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CHAPTER 3

Sales Finance Companies

SALES finance companies engage primarily in buying instalment credit contracts secured by automobiles or other consumer goods from retailers. Since they deal initially with the merchants who sell the goods rather than with the consumers, they have been free from many of the legal limitations and restrictions that have been applied to direct lenders. Since 1935, however, a growing number of states have adopted laws that regulate various aspects of retail sales financing and place ceilings on finance charges. In general, sales finance companies are still subject to less detailed governmental supervision than other types of financial institutions extending credit to consumers.

Sales finance companies engage in a wide variety of activities other than purchasing consumer instalment credit contracts. All of the major companies finance inventories of the dealers who customarily sell them their consumer credit contracts. Some companies provide other types of financial aid to retailers; some engage in extensive insurance operations of nearly all types; some engage in a wide range of business financing; and a few have factoring or manufacturing subsidiaries. All of the companies covered by this study, however, obtained a large share of their income from automobile finance.

Sales finance companies held $10.1 billion in consumer credit at the end of 1959. They ranged in size from giant nationwide companies with assets of several billion dollars to companies owned by a single individual that held only a few thousand dollars in instalment paper. The study covers ten large companies that were willing and able to provide cost infomation. It does not necessarily present a complete picture of the cost of consumer credit in the sales finance industry as a whole. The companies in the sample account for a sizable segment of the industry, and at the end of 1959 held 83 per cent of the automobile paper of all sales finance companies. The sample is described in detail in Appendix A.

Diversification of Lending Activities

Consumer credit receivables accounted for 72 per cent of the total assets of the ten sample companies and 81 per cent of their earning assets (Table 9). Earning assets other than consumer credit receivables included instalment paper on industrial equipment, trucks, buses, and machinery; wholesale paper on automobiles, appliances, and industrial equipment; business loans; securities; and investments in many types of subsidiaries.

TABLE 9

USES OF FUNDS BY SALES FINANCE COMPANIES, END OF 1959
(per cent)

Item	Mean Distribution	Range of Ratios[a]	
		Maximum	Minimum
Earning assets, net	88.6	95.4	83.5
Consumer credit	72.0	79.6	41.7
Automobile paper	52.9	77.3	28.3
Other goods paper	2.3	12.0	0
Personal loans	16.8	45.2	0
Other	16.6	50.9	6.6
Cash and bank balances	9.9	15.3	3.7
Other assets	1.5	2.9	.3
Total	100.0	--	--

Source: All data are averages of ratios for ten sample companies.

[a] Components in columns for maximum and minimum ratios are not additive as ratios for individual items were taken from statements of different companies.

The companies covered by this study engaged primarily in automobile financing, which accounted for 53 per cent of their total assets. Other consumer goods paper on appliances, boats and mobile homes, etc., accounted for 2 per cent of their assets; and personal loans accounted for about 17 per cent.

Most of the personal loans made by these companies were made under state small-loan laws and were handled by consumer finance company subsidiaries. The distinction between a sales finance company and a consumer finance company is arbitrary in some cases because a company may engage in both types of business. A sales finance company has been defined for statistical purposes by the Federal Reserve System as any finance company that has more than half of its consumer receivables in sales finance paper. All but one of the sample companies made personal loans. One company reported 52 per cent of its consumer assets in personal loans at end of 1959 and would have been classified as a consumer finance company on that date. Its activities in earlier years justified its inclusion as a sales finance company.

Gross Finance Charges

Consumers paid approximately $15 per $100 for automobile loans at the ten sample sales finance companies in 1959.[1] Of this amount, one-fourth of the total was estimated to have been retained by dealers under participation agreements. The remaining three-fourths was retained by the finance companies.

The average charge at individual companies varied widely. The lowest average charge on automobile paper in 1959 was $11 per $100 of outstanding credit, while the highest was $20 per $100. Part of this difference reflected variations in the composition of their receivables rather than differences in rates on similar contracts. Since used-car paper and high-risk paper carry higher rates, companies that hold a relatively large portion of such contracts show a higher average rate of charge.

The average charge on new- and used-automobile credit (using the simple average for the ten companies) declined during the 1950's to a low in 1956, rising slightly during the next few years (Chart 4). The downward trend in average charges conceals divergent trends at individual companies within the sample. The companies with the lowest charges in 1949 showed a slight increase in average charges during the decade, while those with highest charges showed a sizable decline. Thus the decline in the over-all average reflects a reduction in the spread between companies with the highest and lowest charges rather than a general decline at all companies. Since the companies with the lowest charges also hold a large share of the automobile paper held by all sales finance companies, the over-all average weighted by the dollar size of each company shows a considerably smaller percentage decline than the simple average.

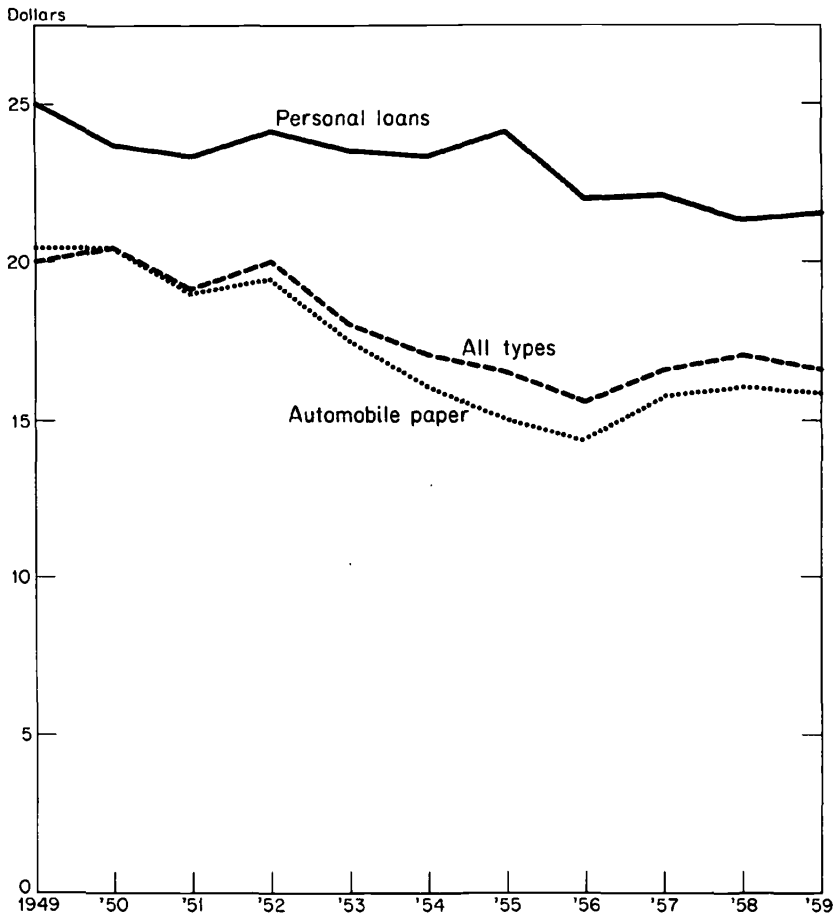
The changes in the average rates on all automobile paper as measured by the ratio of income to receivables do not correspond closely to the

[1] Charges quoted are approximations based on two methods of averaging the data from the ten sales finance companies. The simple average treats each company as a unit. The weighted average weights each company by its receivables. The relevant gross finance charges are:

	Simple Average			*Weighted Average*		
	1949	1959	Percentage Change	1949	1959	Percentage Change
Automobile paper	$20.40	$15.80	–23	$14.30	$13.70	–4
Personal loans	$25.00	$21.50	–14	$24.70	$22.40	–9

CHART 4

Gross Finance Charges on Consumer Credit at Sales Finance Companies, by Type of Credit, 1949–59
(per $100 of average outstanding credit)



SOURCE: Ten-company sample. Based on data in Appendix Table C-5.

changes in rates indicated by a series of new-automobile rates developed from other sources as another part of the study.[2]

The rates paid for personal loans at sales finance companies were similar to those paid at consumer finance companies. Consumers paid about $22 per $100 for personal loans at sales finance companies in 1959, compared with an average of $24 per $100 at consumer finance companies in the same year. With one exception, the average rate paid at each individual sales finance company fell within the range of rates reported by the consumer finance companies. The trend in charges for personal loans at sales finance companies was also similar to that shown at consumer finance companies. The average charge on these loans at sales finance companies (using simple averages) declined by $3.50 per $100, or 14 per cent, from 1949 to 1959.

Components of Finance Charges

The gross finance charges at sales finance companies include the dealer's share of the charge, the lender's operating expenses, the cost of funds, including the owner's funds, and taxes (Table 10). The average finance charge on all types of consumer credit held in 1959 was $16.59 per $100 of outstanding credit. Of this total, an estimated $2.95 was retained by dealers,[3] leaving $13.64 per $100 as the lender's gross income from consumer credit.

Operating expenses of providing consumer credit accounted for the largest share of the total finance charge. They amounted to $7.74 or nearly one-half of the cost to the consumer in 1959. Since this figure includes the cost of handling sales finance paper, personal loans, and other goods paper, it understates the average cost of handling personal

[2] Robert P. Shay, *New Automobile Finance Rates, 1924–62*, NBER, OP 86, 1963. The two series are not directly comparable since they reflect differences in scope, coverage, and weighting procedures. The Shay new-auto finance rate series represents an average of rates paid by new-car purchasers at the time the credit contract is originated. Thus, its scope and coverage are narrower than the data presented here. Further, the Shay series represents average rates from four large companies *per credit contract* on *credit extended.* As noted in Chapter 1, data in this study are *simple company averages* of annual earnings per $100 of *average credit outstanding.* Thus, the series in this study is subject to the following influences that would not be reflected in the Shay series: (1) changes in the relative importance of new- and used-car contracts; (2) changes in rates on used-car contracts; (3) changes in the share of the finance charge retained by the dealer; (4) changes in rates charged by companies not included in Shay's sample; and (5) a time lag between changes in rates on contracts written and their effect upon the receipt of income relative to average credit outstanding.

[3] The gross finance charges and this estimate of the dealer's share of the gross charges are understated by the amount of any dealer's share on consumer goods other than automobiles, as no estimate was included for such amounts.

TABLE 10

COMPONENTS OF GROSS FINANCE CHARGES ON CONSUMER CREDIT AT SALES FINANCE COMPANIES, 1959
(per $100 of average outstanding credit)

Item	Mean Distribution		Range of Ratios[a] (dollars)	
	Dollars	Per Cent	Maximum	Minimum
Gross finance charges[b]	16.59	100.0	--	--
Dealer's share of gross finance charges	2.95	17.8	--	--
Lender's gross revenue	13.64	82.2	17.69	9.55
Operating expenses	7.74	46.6	11.96	2.96
Salaries	3.47	20.9	5.13	1.59
Occupancy costs	.43	2.6	.82	.09
Advertising	.31	1.9	.81	.02
Provision for losses	1.46	8.8	2.35	.35
Other[c]	2.07	12.4	2.97	.88
Nonoperating expenses	5.90	35.6	7.16	2.99
Cost of nonequity funds	4.02	24.2	4.57	3.44
Income taxes	1.07	6.5	1.00	.47
Cost of equity funds (lender's profit)	.81	4.9	1.31	-1.11
Dividends	.48	2.9	.77	0
Retained	.33	2.0	.90	0

Source: Ten-company sample.

[a] Components in columns for maximum and minimum ratios are not additive as ratios for individual items were taken from statements of different companies.

[b] Includes all finance charges and fees collected on consumer credit activities. Charges for insurance are not included and the cost of free insurance provided to borrowers was deducted.

[c] Includes a wide variety of cost items, such as supplies, legal fees, insurance, etc., for which separate information could not be obtained from all companies.

loans and overstates the average cost of handling automobile paper. The average cost of handling personal loans at consumer finance companies was $14.42 or nearly twice the average operating costs at sales finance companies. If the consumer finance cost figure is used to estimate the cost of handling personal loans at sales finance companies, the derived cost of handling sales finance paper was only $5.26 per $100 of outstanding credit.[4]

[4] See Table 30.

The average operating costs of consumer credit at individual sales finance companies ranged from $2.96 to $11.96 per $100 of outstandings. Part of this differential reflects differences in importance of personal loan activities. When the extreme ratios are adjusted by an estimate of the cost of handling personal loans, the gap narrows slightly, but the range is still sizable. This difference indicates wide variations in the type of receivables held and efficiency of the sales finance company operations.

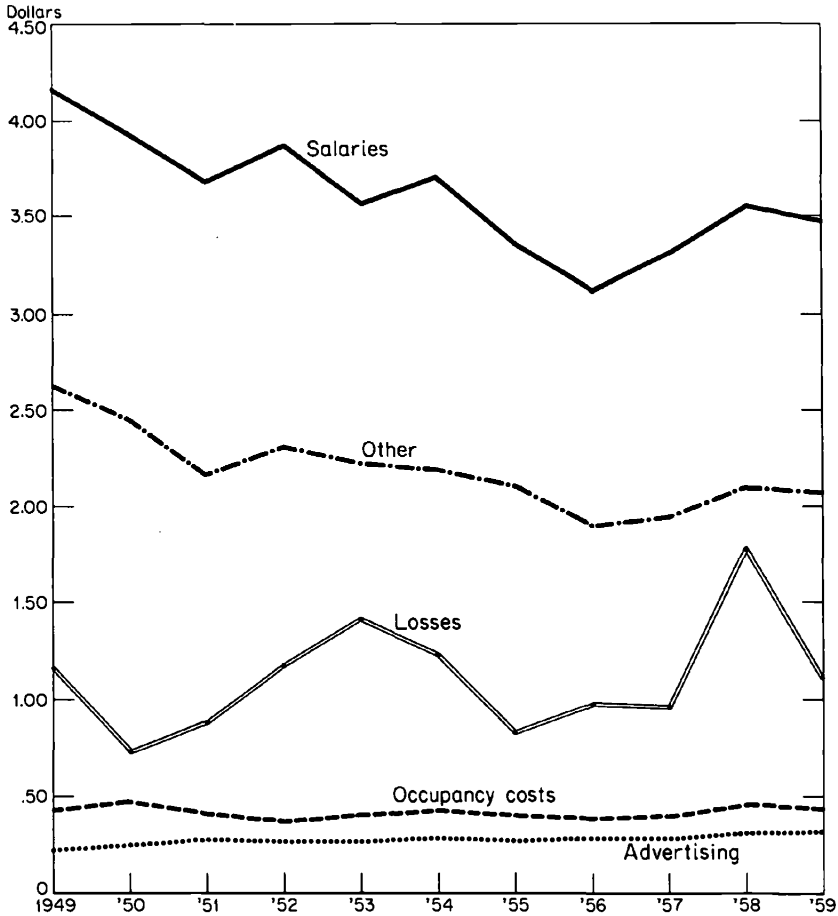
The cost of funds, both equity and nonequity, accounted for 29 per cent of total consumer credit costs and amounted to $4.83 per $100 outstanding in 1959. These costs include interest payments on borrowed funds, dividend payments to the owners, and the share of net profits retained in the business. Payments for nonequity funds accounted for four-fifths of the total cost of funds in 1959. The spread in costs of funds among individual companies was small relative to the spread in operating expenses. The cost of nonequity funds at individual companies ranged from $4.57 to $3.44 per $100 of outstanding credit.

Operating Expenses

Salaries and wages account for nearly half of the total operating expenses of handling consumer credit receivables at sales finance companies. They averaged $3.47 per $100 of credit outstanding in 1959. Individual company variations were sizable, ranging from $1.59 to $5.13. Part of this range reflects variations in the type of credit handled and, in particular, the extent of their personal loan operations. When the salary costs of the highest- and lowest-cost companies were adjusted for an estimate of expenses of personal loan operations, the variations in salary expense were reduced but were still sizable. The wide spread in salary cost suggests major differences in the nature of sales financing operations among individual companies.

Salary expenses declined during the period studied despite the rise in wage rates and employee benefits that characterized this period. A low was reached in 1956 when salary costs were $3.12 per $100 of credit, compared with an average of $4.16 in 1949 and $3.47 in 1959 (Chart 5). Despite this decline, salary expenses accounted for about the same percentage of total operating expenses throughout the period. A number of influences may have contributed to the reduction of salary expenses. The average contract size more than doubled from 1949 to 1959, thus reducing the handling costs in relation to the dollar volume. Improved operating procedures and the increased use of electronic tabulating and bookkeeping equipment probably also helped to reduce personnel costs.

CHART 5
Operating Expenses on Consumer Credit at Sales Finance Companies, 1949–59
(per $100 of average outstanding credit)



SOURCE: Ten-company sample. Based on data in Appendix Table C-4.

Losses are an unavoidable expense of sales finance operations and provisions for losses represented a sizable item of expense. In 1959, sales finance companies set aside about 19 per cent of total operating expenses for potential losses. Since these provisions represent the companies' judgment of the range of possible losses, they do not reflect the actual loss experience from year to year. Provisions for losses exceeded actual losses (net of recoveries) during every year of the study except 1958. In 1959 actual losses amounted to $1.11 per $100 of receivables or about three-fourths of the total provisions for losses. Individual company differences in losses and in provision for losses were sizable. Actual losses ranged from $.21 to $1.66 in 1959 and provisions for losses ranged from $.35 to $2.35. These differences suggest considerable variation in the quality and type of paper that is handled among the individual companies and in the nature of recourse agreement.

Advertising and occupancy costs are a comparatively small part of the total operating expense for sales finance companies as they deal primarily with auto dealers or other retailers rather than directly with the public. They do not need numerous or expensive locations for the success of their operations. Many promotional costs are incurred as part of their regular operations and show up as personnel costs and other expenses, rather than as separate advertising or promotional expenses. Their advertising costs amounted to only 31 cents per $100 of credit in 1959 and costs of quarters amounted to only 43 cents per $100. These costs remained relatively stable throughout the period.

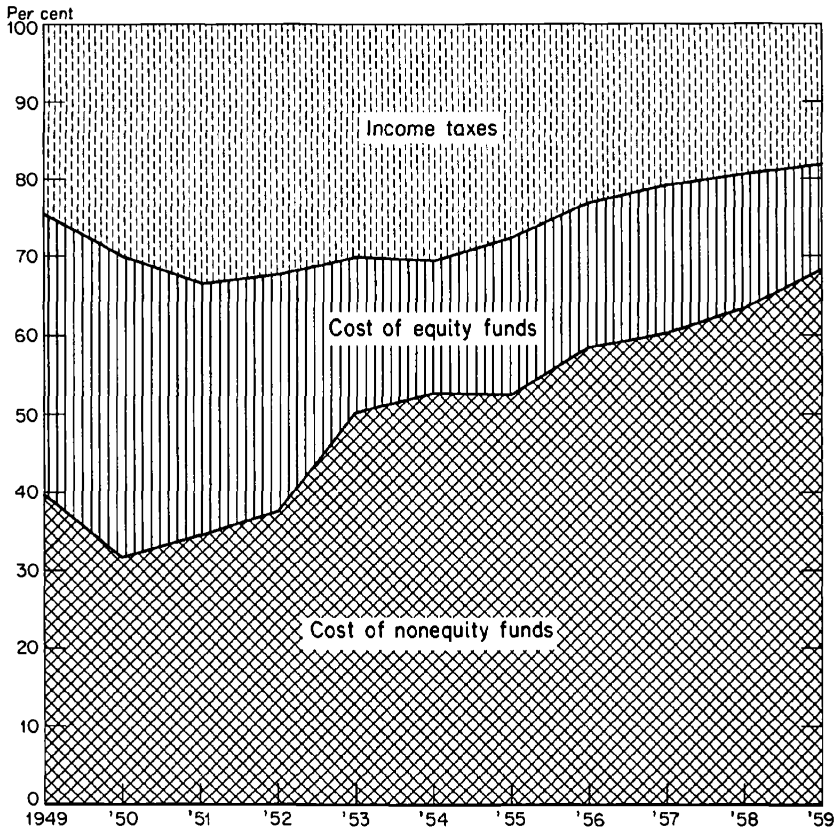
Many of the expenses of the sales finance companies could not be tabulated separately because of the lack of uniform accounting. These unclassified items, which accounted for 27 per cent of total operating expenses in 1959, included such items as auditing, credit reports, donations, taxes (other than income), fidelity bonds, insurance, legal bills, postage, telephone, telegraph, travel, depreciation, recording fees, and others. The total of these miscellaneous expenses declined from $2.63 per $100 of receivables in 1949 to $2.07 per $100 in 1959 (Table 10) but the changes in composition could not be traced.

Nonoperating Expenses

Nonoperating expenses accounted for 36 per cent of the average gross finance charge on consumer credit at sales finance companies in 1959. They included the cost of funds, equity and nonequity, and income taxes. The cost of nonequity funds made up more than two-thirds of these costs with the remainder split almost evenly between the cost of equity funds (lender's profit) and provisions for income taxes.

The amount of nonoperating expenses as well as the relative importance of these expenses in the total cost of credit varied considerably from year to year without any clear-cut trend. Among components of nonoperating expenses, the cost of nonequity funds increased in importance from 40 per cent in 1949 to 68 per cent in 1959. The share going to equity funds and for income taxes dropped accordingly (Chart 6).

CHART 6
Distribution of Nonoperating Expenses on Consumer Credit at Sales Finance Companies, 1949–59



SOURCE: *Ten-company sample. Based on data in Appendix Table C-4.*

SOURCES OF FUNDS

The cost of funds, as well as the distribution of payments between equity and nonequity sources, depends in large part upon the financial structure of the company. During 1949, equity funds provided an average of 19 per cent of the total resources of the sample sales finance companies. They declined in importance, however, as a source of funds during the period and by the end of 1959 accounted for only 15 per cent of the total (Table 11).

All of the major credit markets were tapped by sales finance companies to obtain funds for their rapid growth during the 1950's. Banks

TABLE 11

SOURCES OF FUNDS FOR SALES FINANCE COMPANIES, END OF 1959
(per cent)

Item	Mean Distribution	Range of Ratios[a] Maximum	Range of Ratios[a] Minimum
Debt, total	78.5	82.7	73.2
Short-term to banks	29.8	46.9	2.9
Other short-term	16.6	33.9	9.7
Senior long-term	21.0	49.5	8.9
Subordinated	11.1	16.6	8.8
Dealer reserves	1.8	3.2	.7
Other liabilities	4.6	9.3	1.3
Total nonequity funds	84.9	91.5	82.4
Equity funds, total	15.1	17.6	8.5
Reserves	2.0	4.3	1.1
Preferred stock	2.7	4.6	0
Common stock and surplus	10.4	13.9	6.2
Total	100.0	--	--

Source: Ten-company sample.

[a] Components in columns for maximum and minimum ratios are not additive as ratios for individual items were taken from statements of different companies.

provided the largest share, although the importance of bank borrowing declined during the period. At the end of 1959 bank loans accounted for 30 per cent of the total resources of the sample companies compared to 50 per cent at the end of 1948.

The importance of bank borrowing among individual companies ranged from 3 to 47 per cent of total resources at the end of 1959. Commercial paper markets provided funds to supplement bank credit. Although separate figures were not collected on commercial paper, it accounted for most of the nonbank short-term debt, which amounted to 17 per cent of total resources at the end of 1959.

The anticipated growth of financing needs and changing money market conditions brought about a wider use of long-term debt during the 1950's. Senior long-term debt increased as an average source of funds from 7 to 22 per cent of total resources from 1949 to 1959. One company reported that nearly half of its total funds were obtained from senior long-term sources. At the other extreme, another company reported only 9 per cent from these sources.

Subordinated debt plays a dual role in the financing of consumer lending. It provides nonequity funds and serves as a base for the expansion of other borrowing. The expanding needs of sales finance companies for nonequity funds combined with institutional interest in high-yield securities led to the increased use of subordinated debt. This type of debt supplied 11 per cent of total resources in 1959 compared with only 7 to 8 per cent in the early 1950's. Subordinated debt was used by all of the companies covered by the study and ranged in importance from 9 to 17 per cent of their total resources in 1959.

Miscellaneous liabilities and dealer reserves provide a steady source of noninterest-bearing funds for finance companies. Dealer reserves, or the amounts retained by the finance company as protection against possible losses, averaged 1.8 per cent of total resources of the sample companies at the end of 1959. Other liabilities accounted for another 4.6 per cent, bringing the total of noninterest-bearing sources of funds to 6.4 per cent of total resources.

COST OF NONEQUITY FUNDS

The cost of nonequity funds averaged $4.02 per $100 of outstanding consumer credit in 1959, or 24 per cent of the gross finance charge at sales finance companies. These costs depend upon the rate paid for these funds and the proportion of nonequity funds used in financing consumer receivables. In 1959 sales finance companies paid an average rate of 4.5 per cent for borrowed funds. The effective rate on all nonequity funds including noninterest-bearing liabilities was 4.2 per cent. This rate understates the total cost of borrowing, however, because it does not allow for the reduction in usable funds that results from compensating balance requirements. Bank requirements for sales finance companies are similar to those discussed for consumer finance companies in the previous chapter. The costs of compensating balances and other nonearning assets added about .5 of a percentage point to the cost of funds used in lending to consumers in 1959 (Table 12).

The amounts of nonequity funds required for consumer lending are reduced by the use of equity funds, however, which reduces the effective cost of these funds per $100 of consumer credit. The sample sales finance companies obtained about 16 per cent of their resources from equity sources and the effective cost of nonequity funds was reduced accordingly, as indicated by the difference between columns 3 and 4 of Table 12.

The cost of nonequity funds as a percentage of consumer credit receivables rose from 2.6 to 4.0 per cent from 1949 to 1959, primarily as

TABLE 12

COST OF NONEQUITY FUNDS AT SALES FINANCE COMPANIES, 1949-59
(per cent of average outstanding balances)

	Ratio of Dollar Cost of Nonequity Funds to			
Year	Debt	Total Nonequity Funds	Nonequity Funds Minus Nonearning Assets	Consumer Credit Receivables[a]
1949	3.0	2.6	3.2	2.6
1950	3.0	2.6	3.2	2.5
1951	3.3	2.9	3.4	2.7
1952	3.5	3.1	3.6	2.9
1953	3.9	3.4	4.1	3.3
1954	3.7	3.3	3.9	3.2
1955	3.6	3.3	3.9	3.1
1956	4.1	3.7	4.4	3.5
1957	4.5	4.1	4.7	4.0
1958	4.3	3.9	4.6	3.7
1959	4.5	4.2	4.8	4.0

Source: Ten-company sample.

[a] Based on the dollar share of the total cost of nonequity funds allocated to consumer credit receivables by the ratio of consumer receivables to total earning assets.

a result of an increase in rates paid for funds. Sales finance companies paid an average of 4.5 per cent for money in 1959 compared with 3.0 per cent in 1949. At the same time the proportion of equity funds dropped from 18.6 to 15.8 per cent of total resources.

COST OF EQUITY FUNDS

The cost of equity funds (lender's profit) averaged only 5 per cent of the gross finance charge on consumer credit in 1959. This element of cost declined sharply as a proportion of both the finance charge and non-operating expenses during the period covered by the study (Chart 6). The cost of equity funds used in consumer lending fell from a high of $2.97 per $100 of credit in 1950 to the low of 81 cents per $100 in 1959. The decline was fairly steady and resulted from a decline in the proportion of equity capital used and from an increase in interest rates. The nature of this decline can best be seen in the perspective of the factors affecting the over-all profits of sales finance companies.

Lender's Rate of Profit

As noted in Chapter 2, the return that a lender obtains on net worth or equity funds depends upon all phases of the companies' operations: the net return on consumer credit; the net return from other activities (which may be related or unrelated to consumer credit activities); the proportion of resources that is invested; the financial advantage that can be achieved through the use of borrowed funds; and the income tax rates.

RETURN FROM OTHER EARNING ASSETS

In addition to their consumer credit operations, all of the sales finance companies in the sample engaged in some other activities. They all provided wholesale financing for retailers and wrote some types of insurance. In addition, some of them engaged in a variety of other financial and industrial activities. The sample companies showed a larger average net operating return on their total earning assets than they did on their consumer credit receivables in every year covered. In 1959, all but one of the sample companies showed a larger return on all earning assets than on their consumer credit receivables.[5]

Other activities may be tied in with their consumer credit business or may be completely unrelated. A company that sells the accident insurance on automobiles and lends the money on the same cars can consider the combined return from both activities in establishing its policies. Such a company may reduce its rates on its consumer credit without sacrificing profits if it can gain on its insurance.

COST OF NONEARNING ASSETS

The ten sample companies held 11.4 per cent of their total assets in nonearning forms at the end of 1959; 10 per cent was in cash and bank balances and the remainder in other forms.

The cash requirements of sales finance companies are determined by their operating needs, the number of offices and compensating balances required by their creditors. These funds must be supplied either by borrowing or from equity funds and are a cost of doing business. The imputed costs of nonearning assets can be approximated by the difference between the return on total assets and the return on earning assets. In recent years this spread has averaged slightly less than 1 percentage

[5] See the corresponding section in Chapter 2 for a discussion of the problems involved in estimating the return on assets other than consumer receivables.

point on total assets for the sample companies. The most efficient company in this respect managed to hold the costs of nonearning assets to about .3 of a percentage point. At the other extreme, nonearning assets cost one company 1.3 percentage points.

FINANCIAL ADVANTAGE OF THE USE OF NONEQUITY FUNDS

When the lender can earn a higher rate of return on the funds he invests than he pays for the funds he borrows, the differential accrues to the owners. This financial advantage from the use of nonequity funds is an important element in the profitability of sales financing operations. The sample sales finance companies earned an average of 6.3 per cent on total assets in 1959 before the cost of funds and income taxes (Table 13). The net profits before taxes of these companies, however, amounted to 18 per cent of equity funds, nearly three times the rate earned on total resources. Thus, nearly 65 per cent of their profits could be traced to the financial advantage of using nonequity funds. The sample sales finance companies were able to obtain nonequity funds at an average rate of 4.2 per cent and were able to earn 6.3 per cent on these funds, or a net of 2.1 per cent. They employed $5.6 of nonequity funds for every dollar of equity funds so that they were able to earn 2.1 per cent times 5.6, or 11.8 per cent, on their equity funds from the use of nonequity. This return, plus the average return on total resources of 6.3 per cent, equals the return on equity of 18 per cent (see the lower panel of Table 13).

The sample companies set aside an average of 45.5 per cent of the net profits before taxes as provision for tax payments during the eleven years covered by the study. The reported amount varied considerably from year to year as the allowance reflected adjustment for under- or overestimates and for special tax situations. After taxes, the sample companies earned an average of 10.3 per cent on their equity funds with individual companies showing variations between 7 and 14 per cent.

TREND IN LENDER'S PROFITS

The rate of profit on equity funds declined in the late 1950's and averaged less than 11 per cent in the last three years of the study, compared with an average of over 15 per cent in the first three years. The decline reflects the increase in the cost of nonequity funds and a decline in net operating income from consumer credit, which resulted in a slight decline in net operating income from total assets. Although the return on total assets varied from year to year, the average in the late 1950's was below that in the earlier years. The effects of this decline in return

TABLE 13
FACTORS IN SALES FINANCE COMPANY PROFITS, 1949-59
(per cent of average outstanding balances)

Ratio	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959
1. Net operating income from consumer credit to consumer receivables[a]	6.5	7.8	7.8	7.8	6.6	6.0	5.9	6.1	6.6	5.9	5.9
2. Net operating income to earning assets	7.8	9.0	8.5	8.5	8.2	8.1	7.5	7.3	7.6	7.0	7.2
3. Net operating income to total assets	6.4	7.6	7.3	7.3	7.1	7.1	6.6	6.4	6.6	6.1	6.3
4. Profits before taxes to equity funds	23.6	30.6	27.9	28.1	26.9	27.3	25.7	22.7	21.7	18.7	17.9
5. Net return from nonequity to equity funds (line 4 minus line 3)	17.2	23.0	20.6	20.8	19.8	20.2	19.1	16.3	15.1	12.6	11.6
6. Provision for income taxes to profit before taxes	37.6	41.9	47.3	48.7	50.0	50.3	48.4	46.6	45.0	43.1	42.5
7. Net profits to equity funds	14.7	17.6	14.4	14.1	13.4	13.5	13.2	12.1	11.9	10.5	10.3
8. Percentage of profit obtained from leverage on nonequity funds (line 5 ÷ line 4)	72.9	75.2	73.8	74.0	73.6	74.0	74.3	71.8	69.1	67.4	64.8
ALTERNATIVE DERIVATION OF LINE 5											
a. Net operating income to total assets (line 3)	6.4	7.6	7.3	7.3	7.1	7.1	6.6	6.4	6.6	6.1	6.3
less											
b. Cost of nonequity funds to nonequity funds	2.6	2.6	2.9	3.1	3.4	3.3	3.3	3.7	4.1	3.9	4.2
equals											
c. Net return from nonequity funds to nonequity funds	3.8	5.0	4.4	4.2	3.7	3.8	3.3	2.7	2.5	2.2	2.1
times											
d. Leverage coefficient (ratio of nonequity to equity funds)	4.6	4.8	4.9	5.1	5.6	5.7	6.0	6.2	6.1	5.7	5.6
equals											
e. Net return from nonequity to equity funds (line 5)[b]	17.5	24.0	21.6	21.4	20.7	21.7	19.8	16.7	15.3	12.5	11.8

[a] Equivalent to nonoperating expenses per $100 of average consumer credit receivables, see Table 10.

[b] Differences between lines 5 and e result from rounding errors introduced by alternative methods of calculation.

on profits was accentuated by the sharp rise in interest rates paid for nonequity funds. The average rate paid for nonequity funds increased by 62 per cent during the eleven years of the study. An increase in the ratio of nonequity to equity funds increased the leverage from the use of nonequity funds, but the high cost and lower return more than offset the gain obtained through the higher leverage, and the profit rate fell accordingly (Table 13).

The success of individual companies in maintaining their profit margins differed. All of the sample companies showed a lower return on equity toward the end than at the beginning of the decade. In 1959 net profits varied from a maximum of nearly 14 per cent of equity to a low of 7.8 per cent, while in 1950, the year of peak profits, the range was from a high of 26 to a low of 11 per cent.

Sales finance companies typically pay a substantial part of their net profits to shareholders in the form of dividends. In 1959 they paid out 57 per cent of their profits in dividends on preferred and common stock. The return to the common stockholders amounted to 5.9 per cent on the book value of the stock. Since the market price of stocks of most sales finance companies was above the book value of the stock in 1959, the return per share on market value of the stock was below that indicated for book value.

Comparison of High- and Low-Profit Companies[6]

None of the sales finance companies in the sample showed a consistently high ratio of net profit to equity throughout the entire period of the study. Similarly, no company showed a consistently low profit during the entire period. During the four years 1956–59, however, two companies were consistently in the highest position and two other companies were consistently among the three lowest companies in terms of profits. The two most profitable companies were among the largest companies, while the two least profitable were among the smallest companies in the sample.

The high-profit companies averaged a return of 14.7 per cent on their equity funds during the four years 1956–59. This was 5.5 percentage points above the profit rate for the low-profit companies (Table 14). The difference in profits arose almost entirely from the financial structure of

[6] The diversification of consumer credit activities among the sample sales companies made it impossible to make a meaningful comparison of companies showing the highest and lowest average finance charges similar to that shown in Chapter 2 for consumer finance companies.

TABLE 14

SELECTED RATIOS OF HIGH- AND LOW-PROFIT SALES FINANCE COMPANIES, 1956-59[a]
(per cent)

Ratio	Two High-Profit Companies (1)	Two Low-Profit Companies (2)	Difference (col. 1 minus col. 2) (3)
1. Net operating income from consumer credit to consumer receivables	6.1	6.1	—
2. Net operating income to earning assets	6.5	7.5	-1.1
3. Net operating income to total assets	6.2	6.3	-.1
4. Cost of nonequity funds to nonequity funds	3.6	4.1	-.5
5. Net return on nonequity funds to nonequity funds (line 3 minus line 4)	2.6	2.2	.4
6. Leverage coefficient (ratio of nonequity to equity funds)	9.3	5.1	4.2
7. Return from nonequity funds to equity funds (line 5 times line 6)	24.2	11.2	13.0
8. Net profit before taxes to equity funds[b]	29.0	18.0	11.0
9. Income taxes to equity funds	14.3	8.8	5.5
10. Net profit to equity funds	14.7	9.2	5.5

[a] All data are averages for the four years 1956-59.

[b] The ratio of net profits before taxes to equity funds in line 8 differs from the ratio derived by adding lines 7 and 3 because of rounding differences involved in the two methods of calculation.

the two groups rather than from their lending operations. Both groups of companies showed the same net operating income on consumer assets. The less profitable companies reported somewhat higher earnings on total earning assets but only a slightly larger return on total assets than the high-profit companies.

The high-profit companies were able to earn more than twice as much on their nonequity funds as the less profitable companies (Table 14, line 7). This rate of return was achieved by the more extensive use of debt financing and the less expensive funds. The high-profit companies paid .5 of a percentage point less for their nonequity funds than the less profitable companies and they used nearly twice as much debt relative to equity. The high-profit companies reported an average ratio of nonequity to equity funds of 9.3 compared with 5.1 for the other group. The financial advantage of using a high ratio of debt and low-cost funds permitted the high-profit companies to show an average profit before taxes of 29 per cent on equity for the four years 1955–59, 11 percentage points higher than the return reported by the two low-profit companies.