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Nature and Scope of Industrial Lending

THE field of consumer credit described as "industrial lending" has no fixed limits, and the institutions it encompasses—here called industrial banking companies—operate under a wide variety of names.[1] The initial problem, then, is to formulate a definition which will describe the agencies and at the same time distinguish them from others operating, in some respects, along similar lines. For the purposes of the present study, an industrial banking company is held to be an institution which extends consumer loans repayable on an instalment basis, and obtains at least part of its working funds from the acceptance of deposits or the sale of investment certificates. This definition will be adhered to throughout the discussion, and since it may appear to some readers too arbitrary or too restrictive, and to others too comprehensive or too indefinite, it is advisable to summarize the considerations which have governed its adoption.

THE PROBLEM OF DEFINITION

It is impossible to mark off the field of industrial lending simply by including in it only those agencies which call themselves "industrial banks." Such a procedure would exclude many companies which because of legal restrictions cannot employ the term "bank" in their corporate titles.

[1] In addition to "industrial bank," the names most frequently encountered are "industrial loan company," "industrial savings and loan company," "finance and thrift company" and "discount company."

Nor would the presence of the term "Morris Plan" in the title of an institution be a sufficient criterion. All banking companies in the Morris Plan system—which will be described below—come within the scope of the present study, but that system does not include a growing number of agencies which perform similar functions though they are entirely unconnected with this group of companies. Moreover, there are a few firms which are affiliated with the Morris Plan system, in the sense that they have paid the requisite general franchise fee to The Morris Plan Corporation of America for the right to do business as a Morris Plan institution in a certain specified territory, yet do not exercise the privilege of using the name "Morris Plan" in their corporate titles.

Even less satisfactory than the title of a firm, as a basis for a definition of an industrial banking company, is its legal status. As will be shown more fully in Chapter 2, the laws under which such companies operate vary markedly from one state to another. In some states, for example, companies engaged in industrial lending are chartered as state banks, in others they operate under the law which applies to small loan companies. A large number of states have provided special statutes for industrial banking companies. Some laws expressly forbid the inclusion in the firm name of the word "bank," and also prohibit the taking of deposits.

Thus within the field designated as "industrial lending" there is a wide assortment of institutions, ranging from firms which are "banks" in every sense of the word and differ from commercial banks only in that they deal principally in consumer instalment loans, to agencies which are almost indistinguishable from personal finance companies.

Since neither terminology nor legal status constitutes a workable criterion of an industrial banking company, it is only from a functional point of view that an institution can be classified as belonging to this separate and distinct group of consumer credit agencies. In other words, its inclusion in this category depends not on its name or on the legal conditions under which it operates, but on the sources of its working funds and the character of its lending activities.

Industrial banking companies have two main functions: they act on the one hand as savings or thrift institutions and on the other as consumer lending agencies. The first of these functions is the best identifying characteristic, for such companies have traditionally emphasized their services as thrift institutions. Where the law under which they operate denies them the deposit-taking privilege, they resort to the sale of what are called instalment or investment certificates. These, in practice, are generally cashable on demand and always, of course, carry a rate of interest or return for the company's use of the funds. It is the thrift or savings feature which distinguishes industrial banking companies from both personal finance companies and sales finance companies, but it is the lending feature which sets them apart from other banking institutions, for the assets of the industrial banking company are invested predominantly in loans of relatively small size, made largely to individuals for consumption purposes and generally repayable in regular periodic instalments.

It is possible, therefore, to regard industrial banking companies as a group of firms which acquire part of their working capital through the taking of deposits or the sale of instalment or investment certificates, and use their funds primarily by granting loans to consumers repayable on an instalment basis. As has already been noted, however, the group is far from homogeneous, and under the pressure of competition the agencies which go to make it up tend to expand their operations in all directions in order to obtain additional business.

SYSTEMS OF INDUSTRIAL BANKING COMPANIES

Industrial lending has grown to its present importance over a period of approximately thirty years, during which time a number of organizations of varying degrees of stability have acted as promotional agencies in the establishment of this type of institution. A large proportion of the firms now in existence were established as parts of a system of companies, and many currently independent units owe their inception and growth mainly to the promoters of group systems.

The Morris Plan System

The most important system, with regard to both quantitative importance and continuity of existence, is the Morris Plan group. The first of the Morris Plan companies, the Fidelity Savings and Trust Company, was established in 1910 by Arthur J. Morris at Norfolk, Virginia. The new institution proposed to lend money to persons employed in industry (hence the name "industrial" loan), on the security of the borrower's income and the endorsement of two or more comakers; this policy is commonly expressed as a willingness to lend on "character and earning power." It also proposed to acquire some of its working funds by selling investment certificates which might be paid for, if the purchasers desired, on an instalment basis. This scheme, while unusual in the United States, had much in common with the program of certain institutions in Europe, notably the Schulze-Delitzsch, Raiffeisen and Luzzatti banks. In 1911 Mr. Morris copyrighted the "Morris Plan," and initiated an active program of expansion aimed at the establishment of Morris Plan companies in large cities throughout the country.[2]

[2] Subsequent legal decisions denied the right to sole ownership of this type of lending to any person or corporation. See Louis N. Robinson, "The Morris Plan" in *American Economic Review*, vol. 21, no. 2 (June 1931) pp. 227-29, for a discussion of the litigation involved.

A measure of the rapidity with which this movement spread is available only in a record of the opening dates of companies now in existence.[3] Of the 94 companies (exclusive of branches) functioning at present, 71 were established in the seven-year period 1911-17. During this period companies were started in such large cities as Atlanta, Baltimore, New York, St. Louis, Albany, Cleveland, Boston, Minneapolis, San Francisco, Philadelphia and Detroit, as well as in smaller cities. After 1917 the system continued to expand, although more slowly. The growth of the Morris Plan system appears to have been affected considerably by domestic and international conditions. The development was gradual until the outbreak of the war in 1914; then the system expanded rapidly until the United States' entrance into the conflict. Of the companies now in existence few were formed in the immediate postwar period, but between 1921 and 1930 there was a steady rise. None of the present companies was established in 1931 or 1932, and only a few from 1933 to 1938. A number of the participating companies have opened branches in other cities; this development occurred especially in the period 1925-30, when 13 of the 25 branches now in existence were formed.

Efforts to establish more Morris Plan banks and companies are apparently continuing, for a recent report discusses the preparation of a new franchise and operating contract, and expresses the hope that the formation of new companies may result from this move.[4] At the present time 14 of the 94 Morris Plan banks and companies do not make use of the term Morris Plan in their titles, and at least one large company, the Personal Loan and Savings Bank in Chicago, has dropped out of the system altogether.

The methods employed in the extension of the Morris

[3] *Official Directory of Morris Plan Banks and Companies* (1938), issued by the Morris Plan Bankers Association, Washington, D. C.

[4] Industrial Finance Corporation, *Annual Report to Stockholders,* for the year ended January 31, 1936, p. 3.

Plan system were at first relatively simple. Mr. Morris and his associates made contacts with outstanding business and civic leaders in the various cities, formed a corporation under the legal conditions most nearly applicable to this particular type of institution, sold stock in the company and served in an advisory capacity in regard to techniques of organization and operation. After a time a more highly systematized scheme of expansion was worked out, through the Industrial Finance Corporation.

In 1912 Mr. Morris had formed the Fidelity Corporation of America, with an authorized capital of $300,000, and by 1914 this corporation had established 9 Morris Plan companies in southern states. Its assets were taken over by the Industrial Finance Corporation, formed in the latter part of 1914 with an authorized capital of $7,000,000 and a subscribed capital of $1,500,000. The function of the Industrial Finance Corporation was to present and explain the Morris Plan in each city for which it contemplated a new company, to enlist the active interest of prominent citizens, to organize and train the local staff and to furnish necessary accounting records and information. It subscribed for 25 percent of the capital stock of the local company and received in return a cash fee of $10 for each share of the total stock; in addition, of course, it participated in the earnings of the company to the amount of its paid-up stockholdings.

At the present time the Industrial Finance Corporation is the parent body of a complicated corporate system. It has direct control, through stockownership, of The Morris Plan Corporation of America, the Industrial Acceptance Corporation, the Industrial Realty Shares, Inc., and the North American Funding Corporation; it has indirect control, through The Morris Plan Corporation of America, of a number of Morris Plan banks and companies and The Morris Plan Insurance Society.

The Morris Plan Corporation of America is the most important of these subsidiary companies. When it was formed in 1925 it acquired the Industrial Finance Corporation's rights, patents and interests in the extension of the Morris Plan, and it is now the licensor of all existing Morris Plan banks and companies. In some of them it owns stock, either directly or indirectly through a wholly owned subsidiary, the Industrial Bancshares Corporation; in its annual report to stockholders for 1938 The Morris Plan Corporation of America stated that it owned approximately one-fourth of the total outstanding stock of Morris Plan banks and companies. This does not mean that it controls one-fourth of all these organizations. In 1937, according to its report for that year, it held controlling stock interest (directly or indirectly) in 15 companies, including those in New York, Philadelphia, Richmond, Washington, D. C. and Boston, and minority stock interest in 50 others; there were in that year 29 Morris Plan banks and companies, exclusive of branches, with which it was not connected through stock-ownership.

The Morris Plan Corporation of America, and its wholly owned subsidiary, Industrial Bancshares Corporation, derive their income mainly from dividends on stockholdings in Morris Plan banks and companies. Out of a total income for 1938 of $486,212, this source provided $441,788, and $36,962 came from "services to Morris Plan Banks and Companies."[5] Presumably the latter income arises largely from the general franchise fees paid by local banks and companies, and from payments for auditing services.

Industrial Bancshares Corporation was formed in 1927 as the Morris Plan Shares Corporation; its present title was adopted in 1929. When this corporation was organized the Industrial Finance Corporation had large liabilities which had been incurred in order to finance investments in Morris

[5] The Morris Plan Corporation of America, *Annual Report to Stockholders*, for the year ended December 31, 1938.

Plan banks and companies. The new corporation took over these stockholdings, making payment for them out of the proceeds of a sale of 6 percent bonds maturing in 1947 and by delivering to the Industrial Finance Corporation its entire authorized capital stock. At the present time $2,917,500 of these bonds are outstanding.[6]

In addition to holding a large interest in Morris Plan banks and companies, the Industrial Finance Corporation has branched out into three other fields, mortgage financing, time-sales financing and industrial loan insurance. In 1926 it organized a company, under the name of General Bond and Share Corporation, which acquired the assets and business of the Puritan Corporation and the Realty Acceptance Corporation. The Puritan Corporation had been engaged in underwriting first mortgage real estate bonds, the Realty Acceptance Corporation in the financing of second mortgages. These two companies were taken over through an exchange of stock which resulted in the Industrial Finance Corporation's acquisition of more than 50 percent of the common stock of General Bond and Share. The latter was in turn absorbed in 1930 by Industrial Realty Shares, Inc., a Delaware corporation organized for this purpose and also controlled by Industrial Finance Corporation.

In 1928 another company, the North American Funding Corporation, was organized, this too controlled by the Industrial Finance Corporation. The aim of the North American Funding Corporation was to extend amortized first mortgage loans on residential property to the customers of Morris Plan banks and companies. The corporation was to lend up to 75 percent of the appraised value of the property, and it could then pledge up to 60 percent of the value of the property as security for its bonds; the balance of the mortgage was purchased as a junior lien by the Realty Acceptance Corporation.

[6] *Ibid.,* for the year ended December 31, 1939.

The operations of the North American Funding Corporation were financially successful until the collapse of real estate values in 1929-30. In the following period the corporation gradually liquidated its holdings at substantial loss, and suspended new financing. By 1933 it was repurchasing at prices "materially below their par value"[7] the $3,000,000 of bonds issued in connection with its financing. This process was financed in part by a loan of $525,000 from the Reconstruction Finance Corporation, which was fully repaid during 1935, and in part through "the conversion of mortgages into Home Owners Loan Corporation bonds and the subsequent sale of these bonds."[8] The fact that during the year 1937 the North American Funding Corporation wrote off $617,713 in assets[9] provides some indication of the loss sustained by the company as a result of its venture into real estate financing. By the end of 1938 the corporation had reduced its bonds outstanding to $195,900, and its assets amounted to only about $650,000, of which some $425,000 was the equity of the Industrial Finance Corporation.[10]

It may be observed that the same annual report of the Industrial Finance Corporation, which notes this reduced position of the real estate financing subsidiary, states that the relation of net earnings to capital, surplus and undivided profits for 86 identical Morris Plan banks and companies had increased from 11.5 percent in 1929 to 13.0 percent in 1938. These strikingly divergent records, both based on financing activities in the general field of consumer credit, may be reconciled by the fact that Morris Plan banks and companies participated only slightly in this program of real estate financing.

The second direction in which the Industrial Finance Cor-

[7] Industrial Finance Corporation, *Annual Report to Stockholders,* for the year ended January 31, 1933, p. 3.
[8] *Ibid.,* for the year ended January 31, 1931, p. 3.
[9] *Ibid.,* for the year ended January 31, 1938, p. 4.
[10] *Ibid.,* for the year ended January 31, 1939, p. 4.

poration expanded its consumer financing activities was in the discounting of time-sales contracts. In 1924 the Industrial Acceptance Corporation was formed, and this company, which was controlled through stockownership by the Industrial Finance Corporation, took over the sales financing business formerly handled by the Automobile Division of the parent corporation. The Automobile Division had concentrated mainly on financing sales of Studebaker cars, and for some time this continued to be true of the new company. From May 21, 1919, to May 1, 1928, the Studebaker Corporation had formal arrangements, first with the Industrial Finance Corporation and later with its subsidiary, the Industrial Acceptance Corporation, providing for wholesale and retail financing of sales,[11] but in its annual report for the year ended January 31, 1929, the Industrial Finance Corporation stated that its subsidiary had diversified its activities and was no longer "dependent upon one contract with a single manufacturer." During the year 1928 Industrial Acceptance Corporation acquired from General Electric Company the capital stock of General Contract Purchase Corporation and its affiliates. The general program of sales financing was described as follows in the annual report of Industrial Finance Corporation for the year ended January 31, 1930: "Whenever Industrial Finance Corporation owns a controlling interest in a Morris Plan Bank or Company, local subsidiaries of those companies carry on the business of installment financing, rediscounting their receivables where necessary with Industrial Acceptance Corporation . . . Emphasis is being laid throughout our whole system on handling the financing for the sale of General Electric refrigerators and other products under a national arrangement with the General Electric Company."

During this same period a most pretentious plan was an-

[11] Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) (76th Congress, 1st Session, House Document No. 468) p. 817.

nounced, in which Industrial Acceptance Corporation was to participate. Under this program Industrial Finance Corporation was to organize "a system of banks covering all the important cities of this country, to extend to the public every form of industrial banking service."[12] This system of industrial banking companies was to operate through 22 regional companies; it provided for the inclusion of companies currently controlled by Industrial Finance Corporation and for the organization of many more so-called "member banks." The plan was mentioned again in the report for the year ended January 31, 1930, but was never actually put into operation.

Even the relatively modest Industrial Acceptance Corporation failed to withstand the post-1929 years. In 1931 arrangements were completed with Commercial Credit Company whereby that corporation was to take over the instalment financing business previously transacted by Industrial Acceptance Corporation in cities where no controlled Morris Plan company was located. This meant, of course, a very drastic reduction in the field of operations of the Industrial Acceptance Corporation. At the end of 1933 the acceptance business was being liquidated and no new business was being sought. A plan for the Industrial Acceptance Corporation to go into the small loan business, presumably on a large chain basis, was announced in 1935, but no further developments were forthcoming and by 1939 the company was virtually inactive.[13]

A far more successful venture of the Industrial Finance Corporation has been its connection with the insuring of loans extended by Morris Plan industrial banking companies. This business was developed through the formation, in 1917, of The Morris Plan Insurance Society, controlled through

[12] Industrial Finance Corporation, *Annual Report to Stockholders,* for the year ended January 31, 1929, pp. 4-5.
[13] *Ibid.,* for the year ended January 31, 1939, p. 5.

stockownership by The Morris Plan Corporation of America. The purpose of the society is to offer the group life insurance service commonly associated with the extension of credit to consumers. Although the real estate and time-sales financing activities initiated by Industrial Finance Corporation failed to withstand depression strains, the record shows that The Morris Plan Insurance Society, deriving its business from the local industrial banking companies, has remained remarkably stable. In fact, it has enjoyed a considerable rise in business, and rather steady and substantial earnings. In the twenty years from 1917 to 1937 its policies mounted in number from 1,432 to 250,765. At present the society is licensed to do business in 28 states, including New York.

Other Systems

During the period when Industrial Finance Corporation was setting up Morris Plan banks and companies, other organizations, and also individuals, were establishing similar systems. One of these, the Wimsett System, extended from the east coast to Honolulu; the others were for the most part regional in their operations. Thus the Hood System companies were confined largely to North Carolina, the Morgan Plan companies to Alabama and other southern states, the Peoples Finance and Thrift companies mainly to California, the Community Savings and Loan companies to Pennsylvania, the Thrift companies also to Pennsylvania, and the Citizens System companies to the midwestern states. None of these systems has survived to the present time, however. Many of the component companies failed, and some were merged with other companies. Those still in existence now operate independently of any system but many of these have retained the name of the system under which they were originally formed, although there is no formal relationship between units.

The methods by which these companies were set up varied only in detail. In general, it appears that the organizers were interested mainly in promotional gains, and withdrew after the companies were established. They would merely introduce the plan in a chosen city, help raise capital, train the staff of the new company and supply certain materials for the keeping of operating records. In a few cases the promoters retained stockownership, but generally they were compensated by a flat fee, or a fee related to the volume of loans made by the new company in the first year or two of operation. Where the promotional group received stock the local company often reserved the right to buy it back at a stipulated price, and where this procedure was followed a commission was received on the whole stock flotation.

In recent years two other systems of industrial banking companies have been organized along somewhat different lines. One of these, Southeastern Industrial Bankers, Inc., was founded in 1930 and now operates 14 companies in Maryland, the District of Columbia, Virginia and West Virginia. The parent organization has control of these companies, through stockownership, and supervises their operation.[14] Capital for the enterprises is raised by Southeastern Investment Company. The second of the new systems, Industrial Finance and Thrift Corporation, was established in Louisiana in 1930 as "an outgrowth and expansion of the business of the D. M. White Company, Inc., of Jackson, Mississippi."[15] At the present time there are 10 White System companies, located in Louisiana, Mississippi and Tennessee. They act in their own localities as agents of Industrial Finance and Thrift Corporation, endorsing and guaranteeing collection on consumer loans extended by that organization. These loans are used by the latter corporation

[14] Southeastern Industrial Bankers, Inc., *Annual Report,* March 31, 1931.
[15] Booklet printed by Industrial Finance and Thrift Corporation, New Orleans, Louisiana, providing information on its activities.

as security for its collateral trust notes, which are sold to raise working funds. Both of these networks are very close-knit, a characteristic that distinguishes them from the earlier systems, many of which were rather loosely organized.

QUANTITATIVE IMPORTANCE OF INDUSTRIAL BANKING COMPANY CREDIT

In view of the difficulties involved in the definition of an industrial banking company, the number of such companies which operate in the United States at the present time can be only estimated. One way of arriving at such an estimate is to divide all the firms which come within the above-determined definition into two major types: Morris Plan institutions and those that are outside the Morris Plan system. There are now 94 Morris Plan banks and companies and 25 branches, excluding intra-city branches. Massachusetts, with 16 companies (exclusive of branches), has more than any other state; it is followed by New York, North Carolina and Ohio, with 8 each; the remaining 54 companies are scattered through 27 states and the District of Columbia.

The companies outside the Morris Plan system, since they are far more numerous and less homogeneous, are considerably more difficult to count. It was estimated in 1935 that "approximately 750 industrial banking institutions, other than commercial banks with time-payment departments, are now operating in this country."[16] This estimate, however, appears to be too high.

At the end of 1938 the American Industrial Bankers Association had 137 members in continental United States, and its list of prospective members totaled 397. It should be remembered, however, that the "reputable industrial banks and loan companies" which are acceptable for membership

[16] Myron R. Bone, "Dividends from the A.I.B.A." in *American Industrial Banker*, vol. 1, no. 4 (December 1935) p. 16.

in this organization are defined as any "incorporated company 51 per cent or more of whose loan business is in the lending of money and discounting of contracts repayable in weekly, semi-monthly or monthly installments . . .,"[17] whereas in the present study an industrial banking company is regarded as an institution which not only lends funds to consumers for repayment on an instalment basis but also, at least in part, obtains its working funds from the acceptance of deposits or the sale of certificates. Of the present and prospective members of the American Industrial Bankers Association there are, according to our estimates, only 317 that conform with the definition used here.[18] With only a single exception, this organization does not include members of the Morris Plan Bankers Association. Thus, with the addition of the other 93 Morris Plan banks and companies, there are 410 institutions which, in the usage of the present study, may be regarded as industrial banking companies.

It is not possible to derive from any single source an estimate of the volume of credit extended by these 410 companies, or of the amount of their outstandings at any particular time. Various sets of incomplete data may be combined, however, to suggest the quantitative importance of credit extended by this type of agency.

Questionnaire reports are available from 50 industrial banking companies outside the Morris Plan system, showing that on December 31, 1938, the average outstandings per company were $401,000. If this average is multiplied by 316, a result of $126,716,000 is arrived at, representing the 1938 year-end outstandings of the total estimated number of in-

[17] "A.I.B.A. By-Laws Approved as Amended" in *American Industrial Banker*, vol. 2, no. 4 (December 1936) p. 13.

[18] This number is based in part on an elimination of those companies on the lists which, judging from name alone, do not appear to be of the type here defined as industrial banking companies, and in part on correspondence with individuals whose general experience enables them to classify the firms according to this criterion.

dustrial banking companies not within the Morris Plan system. For the same date The Morris Plan Corporation of America has estimated the outstandings of all Morris Plan banks and companies at $122,295,000. Thus the total outstandings of all industrial banking companies on December 31, 1938, may be put at approximately $250,000,000.

From these figures it is possible to derive an estimate of the volume of credit extended during the year. For industrial banking companies the ratio of loans granted to loans outstanding is probably between 1.5 and 1.7. Data from the American Industrial Bankers Association indicate that in 1936 loans granted were 1.7 times loans outstanding, whereas in 1937 the ratio was 1.5. The difference is difficult to account for, but probably it is attributable not so much to a lengthening of maturities as to the fact that the companies reporting in the two years were not identical. On the basis of the 1.5 ratio the total loans granted during 1938 by all industrial banking companies may be computed at $373,516,500, with Morris Plan banks and companies accounting for $183,442,500 of this amount. If the ratio of turnover is considered to be 1.7, the total of loans granted during 1938 is raised to $423,318,700. Thus it may be concluded that aggregate loans granted by industrial banking companies in 1938 ranged between $370,000,000 and $425,000,000; these figures include $10,500,000 of loans made during 1938 that were insured under Title I of the National Housing Act.

The foregoing estimates are obviously only rough approximations, but more precise data are too fragmentary to be of use in indicating totals. Thus data from the Federal Deposit Insurance Corporation indicate that the 71 insured industrial banking companies, distributed throughout the country, had about $101,015,000 outstanding in loans and discounts at the end of 1938; these figures, however, pertain only to insured deposit-taking companies, and deposit-taking privileges are granted industrial banking companies in only a few states.

Again, 15 states issue reports on the volume of outstandings of industrial banking companies, and these reports, covering about 150 companies, both Morris Plan and others, show approximately $132,000,000 in outstandings at the end of 1938; the reports are not all as of the same date, however,[19] nor are they equally complete in coverage, and no reports are available from states in which industrial banking firms are incorporated under the general corporation laws and do not operate under special industrial banking legislation.

Another measure of the quantitative importance of credit extended by industrial banking companies is provided by the number of individual borrowers served by this group of credit agencies. On the basis of the foregoing estimates of total loan volume in 1938, and on the assumption that the loans averaged $250, the total number of borrowers served during that year may be put at between 1,480,000 and 1,700,000. For many companies the assumed average size of loan—$250—would be too high, and for most offices loan volume includes some proportion of renewed loans. In a computation of the number of borrowers served these two factors would tend to counteract one another, but it cannot be determined from available evidence whether they are in this case exactly counterbalancing. It would seem reasonably certain, however, that industrial banking companies extended their credit to approximately 1,500,000 persons in the year 1938.

[19] Data for Nebraska are available as of June 30, 1937; for Indiana and Virginia, as of December 31, 1937; for Florida, New Hampshire, Utah and West Virginia, as of June 30, 1938; for Connecticut, as of September 30, 1938; for Maine, Maryland, Michigan, New York, North Carolina, Ohio and Rhode Island, as of December 31, 1938.