

This PDF is a selection from an out-of-print volume from the National Bureau of Economic Research

Volume Title: Financing Inventory on Field Warehouse Receipts

Volume Author/Editor: Jacoby, Neil H. and

Volume Publisher: UMI

Volume ISBN: 0-870-14134-1

Volume URL: <http://www.nber.org/books/jaco44-1>

Publication Date: 1944

Chapter Title: Nature And Development Of Field Warehousing

Chapter Author: Neil H. Jacoby, Raymond J. Saulnier

Chapter URL: <http://www.nber.org/chapters/c4017>

Chapter pages in book: (p. 9 - 18)

*Nature and Development
of Field Warehousing*

THE PAST DECADE HAS WITNESSED a signal growth of certain techniques for introducing working capital into business enterprises. Loans made on the security of field warehouse receipts represent one of these developing techniques which are being utilized by commercial banks, commercial finance companies, the Reconstruction Finance Corporation, the Federal Reserve banks and other grantors of business credit. Like term lending, accounts receivable financing and instalment financing of commercial and industrial equipment, loans secured by field warehouse receipts are a dynamic phase of commercial bank relationships with business enterprise.

Although these credit devices emerged prior to the depression of 1929-32 (some indeed having had a comparatively long history in American finance), it is clear that each of them expanded in both absolute and relative significance under the depression and recovery conditions of the 1930's. This strongly suggests that powerful influences have tended during the past ten years to alter the conditions of demand for working capital. Field warehouse receipt loans, like the other developing types of business credit, may be conceived as adaptations to changes in the character of the market for business credit, both on its demand and supply sides.

Loans secured by field warehouse receipts have attained wide use as a means of introducing credit into two types of business enterprises: first, businesses whose financial strength is regarded as too limited to permit lending institutions to grant them adequate financing on an unsecured basis; second, business concerns whose operations are characterized by large seasonal variations, giving rise to working capital requirements that fluctuate widely through each year. An adequate explanation of field warehouse

receipt financing requires an initial understanding of the nature of the field warehouse, and of the techniques of installing and operating it.

Definition of Field Warehousing

As the term is ordinarily used, "field warehouse" simply means a public warehouse established by a bona fide public warehouseman on the premises of a business concern for the purpose of acquiring custodianship of commodities owned by that concern. Field warehouses are distinguished from "terminal" or other "public" warehouses in two respects: first, the field warehouse exists only for the purpose of receiving deposits of commodities belonging to a single depositor;¹ second, the warehouse is physically located on the premises of the depositor.² The field warehouse is "brought to" the commodities, in contrast to the terminal warehouse, to which commodities are transported for deposit.³

The purpose of establishing a field warehouse under the custody of a public warehouseman is invariably to enable the warehouseman to issue warehouse receipts, which may then be used by the concern depositing merchandise in the warehouse as collateral security for a loan. In effect, field warehousing enables the depositor to make "bankable" his inventories of raw materials, semi-processed, or finished goods. The warehouse receipt acquired by the lender as a result of the establishment of a field warehouse on the borrower's premises conveys to the lender legal title to the goods, providing the field warehouse has been properly established, and thus increases the assurance of the lender that the loan will be repaid.

The basic economic function of field warehousing can be more

¹ Because the field warehouse is at law a public warehouse, the contract between warehouseman and depositor cannot stipulate an exclusion of other depositors. But it would be very unusual for other depositors to utilize a field warehouse, as a matter of practice.

² On occasion, a field warehouse may be set up on premises other than those of the borrower; an illustration would be a warehouse set up for a trade supplier on the premises of the supplier's customer. Title still rests in the supplier's hands, but it is convenient to store the property, pending transfer of title, at the place of business of the buyer. Such instances are uncommon, however.

³ In the present work, "depositor" refers to a business concern borrowing on the security of field warehouse receipts, and "deposit" means merchandise placed within a field warehouse. The context in which these terms are used should prevent any confusion with depositors of money in banks, or bank deposits.

adequately appreciated by asking in what other ways a lender might limit his risk of loss in extending credit to a borrower possessing a stock of commodities. There are, in theory, several alternatives. In the first place, a lender might take a chattel mortgage on the commodities. This would require that the commodities be meticulously described in the mortgage instrument, that the mortgage be recorded according to the laws of the state wherein it was created, and that any substitution of new units of merchandise for old units be made with the express permission of the mortgagee. In the case of constantly changing stocks of merchandise the cost and inconvenience of this procedure makes it impractical.⁴ Another device would be for the borrower actually to pledge the commodities to the lender by physically placing them in the hands of the lender. However, the lender generally has no storage facilities and would be obliged to place the merchandise in a public warehouse. If the merchandise were placed in a terminal warehouse remote from the place of business of the borrower, the pledged commodities could not be quickly drawn upon for processing or sale, and important handling difficulties would arise in quickly disposing of or replenishing these goods.

Still another device is the trust receipt. The borrowing concern might convey to the lender a security interest in the merchandise, giving the lender a trust receipt acknowledging that the borrower takes possession of the property as trustee for the lender. While a trust receipt transaction conveys good title to the holder as against third parties without recording individual receipts, the practical problems facing a banker holding trust receipts in case of bankruptcy of his borrower are extremely difficult. Goods can only be recovered if they can be identified by the lender. Identification is extremely difficult, and sometimes impossible, in cases where the trust receipt goods are mixed with other goods in the products of the borrower, or in cases where other lenders also hold trust receipts of the borrower.⁵

⁴ See Anthony Kane, "The Theory of Field Warehousing," *Washington Law Review*, Vol. XII (January 1937) p. 20.

⁵ See Karl T. Frederick, "The Trust Receipt as Security," *Columbia Law Review*, Vol. XXII (1922) p. 395; *Concerning Trust Receipts* (American Acceptance Council, New York, 1930); and *Uniform Trust Receipts Act*, adopted by several states. The Uniform Trust Receipts Act provides that a notice of intention to do business through the medium of trust receipts shall be filed or recorded with the Secretary of State or other appropriate officials.

The field warehouse receipt overcomes these difficulties. Under the conditions in which it is used effectively, it gives the lender a security interest in goods superior to that afforded by the chattel mortgage or the trust receipt. From the standpoint of the lender, legal title in the goods is unquestioned if the field warehouse is properly established and maintained. From the standpoint of the borrower, facilities can be provided for the convenient deposit and withdrawal of goods for processing or sale, a condition which may be essential to the proper conduct of the business. Under many conditions, therefore, the establishment of a field warehouse may be the least costly method of enabling a business concern to obtain credit and to carry on productive operations that would otherwise be impossible. In addition, field warehouses may be set up to effect savings in storage rates or to avoid costs of transporting goods to a public terminal warehouse. It should be pointed out, however, that there are numerous practical problems of operating field warehouses that must be faced and solved before lenders can feel complete assurance in making advances against warehouse receipts.

Organization of Field Warehousing

American commercial banks have long extended credit to business enterprises on the security of inventories or stocks of commodities. Only within comparatively recent years, however, have loans been made extensively on the security of field warehouse receipts. The business of field warehousing appears to have developed in the United States after the turn of the twentieth century. During the nineteenth century, isolated loans were made against the collateral security of commodities warehoused at the borrower's place of business; but the evidence suggests that such transactions were quite rare, and that the field warehouses were not established by concerns *specializing* in this type of service. It is known that field warehouses were established thirty or more years ago by a number of national banks having charters considered to be broad enough to give them the right to do this business. The warehouses were established in order to give the banks possession of inventories securing their own loans.

At the present time, field warehousing is conducted in the United States by two broad classes of companies. First, there

are a few comparatively large independent field warehousing companies, whose operations extend over the entire nation or over broad regions. Second, there are many small local concerns, each operating a few field warehouses as an adjunct to a terminal warehousing business. For convenience the first group will be referred to as "national or regional" and the latter group as "local" field warehousing companies. The majority of field warehousing companies, national, regional and local, appear to have entered the field as an outgrowth of their occupations as operators of public terminal warehouses. Even today the majority of companies engaging in the installation of field warehouses also operate terminal warehouses through other divisions of the business, or through affiliated corporations.

William H. Banks Warehouses, Inc. was organized in 1891, and was among the first organizations in the United States to install field warehouses for the purpose of creating bankable collateral. It is said to have issued field warehouse receipts as early as 1892. All operations of the company are conducted from the headquarters in Chicago, although the concern is licensed as a warehouseman and operates in the Central, Southwest and Northwest regions.

Douglas-Guardian Warehouse Corporation was formed in 1932, when the Douglas Public Service Corporation of New Orleans purchased the warehousing business of the Guardian Warehousing Company. Guardian Warehousing Company, initially known as Warehouse Securities Corporation,⁶ had been organized in 1926, and operated metropolitan public warehouses as well as field warehouses. During 1932 it divested itself of interests in metropolitan public warehouses and thereafter specialized in field warehousing. Douglas-Guardian restricts its activities to independent custodianship or third-party bailment, and does not make loans against the merchandise deposited by its clients. It operates nationally through 15 regional offices.

The Haslett Warehouse Company was incorporated in 1898, consolidating the warehouse operations of three companies. It

⁶ This company had been organized by a large number of warehousing companies for the purpose of lending money to their depositors. It was owned and controlled by the constituent companies, and was established for the purpose of keeping the lending of money separate from the warehousing function.

does a general warehousing business and operates field warehouses mainly in the State of California. The general office of the company is in San Francisco, with branch offices in five other California cities.

One of the oldest companies to develop the field warehousing branch of the warehousing business on a national scale is Lawrence Warehouse Company. This company is a wholly owned subsidiary of Lawrence Warehouse Corporation,⁷ other subsidiaries of which operate public warehouses in San Francisco and Oakland, California. Lawrence Warehouse Company originated its field warehousing operations in the food canning industry of California about 1910; thereafter its operations were gradually extended to the Central States, and later to the Atlantic Coast region. An office was established in Chicago during 1926, and one in New York during 1935. At the middle of 1941, Lawrence Warehouse Company maintained offices in 22 cities of the United States and in Honolulu, and was operating field warehouses in 44 states. Its warehouses were chiefly concentrated on the Pacific Coast, in the Great Lakes district and on the Eastern Seaboard.

New York Terminal Warehouse Company was organized in 1936 as a subsidiary of Terminal Warehouse Company. The parent company was primarily a terminal warehouse operator, but it had also functioned as a field warehouse company for a number of years. In 1939, New York Terminal Warehouse Company was purchased by St. Paul Terminal Warehouse Company, continuing to operate as a separate corporate enterprise. New York Terminal Warehouse Company's field warehousing business has been mainly in the territory east of the Mississippi River.

St. Paul Terminal Warehouse Company was founded in 1916 and is a large operator of terminal storage in the Twin Cities. Since 1926 it has been actively engaged in field warehousing, mainly through the north central and northwestern states. Its operations are conducted through regional offices in six principal cities of this area. In 1938 the company purchased the field warehousing business of the Hansen Storage Company of Milwaukee, which operated throughout Wisconsin. As indicated above, it acquired the New York Terminal Warehouse Company in 1939.

Terminal Warehouse Company of Baltimore began business in

⁷ See Moody's *Industrials* (1940) p. 1468.

1896 as a metropolitan terminal warehouse operator. Later it branched out into field warehousing in order to meet the demands of numerous small canning companies operating in the Atlantic Seaboard states. Terminal Warehouse Company of Baltimore has consistently made loans to its depositors. It is worth noting that while the Company serves small canners by establishing field warehouses for their inventories, it also creates bankable collateral for these concerns through storage of their canned goods in its terminal warehouses.

Factors Affecting Growth

Available data indicate that the number of field warehouses in operation in the United States has risen steadily during the past two decades, and that the annual increase in the magnitude of field warehousing operations has been greatest during the past decade.⁸ It is necessary to look both to the supply and demand sides of the market for field warehousing services to explain what is apparently a marked secular growth at an increasing rate. On the demand side of the market, the following factors appear to be salient.

First, the protracted depression following 1929 produced operating losses that diminished the working capital positions of many firms.⁹ As a result they were no longer able to obtain their requirements of credit on an unsecured basis, and they resorted to the pledge of inventories, as well as other assets, as a method of circumventing this difficulty.

Second, the growing weight of corporate taxation, especially since 1935, has impaired the ability of concerns to build up net working capital through the retention of earnings, and thus

⁸ In an article in *Burroughs Clearing House*, Vol. II, No. 20 (July 1936) entitled "A Better Look at Field Warehousing," Arthur Van Vlissingen, Jr. stated that there were about 300 field warehouses in use in the United States in 1926, whereas by 1936 there were perhaps as many as 3,000 warehouses. The author does not cite the source of this information. Professor John H. Frederick stated in an address made during 1938 that "The number of field warehouses has increased from about 250 in 1926 to more than 5,000 today, according to the latest estimates, and is steadily growing." Here again no source of information is cited. See *Proceedings of First Educational Conference of Texas Bankers Association* (Austin, Texas, 1938).

⁹ Evidence of this fact with respect to small corporations is contained in Charles L. Merwin's, *Financing Small Corporations in Five Manufacturing Industries, 1926-36* (National Bureau of Economic Research, Financial Research Program, 1942) pp. 5, 86.

increased their dependence upon financial institutions for funds wherewith to carry on business operations during a period of expansion.

Third, the national defense and war production programs after 1939 caused business concerns to seek funds wherewith to finance expanded holdings of inventories.¹⁰ The desire to hold larger inventories has been engendered in many cases by threatened shortages of raw material.

Fourth, the differentials between cash prices and time prices for a great variety of materials appear to have become *relatively* more important during recent years. Cash discounts have long been an important feature in the American economy. While there is no evidence that they have widened in absolute terms, they have become larger relative to the cost of borrowed money to business concerns, as a result of sharp reductions in the whole structure of interest rates during the past decade. Therefore, there have been widening opportunities for loans profitable to borrowers, because credit enables the debtor concern to save more through taking cash discounts on its purchases of inventories than the amount of the costs of the credit, including the costs of establishing and operating field warehouses. Closely allied to this is the use of field warehousing as a result of more general purchasing in carload lots to capture the advantage of lower freight rates.

Fifth, there is evidence that the relatively rising costs of labor as a factor of production, resulting partly from the vigorous growth of the trade union movement in the United States, have made it more profitable for business managements in some industries to stabilize production rates throughout the year. In this way they are able to reduce, or to minimize increases in labor costs by retaining valuable employees and building up a more competent and better-satisfied operating personnel. But since sales of the product continue to display seasonal fluctuations, this means that, during certain seasons, production goes to build inventories. Field warehousing of these inventories is a method whereby many concerns can secure credit to carry on productive activity during dull selling seasons.

Turning to the supply side of the market, the following factors

¹⁰ See *Federal Reserve Bulletins*, 1939-42, for indices reflecting an upward trend in business inventories.

appear to have increased the willingness of commercial banks and other lending institutions to make loans on the security of field warehouse receipts:

First, the banking crisis of 1931-33 caused bankers to set higher credit standards during the period of business expansion following 1933. This attitude was, in part, heightened by the policies and procedures of bank supervisory authorities. Consequently, in making loans to small or medium-sized enterprises, or enterprises with mediocre financial strength, bankers tended to request liens upon specific assets in order to increase the probability of repayment. The field warehouse receipt was a type of specific security that enabled many businesses to make their inventories of raw materials or finished goods "bankable."

Second, the successive adoption by many states of the Uniform Warehouse Receipts Act, taken in conjunction with several judicial decisions clarifying the legal character of the warehouse receipt as a security device, made lenders more certain of their position in extending credit collateralized by warehouse receipts, and augmented their willingness to engage in such credit transactions.

Third, the promotional program of the field warehousing companies resulted in acquainting many commercial bankers with the nature of, and the opportunities inhering in, this basis of lending. This factor must be credited with exerting a real influence on the expansion of the supply of such credit.

In a larger sense, the growth of field warehousing as a device for facilitating the introduction of credit into businesses of small and medium size may be viewed as a part of a significant transition in American banking. The essence of this transition is a movement toward lending against specific collateral, with the lender looking toward the value of the collateral as well as toward the earning power of the business to liquidate the loan. Other manifestations of this trend are the steady growth of accounts receivable financing and the growth in instalment financing of commercial and industrial equipment for small and medium-sized enterprises.

Collateral loans are not new in American banking, but the variety of collateral is increasing and the number of different kinds of business enterprises borrowing on a collateral basis appears to be rising. One factor that aids in explaining this ex-

pansion is the permission given to banks by the National Bank Act and the banking laws of many states to increase the amount of credit that may be granted to an individual borrower where warehouse receipts are taken as security. Under these laws, unsecured loans to individual borrowers are usually limited to specified percentages of the capital funds of the lending banks, but credit may be extended, either without limit or to the extent of much larger percentages of capital funds, if collateralized by warehouse receipts.