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Summary of Findings

LOANS SECURED BY FIELD WAREHOUSE receipts represent a comparatively recent and developing method used by financial institutions to lend working capital to business enterprises. A field warehouse is simply a special warehouse leased from, and established on the premises of, the borrowing concern. The warehouseman takes custody of the raw materials, semi-finished or finished goods of that concern and issues warehouse receipts that are then pledged as collateral security for a loan. Under many circumstances such receipts possess definite advantages over chattel mortgages, pledges of goods, or trust receipts as security instruments. By making the inventories of a business "bankable," field warehousing operates as a credit facilitating device.

American commercial banks have long granted credit on the security of warehouse receipts covering staple agricultural and other commodities deposited in terminal warehouses. But the establishment on the borrowers' premises of field warehouses by concerns specializing in this activity is a comparatively recent development. It originated around the turn of the present century and appears to have undergone steady development. Causes of expansion in the demand for field warehouse receipt loans were: the weakened working capital positions of many business enterprises during and after the great depression of the early thirties, the increasing burden of corporate taxation which impeded the growth of working capital, difficulties in obtaining funds through public sale of securities, efforts to stabilize production rates throughout the year, the relative growth in the importance of cash discounts, and larger inventories held under defense and war conditions. The supply of credit collateralized by field warehouse receipts expanded in consequence of higher credit standards set by banks as a result of their depression experience with unsecured loans, wider adoption by the states and judicial clarification of the Uniform Warehouse Receipts Act, and vigorous educational programs conducted by the field warehousing companies.

At the end of 1941 field warehousing was conducted by a few large companies of regional or national scope, and by numerous small concerns many of which operated a few field warehouses as an adjunct to a terminal warehouse or financing business. The principal national concerns include William H. Banks Warehouses, Inc., Douglas-Guardian Warehouse Corporation, Haslett Warehouse Company, Lawrence Warehouse Company, New York Terminal Warehouse Company, St. Paul Terminal Warehouse Company and Terminal Warehouse Company of Baltimore.

The key to the establishment of a field warehouse is the creation of an effective bailment. This exists when the warehouseman has "continuous, exclusive and notorious" possession of the merchandise, and only his agent, servant or employee has access to the warehouse. Honesty and competence on the part of the warehouseman and his custodian are vital in giving value to the warehouse receipts. Field warehouse companies typically employ as custodian a person formerly employed by the depositor, because this procedure not only reduces costs but also makes available the services of individuals experienced in handling the particular goods to be stored. While this practice has sometimes been criticized on the ground that such custodians cannot be disinterested, yet Federal and state courts have upheld the validity of their warehouse receipts, provided that the bailment was effective. The bonds ordinarily furnished by field warehousemen indemnify the holders of their receipts against loss arising from failure of the warehouseman to perform his duties under warehousing laws, that is, against fraud or negligence. Insurance against loss from fire, water damage, windstorm or other causes arising outside the warehouse must be specially provided.

Warehouse receipts may be negotiable or non-negotiable in form; either type of receipt may cover fungible or non-fungible commodities; in some cases commodities may be held under an agreement of bailment, which operates to reduce the number of receipts to be issued and accounted for. Whatever their type, most warehouse receipts indicate merely that the warehouseman has received so many packages or containers of a specified description or a stated quantity or volume of commodities such as coal or oil; the receipt holder must perform the task of grading and valuing commodities, and of ascertaining the contents of containers.

The average life of field warehouses is three to five years, excepting in industries characterized by highly fluctuating seasonal working capital needs, wherein the average life is much longer. The depositing-borrowing concerns either perfect arrangements with new warehousemen, or frequently they use a field warehouse receipt arrangement temporarily until they are able to secure credit on other bases. In some cases field warehousing is discontinued because the particular circumstances that made advantageous the acquisition of an above-normal inventory have disappeared.

It is estimated on a basis of data secured from five principal field warehouse companies that there were at least 5,000 field warehouses in the United States at mid-1941, about 3,000 of which were operated by large regional or national companies, and about 2,000 of which were operated by small local concerns. The annual average amount of credit outstanding and secured by field warehouse receipts during this period is placed at about $150 million. Forty-three percent of all field warehouses were located in the Central and Pacific states. Although hundreds of different types of merchandise are warehoused in the field, a considerable part of all deposits consists of products of agriculture. Canned goods, miscellaneous groceries, and lumber, timber and building supplies account for 40 percent of all field warehouses. Two-thirds of all the depositors in field warehouses are manufacturers, almost one-third are distributors.

While the value of deposits in a given warehouse is likely to vary greatly through each year, the typical field warehouse contains merchandise worth, on the average, between $25,000 and $100,000, and the typical loan against the warehouse receipts is approximately two-thirds of the value of the deposits. A questionnaire survey of commercial banks at mid-1941 revealed that the average outstanding field warehouse receipt loan balance was $40,000.

Commercial banks appear as lenders upon the receipts of nine out of every ten field warehouses, although commercial finance companies, trade suppliers and warehousing companies also accept such receipts as credit facilitating devices. Warehousemen hold receipts arising from their own custodianship of goods in about 2 percent of all cases, thus combining the functions of custodian and banker.

It appears that at mid-1941 about 13 percent of all the operating and insured commercial banks in the United States extended credit secured by field warehouse receipts, although the frequency of such lending was much greater than this in the Pacific and East North Central Regions and much less in the Eastern and New England Regions. Banks located in large cities tended to make such loans more than four times as frequently as did banks in centers under 10,000 population. Evidently, the largest markets for such credits centered in the metropolitan regions. Field warehouse receipt loans were not, however, significantly large elements in bank earning assets, comprising less than 1 percent of all loans and discounts and about 2 percent of "commercial and industrial" loans of all American banks. Considering only the banks that engaged in this type of credit transaction, nearly two-thirds of the total outstanding field warehouse receipt loans were held by institutions in which such credits formed between 1.5 and 4 percent of total loans and discounts. Moreover, the larger of these banks (measured in terms of deposits) tended to serve a larger number of business concerns on this basis, to make larger loans, and to place a larger fraction of their total loans and discounts in field warehouse receipt credits than did the smaller institutions. Thus, the average loan held by banks in the $500,000 to $1 million deposit class was $11,650, whereas the average loan of banks with deposits over $50 million was $48,490.

As there is a close correlation between size of loan and asset size of borrower, it may be inferred from knowledge of the average amount of field warehouse receipt loans that the majority of business concerns financed on this basis had total assets of between $25,000 and $200,000. Many of these concerns experienced high degrees of seasonal fluctuation in their working capital requirements, and found field warehouse receipt financing to be advantageous because the amount of credit was thereby geared closely to working capital needs. Other concerns used this basis of financing because their operations were expanding rapidly and they needed credit in amounts larger than could be obtained without collateral security. The fact that the typical field warehouse has a duration of three to five years suggests that many concerns make use of this financing device temporarily, until abnormally large inventories are reduced to normal proportions, or they are able to build up more adequate equities or to obtain capital or credit on another basis.

Nearly all commercial banks administer field warehouse receipt loans through the officers who deal with other loans against commodities. Few banks have set up separate departments for handling commodity loans; where found, these are generally supervised by a senior loan officer. The development of field warehouse receipt lending is, to an important degree, attributable to the vigorous promotional work of the field warehouse companies that has educated bankers in the uses of such financing. As a result four-fifths or more of all warehouses are installed by warehouse companies after references made by bank officers, only a few being set up at the direct instance of depositors or trade suppliers.

Lending against field warehouse receipts has posed unique problems of credit appraisal for commercial bankers, resulting in the evolution of special credit standards and procedures for limiting risks. The credit elements entering into each loan fall into four groups: (1) *the field warehouse company*—its financial responsibility, experience, the form of its warehouse receipts, and the amount, coverage and worth of its bond; (2) *the field warehouse*—the validity of the lease agreement, the adequacy of the physical conditions, and the competence and integrity of the custodian; (3) *the borrowing business concern*—the moral and financial responsibility of its principals, its financial strength, the calibre of its management, its past and prospective earning power; (4) *the warehoused merchandise*—its value, susceptibility to deterioration, breadth of market and price fluctuation. Bank officers usually give some attention to each of these elements before entering into a financing arrangement, although the emphasis placed on each element differs widely as between banks.

While credit standards differ widely, bankers insist that the borrower use the loan proceeds for conducting the normal operations of his business and not for the purpose of acquiring commodities against a speculative price rise. Consequently they seek to determine whether the loan fulfils a genuine economic function, such as enabling the borrower to take advantage of quantity discounts, to accumulate inventory in order better to plan production schedules, to purchase necessary supplies at low off-season prices, or to take advantage of low transportation costs. With respect to the character of the warehoused commodity, some banks limit their loans to raw materials for which a ready market exists; other banks will lend against deposits of finished or semifinished goods provided the borrowing concern has non-cancellable orders for the merchandise; still others operate under neither requirement. Where loans are made against field warehoused stores of staples such as sugar, cotton or grain, a banker may occasionally require the borrowing concern to "hedge" its purchases of raw materials if there is a "futures" market for them or for products made from them.

After a banker has satisfied himself that his credit standards are met, he "sets up" a field warehouse receipt financing arrangement by (1) establishing a maximum line of credit on the basis of his analysis of the borrowing concern's financial statements, and (2) fixing the percentage that the amount of funds advanced at any time will bear to the value of the field warehouse receipt collateral.

The percentage advance is a risk-controlling factor of prime importance, because it determines the bank's "margin of safety" or excess of collateral value over outstanding loan balance. Other factors being held constant, the percentage advance will be larger, the broader the market for the warehoused commodity, the smaller the degree of its price fluctuation, the less the normal rate of its deterioration in value during storage, and the smaller the maximum credit line granted the borrowing concern in relation to its financial strength. The majority of field warehouse receipt loans involve percentage advances of between 65 and 85 percent. The percentage advance is usually expressed in terms of market price if there exists a broad market for the warehoused commodity; otherwise it may be expressed in terms of the cost of the commodity to the borrower.

The total cost of credit secured by field warehouse receipts consists of the warehouseman's charge for installing and for operating the field warehouse plus the lender's charge for funds advanced. Field warehousing companies ordinarily charge a minimum annual amount of $350 to $600 for installing a warehouse, plus a specified percentage of the value of deposits or the amount of credit secured by the depositor. The field warehouseman's total fee, expressed as a percent per annum of the amount of credit procured by the borrower depends largely on the size of the operation. It will ordinarily run around 1½ or 2 percent of the loan but on a very large loan may be as little as ¾ of 1 percent. Costs above 2 percent of the credit obtained would be involved where loans are relatively small. Because of the minimum charge, loans to business enterprises of under $10,000 generally are not economical even though the cost of this credit may be lower than if the funds were procured on any other basis. Some field warehousing companies will not establish warehouses in locations where the average value of deposits is less than this amount, unless the costs of operating the warehouse are exceptionally low by virtue of location close to the warehouseman's headquarters or other factors. There is great variation in the effective annual interest rate charged by commercial banks on field warehouse receipt loans, depending upon the size of the loan, the financial strength of the borrower, the nature of the warehoused commodity, and other factors. The majority of loans appear to carry rates from 3½ to 6 percent. The aggregate costs of field warehouse receipt credit to business concerns ranged in mid-1941 from as little as 4 percent to as much as 10 percent.

In the present study no effort has been made to collect data describing the impact of war upon the volume of field warehousing, or to predict the place of this financing technique in the postwar years. But a few observations of a general character may be made on these subjects.

During the years 1941 and 1942, expanding levels of production and rising prices were accompanied by larger physical inventory holdings on the part of business concerns. This factor, plus the enormously expanded production programs of thousands of small war contractors and subcontractors possessing slender working capital, definitely raised the demand for field warehousing service. Many concerns began financing themselves through the use of warehouse receipts arising from the storage of goods within their premises, both because their inventories were larger than they were accustomed to carry and because their working capital requirements for payrolls, taxes and other purposes were swollen beyond traditional levels. On the other hand, new sources and methods of obtaining governmental and banking funds were opened to such producers, including advance payments and progress payments by the Federal government on war contracts and Regulation V loans. These developments prevented the demand for credit secured by field warehouse receipts from expanding to the limits it would otherwise have reached.

Apparently, the volume of field warehouse receipt financing began to decline around the end of 1942 and the beginning of 1943. This may probably be attributed to the declining inventories of materials in the hands of producers and distributors, as the war production program mounted toward its peak, and to the growing availability of credit on other terms and arrangements. No attempt has been made herein to assess the strength, or to predict the duration, of the forces shaping this trend.

It appears reasonable to postulate that in the period of postwar reconversion the factors which caused field warehouse receipt financing to expand during the prewar years will continue to operate. This hypothesis seems especially tenable if the postwar era is one of high levels of production and is characterized by the rejuvenation and growth of new and small business enterprises.