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Recent Trends in Corporate Finance Some Evidence from the Canadian System of National Accounts

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Recent Trends in Corporate Finance: Some Evidence from the Canadian System of National Accounts

Corporations have been posting record profits over much of the last decade. Meanwhile, business fixed capital investment has been relatively sluggish in recent years. This situation has led to a significant shift in the corporate sectors' net lending/borrowing position - from one of a chronic deficit position to one of sustained surplus. After having run deficits for almost 30 years, corporations have emerged with significant surplus positions in the last decade. This has placed the corporate sector in a new role – that of increasingly supplying funds to the rest of the economy.

This note looks at this development from a few angles, focusing on non-financial corporations. It identifies the underlying causes, and the major effects, of the development of an expanding corporate surplus position. In short, non-financial corporations have taken advantage of record profits, historically low interest rates and relatively buoyant stock markets to substantially re-structure their balance sheets. It has reached the point where corporate finances, in aggregate, are the healthiest they have been in decades.

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Recent Trends in Corporate Finance: Some Evidence from the Canadian System of National Accounts

1. Introduction

Over much of the last decade, corporations as a whole have been posting record profits. Meanwhile, business fixed capital investment has been relatively sluggish in recent years. These two factors combined have led to a significant shift in the corporate sector's net lending/borrowing position – from one of a chronic deficit position to one of sustained surplus (refer to Box 1). After having run deficits for almost 30 years, corporations have emerged with significant surplus positions in the last decade.

In conjunction with this, there have been major structural shifts in the economy, in terms of the net lending/ borrowing positions of the sectors[1]. Traditional surplus sectors in the Canadian economy – households and non-residents – have moved into deficit positions, while traditional deficit sectors (corporations and governments) have generated surplus positions. This has placed the corporate sector in a new role – that of increasingly supplying funds to the rest of the economy.

This note will look at the corporate surplus phenomenon from a few angles, focusing on non-financial corporations. First, the note will examine the generation of net lending and its principal components: saving and non-financial investment. It will also explore the uses of the corporate surplus, along with the shift in the composition of corporate financing. Lastly, it will underline the restructuring of corporations' balance sheets.

Box 1: Net lending (surplus) or borrowing (deficit) in the national accounts

The corporate sector is one of the four main sectors of the Canadian System of National Accounts (SNA), which also includes persons and unincorporated business, governments and non-residents. Within a time period, a sector generates incomes and has outlays on current expenditure. The amount remaining after deducting outlays from incomes is referred to as saving (also referred to as undistributed, or retained, earnings in the case of corporations). Adding capital consumption allowances to saving, we can calculate a sector's gross saving, often referred to as internally-generated funds. Each sector also undertakes non-financial capital acquisition in fixed capital, inventories and existing assets. The balance between internally-generated funds (plus capital transfers) and investment expenditure is the sector's net lending or borrowing position – or surplus or deficit position.

A surplus or deficit position is also reflected in financial transactions. A surplus would most often be equated with investment in financial assets and/or the reduction of liabilities; a deficit with borrowing and/or issuing shares (in the case of corporations) and/or a draw-down of financial investments. The reality is that, with a large number of transactors in each sector of the economy and the complexity of financing needs, all of these activities can take place in both a surplus or deficit position, but do so at different levels of intensity. Any sector's surplus or deficit can also be calculated as net financial investment – transactions in financial assets less transactions in liabilities.

2. Generation of corporate surplus – total and non-financial corporations

Corporations posted a record[2] net lending position of $80.6 billion in 2005 (Charts 1 and 2). This trend began from 1993 to 1996, when the sector had four straight surpluses after generating only one in the previous 29 years. Following a brief slide to a deficit position in 1997-1999, the sector rebounded to accumulate impressive surpluses over the past six years.

1. See [Trends in Saving and Net Lending in the National Accounts](), Income and Expenditure Accounts Technical Series, Statistics Canada Catalogue no. 13-604 no. 49

2. Since data started being compiled in 1961.

Chart 1. Corporations running all time high levels of surplus

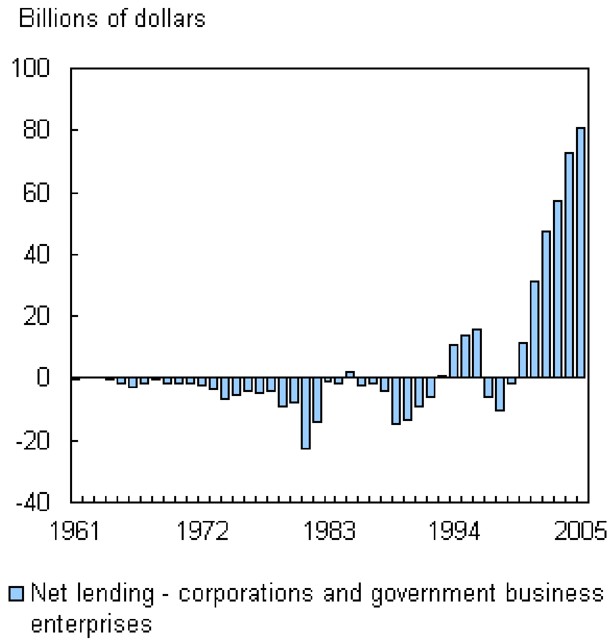
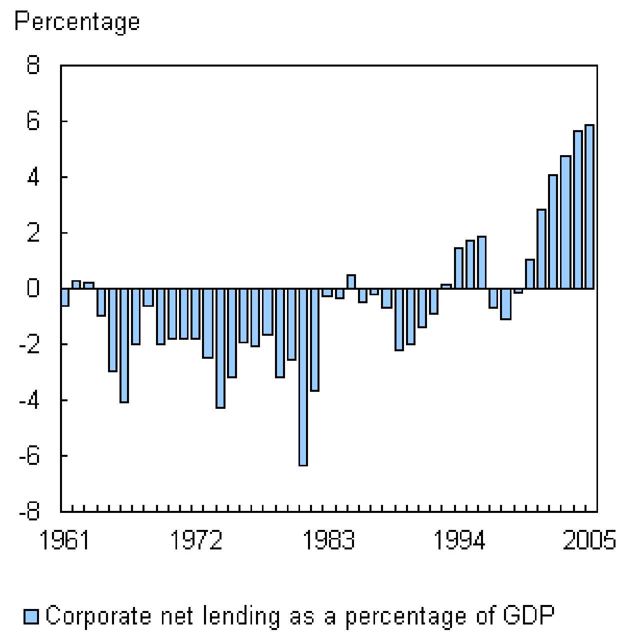


Chart 2. Corporation net lending as a percentage of GDP



Shift to a corporate surplus position in sharp contrast with history

Today's surplus positions are far removed from the situation just a decade and a half ago. Traditionally, corporations have run deficits, with non-financial capital acquisition exceeding internally-generated funds.

The sector experienced a record deficit position of $22.8 billion in 1981. The deep recession of 1981-82 marked by historically high nominal interest rates was the harbinger of a steep decline in corporate profits, and despite a marked slowdown in fixed capital spending, corporations remained in deficit. The deficit positions persisted for most of that decade through to the next economic downturn that began in mid-1990. However, this was soon to change, as the deficit narrowed through to 1992 and surpluses began to be posted in 1993 for the next few years through 1996. The expansion of the past decade helped drive corporate profits to record levels. Undistributed earnings have increased an annual average of almost 16% since 1995.

The return to a deficit position in the late 1990s was short-lived. In 1997 undistributed corporate profits fell, and non-financial capital acquisition advanced sharply. In 1998 undistributed profits receded further (falling 17%), posting their largest decline since the expansion began in 1993, as North American corporations felt the effects of such events as the plunge in commodity prices and the Asian economic crisis.

However, a sharp rebound in earnings, coupled with a more recent slowdown in capital spending growth, has moved the corporate sector into an expanding surplus position since 2000. The impact of both undistributed earnings and capital expenditure on the evolution of the corporate surplus deficit over time is notable (Table 1).

Table 1: Total corporations, selected average annual growth rates

Capital account components	1961 to 1991[1]	1995 to 2005
Gross saving	8.6%	9.6%
Net saving	4.0%	17.0%
Memo: Undistributed profits	4.4%	15.6%
Non-financial capital acquisition	11.4%	6.9%
Fixed capital	11.5%	6.4%

1. *This time period excludes 1982-83 due to extremely volatile swings in net saving and undistributed corporate profits (from negative growth to extreme positive growth) experienced during the end of the recession/beginning of expansion. 1992-1994 was excluded in the current period in the above calculation for similar reasons.*

2. *Source: National Income and Expenditure Accounts (definitions can be found in glossary)*

Profits drive the surplus, as undistributed earnings accelerate

Profits have clearly been the main driver of the corporate net lending surplus for the majority of years over the past decade (Chart 3). Except for a few minor interruptions (for example, the high-tech bust in 2001) corporate earnings have been on a pronounced upward trend since about 1992.

Chart 3. Profit growth leads corporations into an overall surplus position

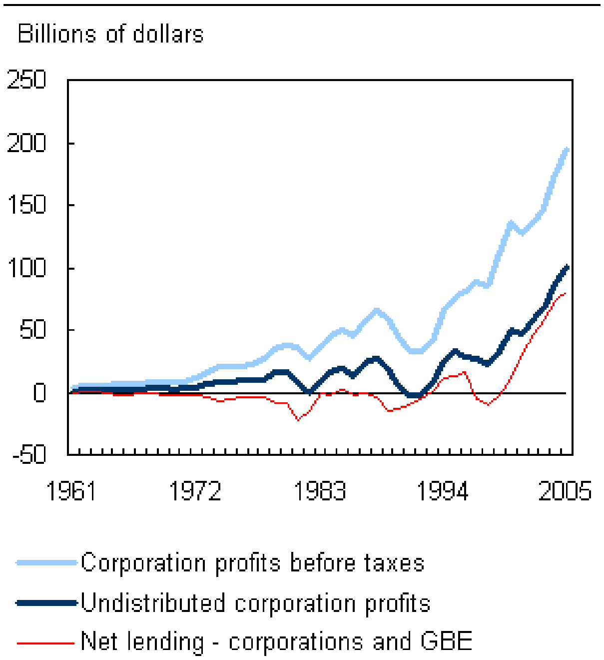
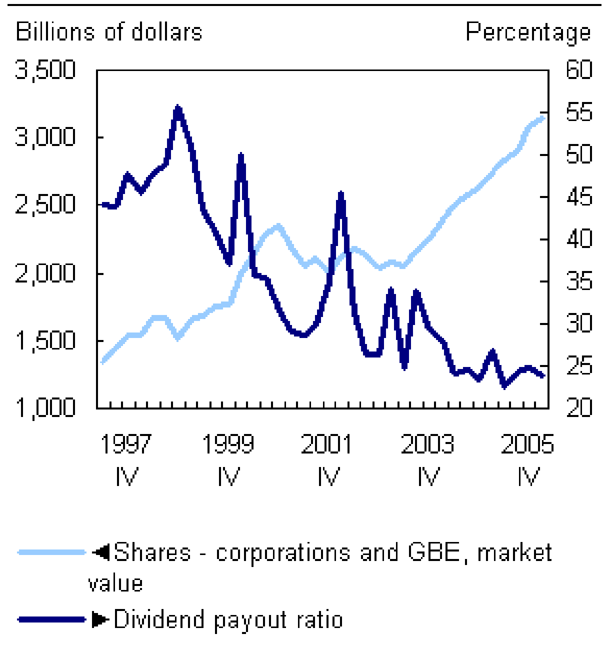


Chart 4. Investors accept higher returns from stock market in lieu of dividends



Historically low aggregate dividend payout ratios[3] helped boost undistributed earnings to a record high in 2005. Lower dividends paid by corporations suggest that shareholders have been disposed to retaining profits in businesses, in favour of alternative returns. Record high market values have contributed to higher wealth positions for respective shareholders (Chart 4).

3. *Dividends paid as a percentage of corporation profits after taxes.*

Non-financial corporations post the largest gains in the surplus

Financial corporations have traditionally been in a small surplus position. By the nature of their business, they do not engage in substantial fixed capital investment. As a result, their expanding surplus in recent years has been largely generated by strong growth in undistributed earnings. The surplus in the financial sector has increased significantly since 2000, led mainly by record profits in the chartered banking and insurance industries.

However, the major shift with respect to the evolution of the surplus has been in the non-financial corporate sector. In 2003, non-financial corporations' surplus overtook that of financial corporations for the first time in forty years (Chart 5) and in 2005 the surplus reached a historical high. Because of this, the focus in the analysis now shifts to private non-financial corporations[4] where the dominant trend in net lending arises, with a $55.8 billion surplus recorded in 2005 (Chart 6).

The higher surpluses for non-financial corporations have been the result of significant domestic and foreign demand for Canadian goods and services. The personal sector's record levels of spending have led to increased revenue for corporations. In addition, Canada's booming exports, contributing to a large current account surplus, have filled corporate coffers with plenty of funds from abroad. The downward trend in interest rates has also played a supporting role in improving the bottom line, by helping to reduce business financing costs and facilitating household borrowing.

Chart 5. Non-financial corporations drive overall corporate net lending

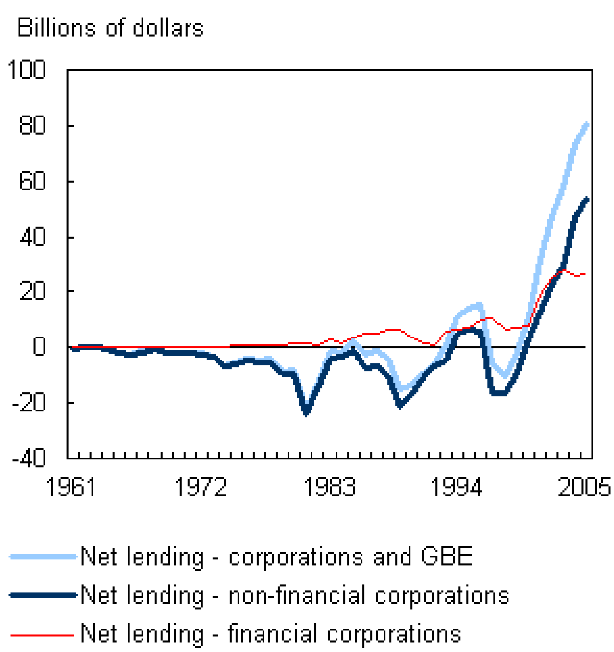
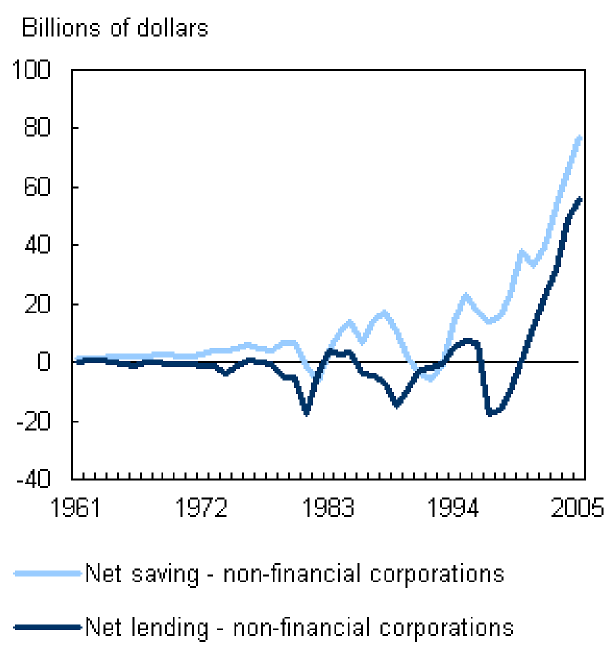


Chart 6. Saving leads non-financial corporations into an overall surplus position



The growth in net profits before taxes[5] has been widespread across non-financial industries with 15 of 17 industry groups[6] experiencing positive growth between 2001 and 2005. Further, since 1999 positive net profits before taxes have been widespread among non-financial industries. This suggests that the undistributed earnings are also reasonably diffused by industry.

4. Non-financial government business enterprises (GBEs) are excluded from the analysis. Including GBEs would produce a $53.9 billion surplus for 2005.

5. Net profit before taxes is an SNA concept not published by industry. However, the SNA use Industrial Organization and Finance Division (IOFD) as a data source, and the SNA data are comparable to IOFD corporate profit before taxes published by industry.

Select industries[7] with the largest impact on profit growth since 2000 have included: oil and gas, led by record high commodity prices; retail, buoyed by firm domestic demand from households; wholesale, lifted by strong exports markets; and, real estate, driven mainly by a booming housing market.

Slower investment spending of non-financial corporations also contributes to the surplus

Another influence on the surplus position for non-financial corporations has been slower capital expenditure. Over the last decade corporate non-financial capital acquisition hasn't grown at near the rate of saving, averaging growth of only 4% per year since 1998, in contrast with the double digit growth in previous decades. In particular, capital expenditure on machinery and equipment has accounted for most of the weakness (Chart 7)[8].

Non-financial corporations dominate corporate capital investment, and investment in fixed capital by private non-financial corporations represents the bulk of total corporate sector non-financial capital acquisition (almost 90% since 1998).[9] Investment in new fixed capital is the dominant component of non-financial capital acquisition, and a significant inverse relationship between new fixed capital investment and net lending/borrowing is evident (Chart 8). This is consistent with the recent role played by investment in the generation of the surplus, since 1998.

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Chart 7. The slowing of investment more evident in machinery and equipment

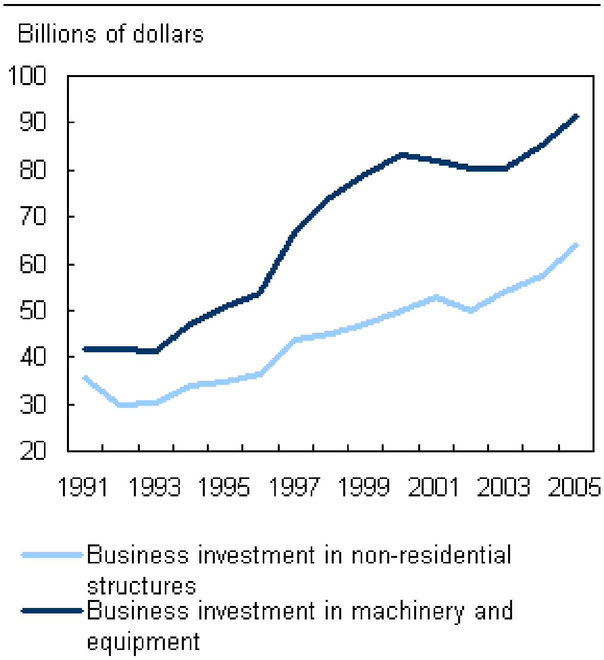
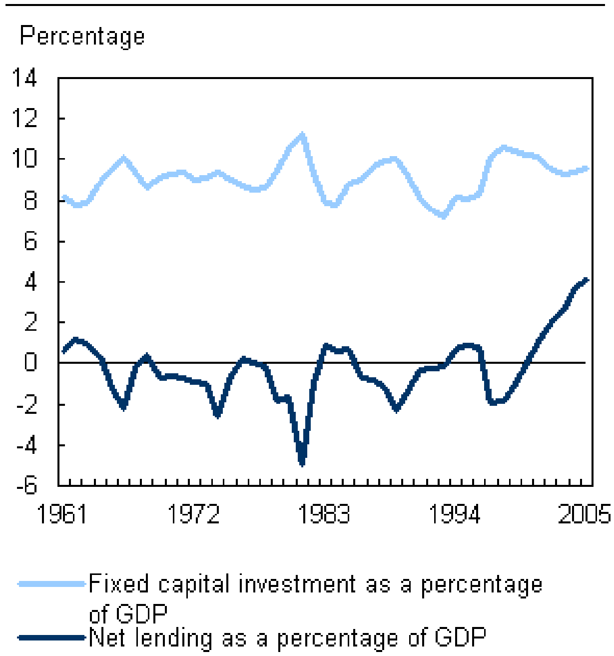


Chart 8. Corporate net lending grows as business investment slow



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6. A grouping of all non-financial corporations into a set of 17 industrial aggregations, based on the North American Industry Classification System (NAICS Canada 2002). See Quarterly Financial Statistics for Enterprises, Statistics Canada, Catalogue no 61-008 for further detail on industrial classification.

7. Manufacturing, which despite showing some profit growth in 2003-2004 has not yet returned to its levels reached in 1999-2000. In 2005, the manufacturing industry's contribution to total non-financial profits before taxes fell to its lowest level since 1992.

8. Since 2002, an appreciating exchange rate may have contributed to lower expenditure on machinery and equipment.

9. After having contributed over 18% to total corporate non-financial capital acquisition (NFCA) from 1961-1996, non-financial government business enterprise's share of NFCA has dropped to less than 7% in the past 9 years. (Non-financial GBEs have been net borrowers from 1961-1996, and in 2003-2005. Only in the years from 1997-2002 have non-financial GBEs posted surplus positions. This was due in part to their sharp reduction in non-financial capital acquisition during this period).

3. Use of the surplus – A further look at the financial account of non-financial corporations

The generation of a substantial corporate surplus in recent years has reflected the fact that undistributed earnings have exceeded capital investment requirements by a wide margin. This suggests a modification in corporate investment behaviour. It is clear that corporate investment patterns have evolved as the surplus expanded.

A perspective on the surplus can be gleaned by looking at the sources and uses of corporate funds (refer to Box 2). With internally-generated sources of funds up strongly in recent years, uses of funds other than non-financial investment have increased in prominence. Since the surplus funds must be used, uses of funds have shifted in favour of various types of financial investments. Specifically, there have been increased investments in various types of financial assets as well as repayment of outstanding debt, as reflected in the Financial Flow Accounts.

Box 2: Sources and uses of funds for non-financial corporations

Sources of funds	
Internal	Saving (undistributed earnings)
	Capital consumption allowance
	Capital transfers
External	Drawdown of financial assets
	Incurrence of financial liabilities and equity issuance (which can include foreign direct investment into Canada)
Uses of funds	
Non-financial	Non-financial capital acquisition
Financial	Investment in financial assets, including liquid assets and inter-company investment (which can include Canadian direct investment abroad)
	Reduction of financial liabilities and share buy backs

Financial investments up strongly in recent years

Corporations have directed an increasing amount of funds into financial investments in recent years. Both portfolio and inter-company investment have contributed to notable acquisitions of financial instruments.

Cash and other portfolio investments surge since 2000

Major flows of financial investment have been directed to liquid assets and other portfolio investments since 2000. In particular, currency and bank deposits (domestic and foreign) and various other types of portfolio investments have advanced sharply.

There have been significant new cash flows as profits strengthened and capital spending softened. These increased flows were most significant in 2001-2005 (Chart 9). Corporations' currency and bank deposits have increased as a share of both their financial and total investment, and their flows have accounted for an increasing proportion of total deposit flows in the economy. In addition, portfolio investment in debt securities and other financial assets have reflected a partly passive financial investment use of the expanding surplus in recent year.

Chart 9. Cash increasing form of investment

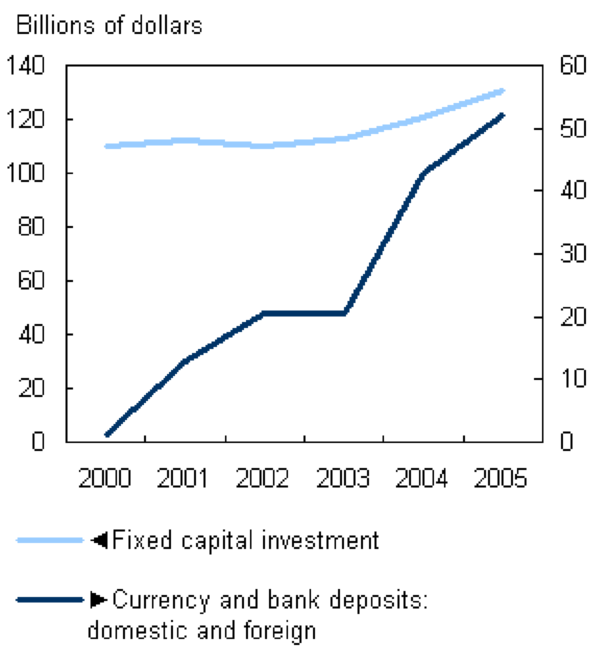
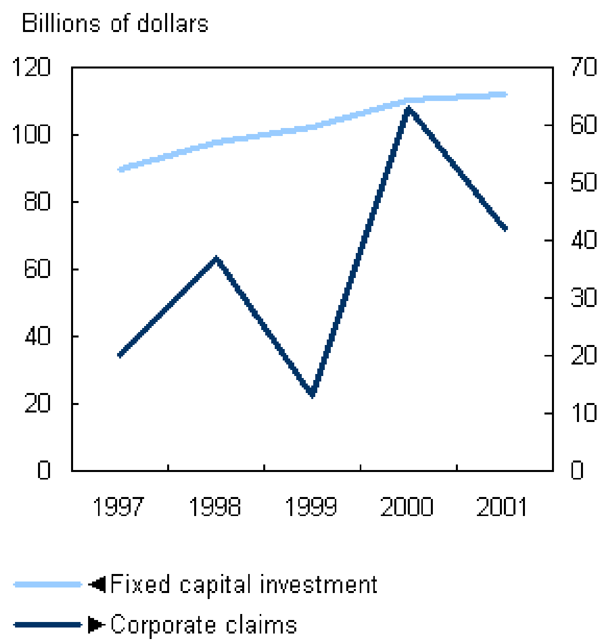


Chart 10. Inter-company investment increasing form of investment



Inter-company investment reflects direct investment takeover's boom

The last decade has seen a surge in inter-company investment[10] reflecting a boom period in corporate mergers and acquisitions (M&A) that began in the late 1990s (Chart 10). A significant proportion of inter-company investment was directed abroad. This suggests that corporations have continued to invest in non-financial capital, but perhaps at an increasing rate outside of Canada.

Claims on foreign subsidiaries and associated enterprises drive inter-company investment

Since 1995, over $256 billion has been invested by non-financial corporations in the form of inter-company investment. This represents almost 32% of total investment in financial assets by non-financial corporations over this period. A principal driver of this growth in inter-company investment by non-financial corporations is direct investment abroad, as the pattern of inter-company investment by non-financial firms is closely correlated with Canadian direct investment abroad (CDIA)[11]. Canadian corporations have invested $231 billion[12] in foreign subsidiaries and associated enterprises operating in non-financial industries since 1995. A closer look at CDIA provides further perspective on this. The main years of direct investment mergers and acquisition activity include

10. This is reflected as corporate claims in the Financial Flow Accounts and National Balance Sheet Accounts. Corporate claims cover investment in shares, marketable debt securities and loans and advances in associated corporations.

11. While there is no one-to-one mapping between non-financial firms' inter-company investment and Canadian direct investment abroad, it is assumed that the majority of CDIA undertaken by Canadian corporations takes place within their same respective industry; for example, an energy parent would invest in an energy subsidiary. However, it is possible that a holding company in the financial sector may invest in a non-financial industry. A certain amount of precision is foregone at this juncture to underline an important trend. The detail by industry for CDIA is available on an 'industry invested in' basis from Canada's Balance of International Payments, Statistics Canada, Catalogue no. 67-001.

12. Net Canadian direct investment abroad flows excluding reinvested earnings. See Balance of International Payments, Statistics Canada, Catalogue no. 67-001.

1997-1998, and 2000-2001, years in which non-financial firms were beginning to emerge from deficit positions. In recent years (2002-2003 and 2005), CDIA flows were largely comprised of capital injections into existing affiliates[13].

Canadian repatriation of domestic foreign held interests – another use of funds – has played a role in the deceleration of foreign direct investment in Canada (FDIC) in recent years (particularly in 2004). Furthermore, the lower levels of FDIC might be related to the sluggish non-financial investment in Canada in recent years.

The decline in the demand for borrowed funds in line with the surplus

In aggregate, there has been a notable slowing of demand by non-financial corporations for borrowed funds over the last 10 years. Up to the mid-1990s there was a close correlation between non-financial capital acquisition and borrowing (Chart 11), as corporations raised the majority of their external funds through credit market debt[14].

Chart 11. Corporations reliance on debt slows

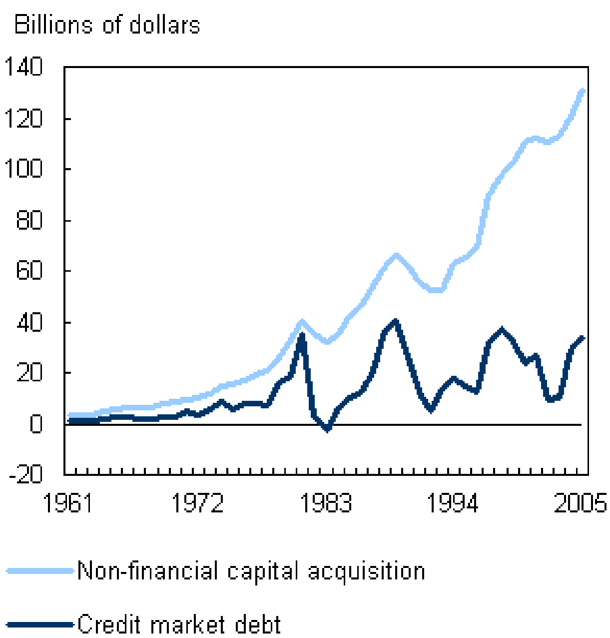
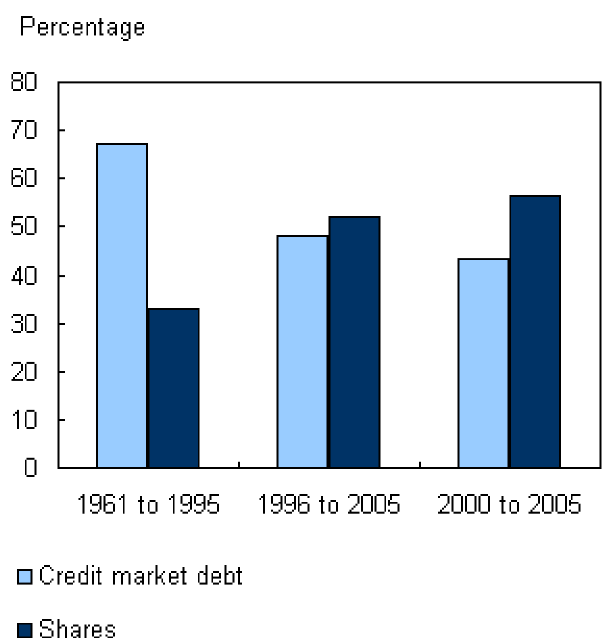


Chart 12. Share issuance overtakes borrowing



Clearly, this is no longer the case. There are two major factors that explain this change. First, the growth in internally-generated funds dampened corporations' recourse to credit markets. This would have been further affected by a softening in capital expenditure in the late 1990s and the early 2000s. Second, the 1990s witnessed strong demand for corporate equities, as net new share issuance overtook borrowing (Chart 12). From 1996-2005, net funds raised by corporations were primarily made up of share issues, reflecting strong stock markets. This development was driven, to a large extent, by the effects of significant increased demand for equity investments, in particular by institutional investors[15] and non-residents. This shift in the demand for borrowed funds has become more pronounced in the new millennium.

13. The corporate sector move to a net lending position has coincided with the non-resident sector becoming a net borrower of Canadian funds. The non-resident sector had been traditionally, up until approximately 1995, a net lender to Canada.

14. Bank loans, other loans, other short-term paper, mortgages, and bonds.

15. This demand emanated from the substantial growth in institutional investors' portfolios, in particular pension funds, segregated funds and mutual funds. The aging of the population has likely played a significant role in the increased demand, as these assets, in turn owned primarily by Canadian households, are often held as retirement related assets.

Weakened borrowing reflects short-term debt repayment

Corporations have been paying down their short-term debt – loans and short-term paper – at a significant clip in recent years, with repayments/retirements exceeding new borrowings in these markets[16] from 2001-2003. This pattern was consistent with reduced demand and the refinancing[17] of short-term debt in favour of longer-term debt instruments, which may have partially reflected corporations' interest rate expectations (as yield curves flattened). The shift in the composition of borrowing in favour of long-term debt (Chart 13) has resulted in almost 3.4 times more long-term than short-term debt being raised since 1995.

Chart 13. Go long, stop short

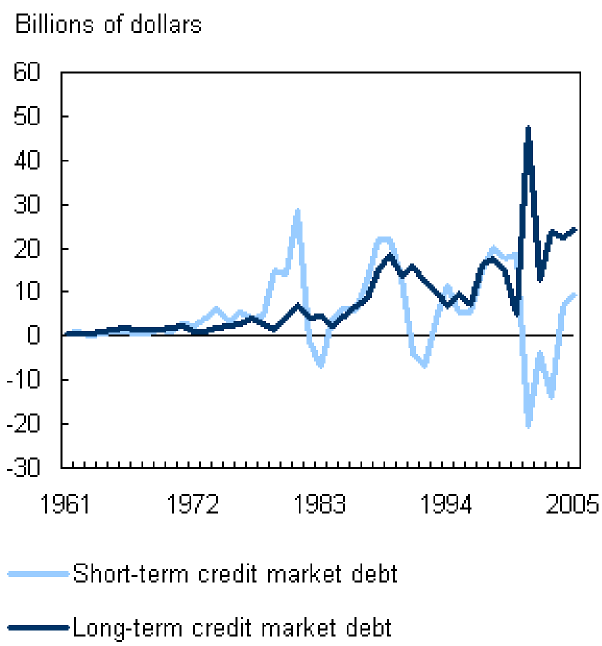
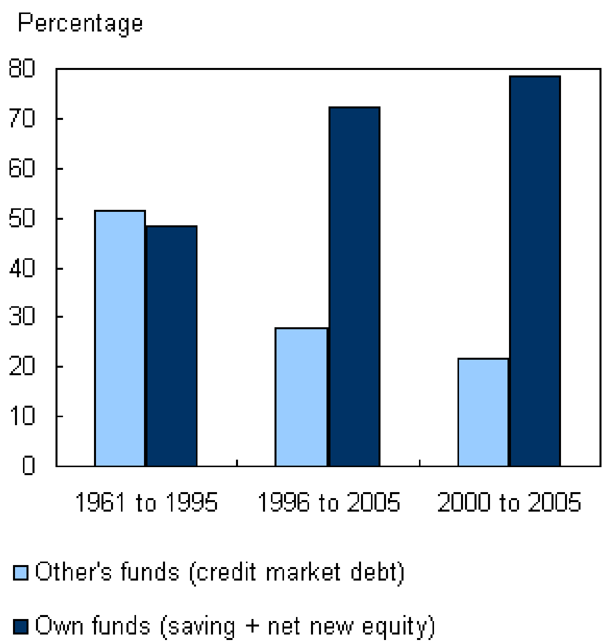


Chart 14. Less reliant on borrowed funds



The growth of equity relative to debt has been substantial

Over the last decade, corporate fund raising activity evolved significantly, and at the same time they were experiencing massive growth in saving. The result is that a greater proportion of sources of funds are arising from own funds – saving and share issues – than in the past. In this respect, the growth of equity relative to debt becomes even more pronounced when internally-generated savings or undistributed earnings are taken into account (Chart 14). In the last decade, corporations' sources of funds have mainly been dominated by own funds as opposed to borrowed (other's) funds. Since 2000, over 78 cents of every dollar of net funds raised has been in the form of saving and share issues.

16. This means that net transactions were negative.

17. This is defined as taking on new long-term debt to pay off short-term debt.

4. Impact of the surplus – Wealth generation and the restructuring of non-financial corporate finances

Record profits and slower non-financial investment, coupled with a downward trend in interest rates and strong gains in stock prices, have provided the opportunity for corporations to substantially restructure their balance sheets. This has taken the form of increased liquidity, strengthened inter-company investment abroad, reduced debt levels and a substantial increase in the equity base. In aggregate, corporate balance sheets are in their best shape in decades, and a closer look at the extent of this restructuring is warranted.

Financial assets have assumed increased importance

The composition of corporate assets has evolved substantially over the last 10 years with financial assets taking on increased importance (Chart 15). This is supported by increased cash holdings (domestic and foreign deposits) reflecting increased liquidity on the one hand (Chart 16) and inter-company investment and changing investment opportunities on the other.

Chart 15. Financial assets continue to advance

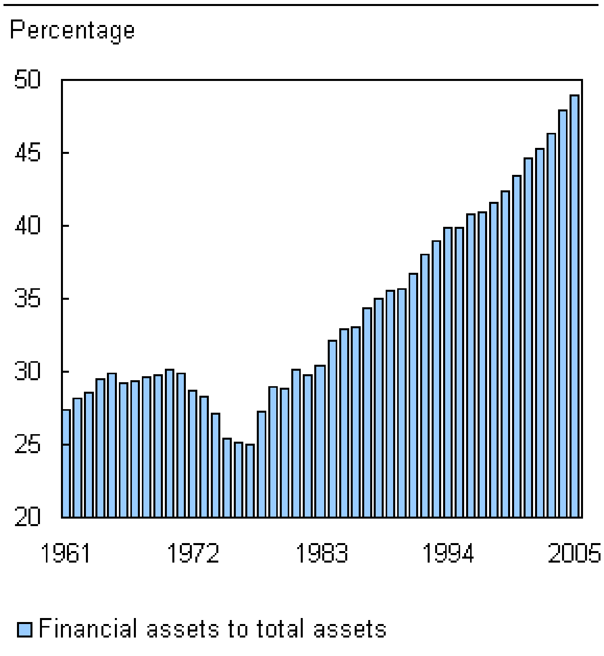
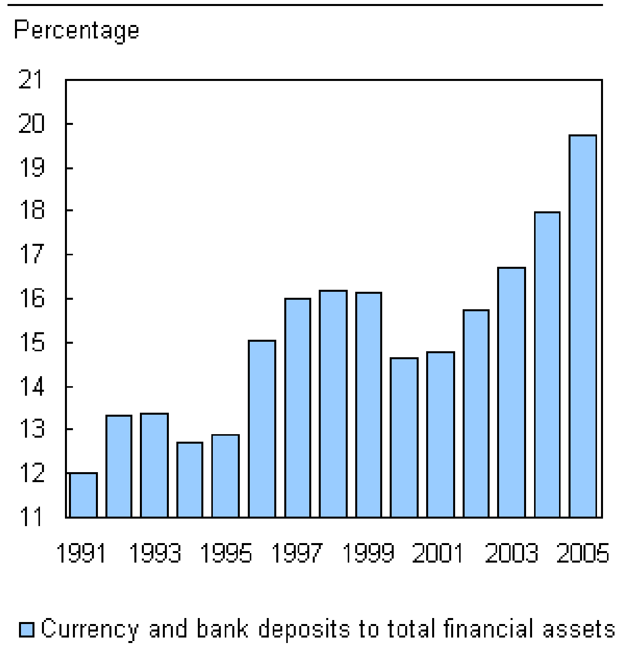


Chart 16. Cash investment increases relatively



Non-financial corporations have been stockpiling cash over the last decade, with the effect that they hold over 19% of the nation's domestic currency and deposits – a sharp contrast to the situation in the mid 1970s when they held slightly over 5%. Including portfolio investments, it is clear that liquid assets have assumed greater importance over this same period, thus minimizing liquidity risk. Inter-company investment positions have also increased in significance since 1992.

Debt picture much improved

The substantially reduced reliance on borrowed funds has contributed in large measure to improved corporate balance sheets. In addition, the slowing growth in credit market debt, combined with the shift in the composition of corporate liabilities in favour of longer term instruments (Chart 17) and the easing of interest rates over a number of years, has contributed to both lower leverage and interest burden (Chart 18)[18]. This has helped reduce the vulnerability of the sector against a significant rise in short term interest rates.

Chart 17. Short term debt pressure eases

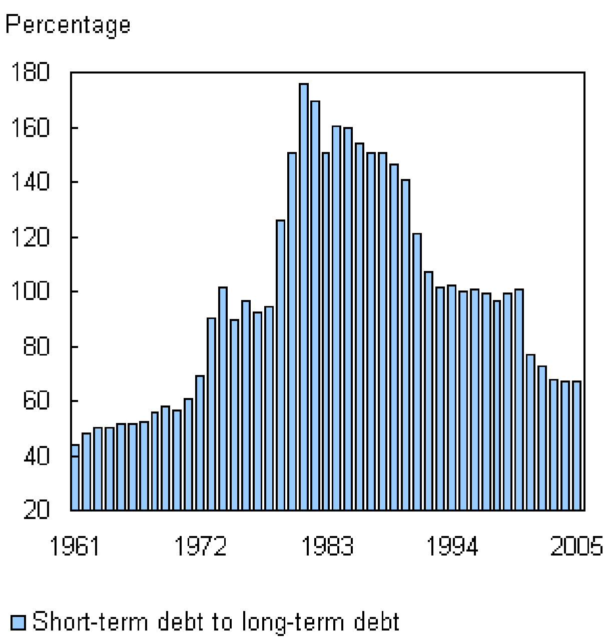
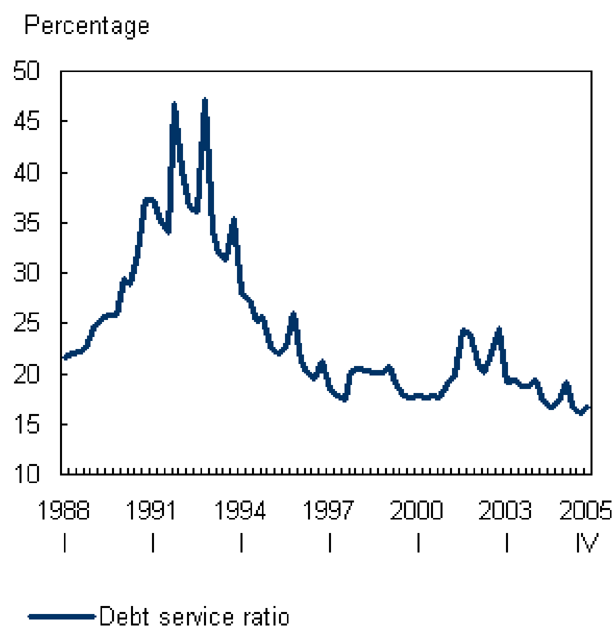


Chart 18. Overall debt burden continues lower



Liquidity improves substantially, as leverage continues to ease

Liquidity risk has also been substantially reduced (Chart 19). The liquidity of non-financial firms, as measured by the quick ratio – that is current assets[19] to current liabilities -, has improved markedly. This ratio has now reached a historical high, reflecting as much a substantial increase in liquid assets as a sharp reduction in short term liability growth.

18. Debt service ratio is defined as interest expense on borrowing as a percentage of profits before income tax, depreciation and interest expense on borrowing. See Quarterly Financial Statistics for Enterprises, Statistics Canada, Catalogue no. 61-008.

19. Excluding inventories as generally they are far less liquid than other current assets.

Chart 19. Record liquidity a feature of corporate balance sheets

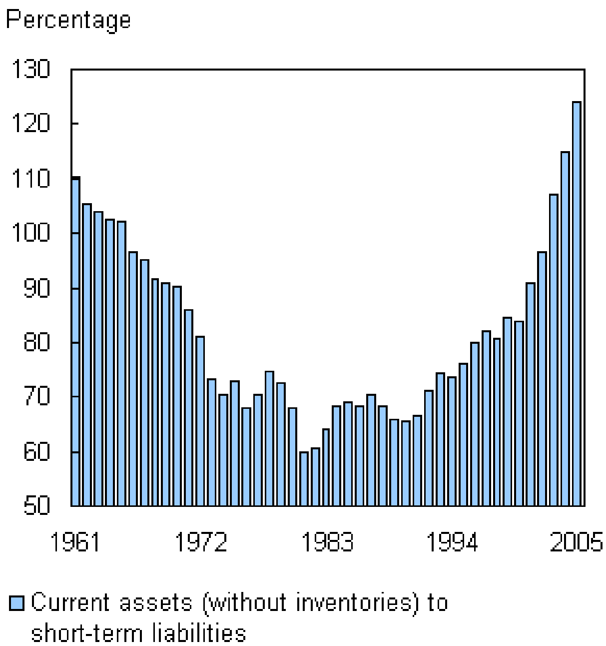
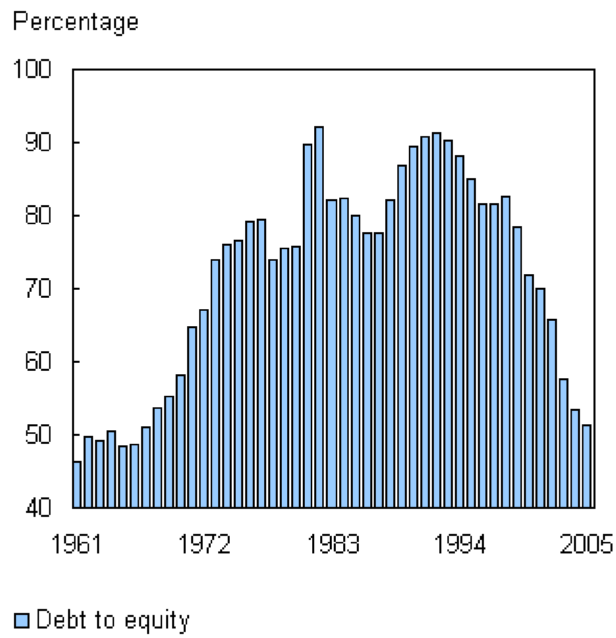


Chart 20. Corporate leverage continues to decline



Further, the changing relationship between debt and equity and the strength of internally-generated funds have combined to drive corporate leverage to a 38 year low. The ratio of credit market debt to shares outstanding plus retained earnings has reflected both economic cycles and structural changes beginning in the mid-1990s (Chart 20). All else being equal, lower leverage indicates that non-financial corporations are better equipped to confront unanticipated economic shocks, deal with interest rate fluctuations and/or to pursue new economic opportunities.

5. Summary and conclusion

Canadian corporations have a significant impact on the performance of the national economy, through their ability to invest on a large scale and their subsequent role in generating income and employment. A significant shift in their financial position is therefore worthy of analysis.

This note has identified the underlying causes, and the major effects, of the development of an expanding corporate surplus position. In short, non-financial corporations have taken advantage of record profits, historically low interest rates and relatively buoyant stock markets to substantially re-structure their balance sheets. It has reached the point where corporate finances, in aggregate, are the healthiest they have been in decades. The ultimate question is what this current situation implies for the economy, looking forward – specifically, with respect to the outlook for investment and economic growth. This is the subject of further research, but a few relevant points are made below.

Corporations finance investment from internally-generated funds and supply funds to the economy

The structural shifts in the composition of sectors' saving and related surplus/deficit positions have been substantial, most notably the generation of substantial corporate saving and surplus as described in this paper. Corporations have been increasingly supplying funds to the rest of the economy, including non-residents.

One issue might be whether there is sufficient saving in the economy to finance investment demand. While a reliance on household saving and funds from abroad have historically been significant, this is not currently the case. In fact, for the last 10 years or so, Canada has continued to generate more than enough funds to finance investment, despite the sharp declines in personal saving and the evolution of a personal sector deficit. The traditional relationship of "households save and corporations invest" has been inverted. Corporate sector saving currently dominates national saving, and exceeds business investment spending needs. One question might be how much of corporate undistributed earnings ultimately accrue to non-residents? Looking at re-invested earnings on foreign direct investment in Canada, there has been a declining trend in the proportion of foreign claims on Canadian business earnings since 2000.

Slowing of investment in recent years is multi-faceted …

The slowing of capital expenditure in recent years may be the result of some loosely-related factors. One factor might be the gradual slowing of foreign direct investment in Canada, given the historical post-war significance of foreign subsidiaries in the Canadian economy. A further factor might be the possibility of capital overhangs, where some firms – in particular in the information and communications technologies (ICT) and telecommunication industry – may have over-invested in the late 1990s into the early part of the new millennium. Evolving corporate objectives may also have had some impact on slower capital spending. Investment does not only imply capital expenditure, but can also include various types of financial investment. This can include increased liquidity and/or decreased debt.

Another such investment is the indirect method of adding to a firm's productive capital by acquiring other firms, so as to achieve an overall reduction in operating costs, assume larger market share or to become more vertically or horizontally integrated to take advantage of medium-term opportunities. It could be argued that corporate takeovers are a more efficient means of acquiring capital, so as to avoid excess capacity in the face of fluctuating demand. Increased inter-company investment has been observed in recent years, with a great deal of this investment having taken place abroad. Does this suggest that with globalization firms may be shifting production offshore, attracted by lower costs or emerging markets outside of Canada[20]?

… but investment has picked up in 2005

In short, it might be that firms have been waiting for more profitable investment opportunities to arise, given economic uncertainties and the stock market correction of recent years, and thus have been exhibiting increased caution in their domestic capital spending plans. However, this appears to be changing.

Notably, quarterly data for 2005 have shown a firming in business capital expenditure, and there are indications that Canada is in the early stages of an upswing in the investment cycle[21]. If a pick-up in investment is in the cards, it is certainly supported by the relative strength of corporate financial positions in aggregate, as evidenced in this note. An obvious conclusion, at this point, is that Canadian corporations are well positioned to participate in the next investment boom.

Evidence suggests that long upswings in investment are generally preceded by periods of lower corporate leverage and accompanied by increases in corporate leverage. The cycle of strong real business investment in the 1960s (1961-1966) was characterized by historically low corporate leverage and high liquidity; the growth in real business capital spending in the 1968-1974 period was ushered in by relatively low levels of corporate leverage; and, the recovery in business investment after the 1981-1982 recession was precipitated by a sharp drop in debt-to-equity, as was the pick-up in 1993. The only departure with established history is that corporate leverage has continued to slide since 1992, largely due to a strong demand for corporate shares and undistributed earnings growth.

20. A perspective on the globalization of Canadian companies through the establishment of foreign affiliates can be gleaned by looking at Foreign Affiliate Trade Statistics (FATS) available from Balance of Payments Division, Statistics Canada.

21. See Long-run Cycles in Business Investment, Canadian Economic Observer, September 2005, Statistics Canada, Catalogue no. 11-010.

Further research warranted

This paper suggests that further analysis of the correlation between elements of corporations' financial health and investment patterns may be warranted. In addition, an analysis of retained profits by industry may serve to better shed light on the investment outlook. The role of direct investment flows and domestic capital expenditure by industry may also be usefully analyzed. Also, since the financial and wealth accounts data of the national accounts are available in substantial financial sector detail, a further look at the evolution of financial corporations' surplus, as a supplement to this paper, would also be worthwhile. Lastly, recent developments would support additional analysis of the shifts in the surplus-deficit positions of the other major sectors of the economy.

Glossary

Fixed capital investment (corporate sector): This expression covers all expenditures on buildings, engineering construction and machinery and equipment. It includes imports of used machinery and equipment, which constitute additions to domestic capital stock, and transfer costs on the sale of existing fixed assets (i.e. real estate commissions). Corporate sector fixed capital comprises two broad categories: non-residential structures and machinery and equipment. This expression is abbreviated as fixed capital in the capital and financial account and is synonymous to gross fixed capital formation.

Gross saving: Net saving plus capital consumption allowances.

Net saving: The current income of a sector, less its current expenditure. Includes current transfers but excludes capital consumption allowances and capital transfers; is synonymous to saving.

Non-financial capital acquisition: The gross fixed capital formation of a sector, plus its investment in inventories and its net acquisition of existing assets. It does not apply to the non-resident sector which, by definition, can only engage in financial investment.

Undistributed corporation profits: Corporation profits after taxes retained in Canada, less dividends paid to Canadian residents less charitable and other contributions.

Source: National Income and Expenditure Accounts.

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