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Source: *The Journal of Finance*, Vol. 17, No. 3 (Sep., 1962), pp. 554-555
Published by: Wiley for the American Finance Association
Stable URL: http://www.jstor.org/stable/2977084
Accessed: 15-03-2016 16:32 UTC

writing dealers, and the rather steady decline over the whole period in the remuneration paid to non-underwriting dealers.

It is evident in reading this small volume that it is the result of careful research. Thirty tables, ten charts, and an outline style of writing combine to give unusual readability to such a technical subject. People in the financial community should find it interesting reading, and it is a valuable reference for some advanced undergraduate or graduate finance courses.

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Corporate Debt Capacity: A Study of Corporate Debt Policy and the Determination of Corporate Debt Capacity. By GORDON DONALDSON. Boston: Harvard Business School, 1961. Pp. xiv+294. $4.00.

The stated objectives of this study are to describe how the managements of a sample of industrial corporations think and behave with respect to the use of long-term debt, to examine and appraise the rationale of existing decision rules regarding the use of debt, and to develop an alternative approach to the determination of the debt capacity of an individual enterprise.

Part I of the book is a field study of "a hopefully representative sample" of manufacturing companies in five industries, in terms of a 20-year flow of funds and of attitudes, toward financing in general and of debt in particular, of managements, and of principal lenders. Donaldson finds, for example, that management strongly favors internally generated funds except when unavoidable peak needs must be met, favors familiar investment areas over new and unfamiliar opportunities, and tends to hold a cost-free concept of retained earnings for the familiar and a rough opportunity cost standard for the unfamiliar investment.

The author cites practical exceptions to such theories as that companies should have long-term goals of appropriate debt leverage and time actual issues to take advantage of low points in interest rates (cf. J. Fred Weston, "The Timing of Financial Policy," *Controller,* December, 1961), that the availability of funds is merely a function of price, and that debt is more advantageous from a control standpoint than is an increase in stock ownership.

Donaldson concludes that the "decision rules" followed by management encompass the whole range from no long-term debt under any circumstances to borrowing the maximum available, with various intermediate positions related to borrowing at no more than the prime rate, maintaining an A rating for bonds, insisting on a minimum earnings coverage, or adopting single-project or rapid pay-back approaches to debt. However, with surprising frequency, lenders and borrowers cite a debt limit of about 30 per cent of capital structure as an appropriate guideline.

In Part II of the study, the conventional criteria of debt capacity are severely criticized. In particular, the author decries the dependence of borrowers on the judgments of others, including lenders, in establishing their standards of debt capacity. The alternative proposed is a cash-flow analysis carried through an assumed recession period. Sales declines, collection lags, and the responses of other factors are estimated on the basis of past experience of the company itself, and estimates are made of the maximum and most probable adverse limits of cash flows and balances. The risks associated with any given amount of debt can then be appraised by determining the probability that the required debt service will threaten cash insolvency under such recession conditions. The author stresses that the study is concerned only with measuring the amount of risk and that willingness to accept risk must be a managerial determination. Since outlays for dividends, research, and even some capital expenditures may be considered mandatory from a policy standpoint, the appraisal may be in terms of risk of cash inadequacy rather than of cash insolvency, and the cash-flow analysis itself would be useful for a wide range of managerial policy decisions.

It may be noted that Donaldson's proposal involves a "true" cash-flow analysis rather than the usual procedure of adding back non-cash charges, such as depreciation, to net income. Almond R. Coleman, in the *Controller,* December 1961, p. 594, suggests a form of cash-flow statement (for a past period) which is consistent with Donaldson's concept.

The intended audience is stated to be those financial and other corporate officers responsible for financial policy. The study provides much useful material on the thinking and practices of management in matters of debt policy and is a welcome addition to the literature in this field. The proposal for a cash-flow approach to an appraisal of debt capacity is provocative and appears soundly conceived but is rather severely limited in applicability. In view of the number of dependent and independent variables involved, the problem of assembling and processing the relevant data is a formidable one. As the author indicates, the proposal is appropriate primarily for larger corporations with extensive cash-flow experience. Donaldson also recognizes that significant managerial inhibitions would have to be overcome before the proposal could be widely adopted. It would be interesting to know how many of the companies consulted in the field study have indicated a willingness to accept the proposed approach.

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Financing Business Firms. By CHARLES L. PRATHER. Rev. ed. Homewood, Ill.: Irwin, 1961. Pp. xi+668. $7.50.

The new edition of this well-known textbook represents a considerable revision without losing the character of the original edition. To give an idea of its scope, the author defines business finance as "a study of the methods and procedures whereby business firms acquire and utilize the funds needed to operate." Eight major parts make up the book. They are: "Nature and Organization of Business Firms"; "Financial Statements and Financial Planning"; "Funds from Operations"; "Short-Term and Intermediate Loan Capital"; "Owners' Equity"; "Long-Term Debts of Business Corporations"; "Business Promotion and Expansion"; and "Recapitalization, Reorganization, and Liquidation of Business Firms." Questions and problems at the end of each chapter provide ideas for discussion.

This book represents an apparent attempt at a compromise between the traditional descriptive and institutional approach to business finance and the recent trend toward an analytical, "management decision"-oriented approach. It