous.

In a word, we propose to set forth a composite income account and a composite balance sheet for a list of industrial corporations which apparently account for somewhere around a third of the country's total corporate net profit; to break down these composite data into series applicable to different leading lines of industrial activity; and then to experiment with the problem of appraising radical individual deviations from these series of averages—all to the end, and in the hope, that some small contribution at least may therewith have been made to current business knowledge and prospective business practice.

The whole problem lies in the field of corporation profits. Corporate income accounts and balance sheets report the size, use and distribution of profits and other capital accretions. After these data have been made available in convenient form, it is the task of economic analysis to explain the variations in profits from year to year, from one line of industry to another, from one individual business concern to another.

To some extent, at least, the study will break virgin ground. The basic material itself is, of course, not new. But the adequacy of the material, the method of handling it which has been adopted, the bringing of it together in composite form, the intensive study of the different items in the composite and of their relationship to one another, mark, we believe, a somewhat new departure in the study of corporation finance.

The accompanying study itself, of course, constitutes no more than a mere beginning, a preface, to the analysis of data of this kind. Much more work, and on a broader scale, remains to be done.

The chief deficiency of this volume, it should be frankly pointed out, is that for the most part the data cover only two years—1926 and 1927. Study of a longer period would, it goes without saying, be of greater value. But the task of assembling data for even the two years 1926 and 1927 has been no light one. Our feeling has been that some contribution to the existing knowledge of such matters is possible even though the time period covered is brief, and we have been able to derive a certain amount of consolation from the further opinion that, regardless of the brevity of the period, the data themselves and the many derivative calculations present for the consideration of the average student of financial affairs as big a mouthful of problems as he will care to bite off in any single volume.

CHAPTER II

THE COMPOSITE INCOME ACCOUNT

ACCOMPANYING is the composite income account, covering the years 1926 and 1927, reflecting the aggregate condition of the 545 leading industrial corporations which it was found possible to compare.

The country's two largest industrial concerns, the United States Steel Corporation and the General Motors Corporation, accounted for some 14 per cent of the aggregate net profit of these 545 industrials last year. Therefore it has been deemed wise to compute results on two bases—to show the aggregate situation for the 545 concerns together, and then to supplement these data by a composite income account statement which excludes Steel and Motors.

The same division has been made in all subsequent calculations, but in the majority of cases the second calculation has been found to be without great significance; in such cases of course, only the results for the full 545 corporations will be reported.

In the accompanying section of the analysis, we shall undertake to explain the *changes* which occurred in the composite income account in 1927 as compared with 1926. In the section immediately following we shall deal with the *changes* which occurred in the composite balance sheet as between these same two years. All additional sections in the study will be devoted to the more important individual items in the income account and balance sheet.

The 1927 Decline in Profits.—In the fact that 1927 business profits registered a substantial decline as compared with the year preceding there is nothing new to those who customarily follow the regularly published corporation statements.

The *extent* of the 1927 decline, however, becomes progressively more surprising. On the basis of reports by 455 leading corporations (excluding Motors and Steel) which had been made public up to the middle of April, 1928, the Standard Statistics Co. computed 1927 net income to have declined just 10 per cent, as compared with 1926. But the addition of 88 more concerns to this list brings the total 1927 decline up to 16.2 per cent.

This is a strikingly large figure. The fact that such an extensive drop could have occurred in a year which is generally conceded to have been a prosperous one is no less striking than the fact that the extent of the drop was not known

TABLE 1

Composite Income Account *

545 INDUSTRIAL CORPORATIONS

	1926 (in Million Dollars)	1927	Per Cent Change
Net profit	$2,810.92	$2,490.26	—11.4%
Fixed charges	223.46	250.24	+12.0
Net income	2,587.46	2,240.02	—13.4
Preferred dividends ..	259.49	241.53	— 7.0
Common dividends ..	1,292.07	1,389.84	+ 7.6
Total payments to security holders ...	1,775.02	1,881.61	+ 6.1
Carried to surplus ...	867.62	474.54	—45.4
Earned per $100 of invested capital ...	$10.6	$9.0	—15.1%

TABLE 2

Composite Income Account *

543 INDUSTRIAL CORPORATIONS, EXCLUDING GENERAL MOTORS AND U. S. STEEL CORPORATIONS.

	1926 (in Million Dollars)	1927	Per Cent Change
Net profit	$2,489.55	$2,149.18	—13.7%
Fixed charges	204.99	233.17	+13.3
Net income	2,284.56	1,917.01	—16.2
Preferred dividends ..	226.62	207.20	— 8.6
Common dividends ..	1,152.56	1,205.19	+ 4.5
Total payments to security holders	1,584.17	1,644.56	+ 3.9
Carried to surplus ...	841.70	363.13	—56.8
Earned per $100 of invested capital ...	$10.4	$8.6	—17.5%

* For definitions of terms used in this table, please refer to pages 18-20, following.

until fully six months after the close of the calendar year.

A number of years' experience in analyzing profits data has strongly suggested the conclusion that the corporations which have the best results to report make those results public promptly, while those which have the poorest showings to report are customarily quite tardy in breaking the news. The foregoing data give still further emphasis to this principle.

Although it has not been feasible to trace the financial histories of the full list of corporations used in this series of studies back over a long period of years, there is basis for the belief that the 1927 decline in net earnings was sharper than in any single year in any previous period of general prosperity. Tests based upon about 100 corporations, rather than upon the full list, validate this assumption.

Reasons for the Lower Earnings.—The reasons for the 1927 slump are now well known: the total volume of industrial output was smaller than in 1926; the trend of commodity prices was mainly downward; the *margin* of profit was smaller; acute depression existed in such important lines as oil, railroad equipment, coal, shipping, textiles and radio, and unsatisfactory (although not really depressed) conditions