

# The Source of "Big" Profits

By MITCHELL S. LURIO

The statement is often made by students of Henry George that our economy is not capitalistic in essence, but that its basic characteristic is land monopoly. If this is true, verification should be found in the financial statements of large industrial corporations.

An examination of the records (as published by Moody, Poor, and Standard Statistics), reveals that, in many cases, rent accounts for more than the net incomes of our industrial giants, and, in all instances, contributes substantially to their incomes. It also explains a paradox. Everyone knows that the enormous corporate empire is comparatively inflexible, unwieldy, overmanned; that it pays higher wages for fewer hours than do the small concerns, and often operates at higher costs per unit than its little, independent, compact competitors. Yet the big fellows keep on absorbing the little ones.

The explanation commonly given is that large aggregations of capital, by volume purchases, mass production, patent and cartel monopoly, are able to overcome their internal weaknesses. It will be seen from the analysis herein that rent is the primary prop of big businesses, sufficiently strong to hold them up in spite of their deficiencies.

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For those who have no acquaintance with balance sheets, a simplified example will help clarify the analysis.

Suppose a corporation is organized with a paid-in capital of \$100,000, of which \$50,000 is in preferred stock and \$50,000 in common stock. Its balance sheet would look like this:

Assets	
Cash .....	\$100,000
Total Assets .....	\$100,000
Liabilities	
Preferred stock .....	\$50,000
Common stock .....	50,000
Total Liabilities .....	\$100,000

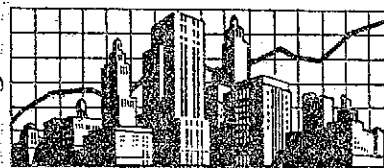
The Company now proceeds to buy a going business. It pays \$25,000 for inventory, \$50,000 for real estate subject to a mortgage of \$25,000, \$5,000 for machinery and \$1,000 for furniture, fixtures and supplies. The balance sheet takes on the following appearance:

Assets	
Cash .....	\$44,000
Inventory .....	25,000
Real estate .....	50,000
Furn. fixtures .....	1,000
Machinery .....	5,000
Total Assets .....	\$125,000
Liabilities	
Mortgage .....	\$25,000
Preferred stock .....	50,000
Common stock .....	50,000
Total Liabilities .....	\$125,000

Although the total of assets is now \$125,000, the Company is no richer than when it started, assuming that it paid the market price for its purchases. Instead of expressing its value in terms of total assets, therefore, we consider it in terms of net tangible worth.

Net tangible worth is defined by Dun and Bradstreet, Inc. as the sum of all preferred stocks and common stocks, surplus and undivided profits, less any intangible items in the assets, such as goodwill, trade-marks, patents, copyrights, leaseholds, mailing lists, treasury stock, organization expenses and underwriting discounts and expenses. The net tangible worth of our corporation, in accordance with this definition, is still \$100,000.

After a year's operation, during which the Company earns, say, \$5,000, after depreciation and dividends and after reducing the mortgage by \$1,000, the statement may look like this:



Assets	
Cash .....	\$6,100
Accounts receivable .....	100,000
Inventory .....	20,000
Real estate .....	\$50,000
depreciation .....	2,000
Real estate, net .....	48,000
Machinery .....	5,000
depreciation .....	1,000
Machinery, net .....	4,000
Furn. fixtures .....	1,000
depreciation .....	100
Furn. fixtures, net .....	900
Total Assets .....	\$179,000
Liabilities	
Account payable .....	\$50,000
Mortgage .....	24,000
Preferred stock .....	50,000
Common stock .....	50,000
Surplus .....	5,000
Total Liabilities .....	\$179,000

The tangible net worth of the Company is now:

Preferred stock .....	\$50,000
Common stock .....	50,000
Surplus .....	5,000
Tangible Net Worth .....	\$105,000

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We can now look at some actual figures. In the case of United States Steel, we find in Moody's for the year 1938:

(In millions of dollars)

Preferred stock .....	360
Common stock .....	653
Capital surplus .....	38
Earned surplus .....	247
Tangible Net Worth .....	\$1,298

From the same source, we find that U. S. Steel, on the asset side of its statement, shows the following items:

Property, plant and equipment .....	\$2,344
Less reserve for depreciation, depletion and amortization .....	1,178
Net property, plant and equipment .....	\$1,166

This means that U. S. Steel over a period of years has spent \$2,344,000,000 for property, plant and equipment, and, up to the end of 1938, has written off on its books against

this item, the sum of \$1,178,000,000, or about half the expenditure. Compare these figures with its tangible net worth of \$1,298,000,000.

Practically all of the write-off for depreciation applies to improvements and equipment and not to the land. The term depletion is applied to the diminution of mineral deposits, but depletion is small compared to the depreciation and obsolescence of capital. It is much more likely that if the land is carried on the books at cost of acquisition many years ago, its present day value is a great deal more than the book value.

The next question is: What percentage of the net figure for property, plant and equipment represents the land value? A rough idea of this percentage may be gleaned from the following assessed values for 1939 in New Jersey cities that I took off while looking up some oil properties:

Description of Property	Land Value	Building Value	Total	% Land to Total
5 water-front oil storage plants, totaling 30.39 acres -----	\$374,600	\$487,100	\$861,700	44%
Department store -----	2,208,600	1,299,700	3,508,300	62%
3 office buildings -----	3,041,300	8,586,200	11,627,500	26%
7 gasoline service stations -----	130,300	81,200	170,500	81%
One oil refinery -----	2,292,587	14,376,004	16,675,591	14%

No effort was made to select favorable examples, as the figures indicate.

Again it must be remembered that these are assessed values and do not represent actual market values. Whether the assessed land values bear the same ratio to actual land values that assessed building values bear to actual building values, I have no means of knowing. It is more than likely that the element of rapid depreciation of buildings is not fully allowed for in assessed valuations, since the assessments in these communities are much below the real values in the first place. Assessed values of buildings are generally the same year after year despite the factor of depreciation.

When it is considered also that the actual value of the land owned by a corporation may be many times the book value, the problem becomes all the more difficult.

Certainly for corporations in general a figure of 25% of the NET value of property, plant and equipment is a conservative estimate of the land values involved.

Hence, in the case of U. S. Steel, which carries on its books a net figure for property, plant and equipment of \$1,166,000,000, one-quarter of this figure or roughly \$300,000,000 may be assumed to be the value of the land.

The next question is: What is the rental value of land worth \$300,000,000? My own estimate is that 10% is a conservative ratio, that is, the rental value of \$300,000,000 worth of land is at least \$30,000,000 a year.

In actual leases of industrial property made by small companies, which haven't sufficient capital to buy land outright, I have found a ratio of rent to land value (as indicated by option of purchase of the land) to be over 20%. Since the option price is always greater than the actual market value at the time the option is given, the actual ratio is still greater than the apparent ratio.

U. S. Steel, therefore, by its own-

ership of \$300,000,000 worth of land, pays rent to itself in the sum of \$30,000,000 a year, using a 10% ratio. I am inclined to think that the actual rental value may be many times the figure that we have finally reached.

U. S. Steel lost money in 1938, but in the ten year period 1929 through 1938, it earned 320 million dollars or an average of \$32,000,000 a year—all rental value.

Despite the advantages that are often credited to large corporations by virtue of patents, volume purchases, mass production, alleged price-fixing, power of large aggregations of capital and tariffs, rent in this particular instance not only accounted for all of its earnings but undoubtedly left a balance to spare, which may have been absorbed in excessive salaries, too much man power, red tape, and inefficiency generally.

Mr. Lurio has prepared studies of the financial statements of several other large corporations that prove the contention that their profits are traceable to monopoly rent. These will appear in subsequent issues of The Freeman.