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Competitive and Cooperative Relations

SINCE industrial banking companies engage in many forms of lending which closely approximate and at times conflict with the activities of other types of consumer credit agencies, they must compete not only with firms in their own field but also with personal finance companies, credit unions, sales finance companies, and the personal loan and time-sales departments of commercial banks. Seeking to clarify their own competitive situation, and also to resolve a number of other problems peculiar to their operations, most of the industrial banking firms have joined together in cooperative associations. The present chapter discusses the nature of competition in industrial lending, and also describes the aims and functions of the cooperative associations that have been formed by organizations operating in this field.

COMPETITION BETWEEN INDUSTRIAL BANKING COMPANIES AND OTHER AGENCIES

The intensity of the competition to which industrial banking companies are subject is to be attributed to their somewhat anomalous position in the field of consumer instalment financing. When they extend cash loans they compete not only with personal finance or small loan companies and credit unions,[1] but also with commercial banks. When they

[1] Since the activities of credit unions have not been included in the Studies in Consumer Instalment Financing, undertaken by the National Bureau of Economic Research, they are not considered in this discussion of competition.

finance instalment purchases they must meet competition from sales finance companies and again from commercial banks. Furthermore, the companies which account for the bulk of industrial loan credit compete with commercial banks for commercial loans and for deposits. Some firms, of course, confine their activities to the granting of small consumer loans, and their competitive situation is correspondingly simplified.

In a number of localities industrial banking companies are engaged, too, in active competition with one another. It has been the policy of the Morris Plan system to enfranchise only one company in a city, but the recent growth of companies not affiliated with this system has introduced a new element of rivalry into the competitive picture.

Competition between industrial banking companies and small loan companies is significantly influenced by the legal conditions under which these two types of agencies operate. The loans made by the latter are limited, in most states, to \$300 or less, while for the former the amount of credit that may be extended in a single transaction is seldom so severely restricted. Sometimes, however, industrial banking companies too operate under small loan laws, in which case their loans are likewise kept to a \$300 maximum, and in the District of Columbia all companies, except those operating on bank charters, are forbidden to extend cash loans in excess of \$200.[2]

The average size of note for small loan companies varies somewhat between states and for different chain companies, but it does not exceed \$200 and is generally closer to \$150.[3] On the other hand, the average size of note for Morris Plan banks and companies, when all types of loans are considered,

[2] See Chapter 2, pp. 37-39.

[3] National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices,* by Ralph A. Young and Associates (1940) Table 7, p. 47.

ranges mainly between $250 and $300.[4] This difference is accounted for in part by the fact that the industrial banking companies deal in certain types of loans, such as sales financing and real estate credit, which small loan companies are not permitted to extend. As for comaker loans made by industrial banking companies, they are in some cases of approximately the same size as those granted by small loan companies[5] and in other cases somewhat larger.[6] The variation in the size of such loans indicates that some industrial banking companies are in closer competition with personal finance companies than others.

The intensification of competition between industrial banking and personal finance companies has arisen from the fact that the former have departed from their almost exclusive preoccupation with comaker loans. Thus the advantage of the personal finance company, which could at one time advertise the uniquely confidential character of its lending operations, has been substantially diminished in recent years by the increasing tendency of industrial banking companies to extend loans secured by the maker's name alone, or by the signatures of husband and wife, or even by household chattels. The last type of loan stands, of course, in direct competition with the primary business of personal finance companies.

From the data at hand it is impossible to measure statistically the income distribution of borrowers from industrial banking companies. The scattered evidence available does suggest, however, that the larger companies depend much less heavily than do personal finance companies on borrowers with annual incomes of $1200 and less, while, in general, the smaller companies cater to borrowers whose income distribution is similar to that of customers of chain

[4] See Table 14, p. 85.
[5] See Table 15, p. 86.
[6] See Table 16, p. 87.

small loan companies.[7] It is probably because in most states they have been granted greater latitude than small loan companies in the matter of maximum size of loan, that industrial banking companies have tended on the whole to attract borrowers in higher income groups.

Data on the occupational distribution of customers of chain personal finance companies show that approximately 50 percent of such borrowers are drawn from the wage-earning classes, about 25 percent from clerical and commercial groups, and about 5 percent from the professional class. Although no comparable data on the occupational distribution of industrial banking company borrowers can be obtained at present, it appears from the limited information available that these companies draw a smaller proportion of their borrowers from wage-earners and larger proportions from the clerical and professional classes than do the chain personal finance companies.[8]

As a general rule small loan companies quote charges as a monthly rate of interest on unpaid principal balance, this rate representing the entire cost of the loan to the borrower. Industrial banking companies, however, almost always quote charges on cash loans as a rate of discount, and in addition levy a fee for credit investigation. Because of this difference in methods of rate quotation the consumer is likely to be confused as to the relationship between the charges of the two types of agencies, and their competitive relations are undoubtedly affected by this situation.

The charges of industrial banking companies, when expressed as an annual effective rate on regularly declining credit balance, amount roughly to twice the rate of discount. When expressed in this way the combined maximum discount and credit investigation charge permitted by special statutes governing industrial banking companies amounts to

[7] See Table 33, p. 136; also Ralph A. Young and Associates, *op. cit.*, pp. 51-54.
[8] See Table 30, p. 131; also Ralph A. Young and Associates, *op. cit.*, pp. 56-60.

approximately 16 to 20 percent.[9] This is lower than the rates charged by small loan companies, which range commonly from 30 to 42 percent when expressed as an annual equivalent of the quoted monthly rate of interest.[10] In many instances competition has operated to reduce the actual rates charged by industrial banking companies to levels lower than the legal maxima. This is most likely to occur where competition with the personal loan departments of commercial banks is especially strong.

Industrial banking companies, as has already been noted, have branched out also toward the development of a larger volume of sales finance business. Through this type of financing the industrial banking company comes into direct competitive contact with sales finance companies and with the time-sales departments of commercial banks. Competition is keenest in the field of automobile financing, for here local, regional and national sales finance companies are actively engaged in serving the same markets as those sought by some industrial banking companies and commercial banks.

The character of competition in this field is conditioned in part by the fact that in most cases the industrial banking companies conduct their sales financing as independent units, whereas in 1937 approximately 75 percent of the automobile instalment financing handled by sales finance companies was conducted by three national chains.[11] The independent position of some Morris Plan banks and companies is modified to a limited degree by the fact that they operate either as wholly owned or as partially owned subsidiaries of companies controlled by the Industrial Finance Corporation. These corporate relationships, however, are not such as to affect the

[9] See Chapter 2, pp. 39-41.
[10] Ralph A. Young and Associates, *op. cit.*, pp. 125-28.
[11] National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by W. C. Plummer and R. A. Young (1940) Table 67, p. 264; the three national companies are there designated as "factory-related."

competitive position of the individual Morris Plan banks and companies. In a few cases industrial banking companies, both Morris Plan and others, operate branches or exercise control over other banking companies through stockownership. In such cases it is possible to coordinate the activities of a number of units into a regional system and thus to take advantage of certain operating efficiencies inherent in this form of organization.

In the past a part of the sales financing activities of some Morris Plan banks and companies was carried out through the Industrial Acceptance Corporation. As pointed out above,[12] those companies in which the Industrial Finance Corporation had a controlling stock interest financed time sales of General Electric products through local subsidiaries, and rediscounted their receivables when necessary with the Industrial Acceptance Corporation. All other time-sales financing was handled directly by the local Morris Plan banks and companies.

The Industrial Acceptance Corporation also entered into an agreement with the Studebaker Corporation whereby it financed instalment sales of the cars produced by that manufacturer. Subsidies were paid to the Industrial Acceptance Corporation by the Studebaker Corporation on a plan not unlike the arrangements formerly in effect between other sales finance companies and certain automobile manufacturers.[13] In its automobile financing the Industrial Acceptance Corporation passed credits and made all collections on its consumer notes. Local Morris Plan banks and companies were not concerned in this financing arrangement.

In competing for retail sales finance business industrial banking companies are confronted by the same problems that beset any consumer credit agency operating in this field.

[12] Chapter 1, p. 21.

[13] See Chapter 1, p. 21; also W. C. Plummer and R. A. Young, *op. cit.*, pp. 266-67.

Where they propose to obtain a substantial volume through dealer contacts, competition requires that they provide the dealer with a reserve sufficient to hold his business, if contracts are purchased on a recourse or repurchase arrangement, or that they offer some kind of bonus, if transactions are effected on a non-recourse basis. In automobile financing, the financing agency is likely to be called upon also to extend credits to dealers to enable them to carry inventories. Credit demands of this sort are likely to be large, especially in transactions with dealers who are in a position to create a large volume of retail instalment paper, and such demands cannot be met easily by the relatively small firms which constitute the majority of industrial banking companies.

As an alternative to obtaining retail instalment business through dealer contacts, some companies have adopted the policy of direct solicitation of purchasers. When this procedure is followed the industrial banking company can select its risks with somewhat greater care than it could otherwise, but it is at the same time cut off from dealers who might provide a ready supply of retail contracts.

Although industrial banking companies have increased their volume of sales financing in recent years they still occupy a relatively insignificant position in the field, far behind that of sales finance companies. It has been estimated that a total of $4,279,000,000 of retail instalment credit was extended in 1937,[14] and of this amount Morris Plan banks and companies, according to data from the Industrial Finance Corporation and The Morris Plan Corporation of America, accounted for only about 1 percent, whereas sales finance companies accounted for about 51 percent.[15] On the other hand, only about one-fifth of the credit extended by Morris Plan companies was for the financing of retail sales. Data on the sales financing activities of other industrial bank-

[14] W. C. Plummer and R. A. Young, *op. cit.*, p. 41.
[15] *Ibid.*, p. 43.

ing companies, outside the Morris Plan system, are not available, but it is unlikely that such figures would more than double the estimate of about 1 percent participation.

Evidence is not available to show how the price policy of industrial banking companies compares with that followed by the three largest sales finance companies. Since only a very small share of the sales finance market is reached by industrial banking companies, it is unlikely that such firms exert a strong influence on competitive conditions in the country as a whole, although in particular communities their operations may attain considerable importance.

Industrial banking companies are in competition with sales finance companies also in the cash loan field, although this development is as yet relatively unimportant. In some instances sales finance companies have licensed their offices as small loan companies in order that they may make renewals on contracts that originated with the instalment sale of a commodity. This enables the sales finance company also to make cash loans to individuals not indebted to them on a retail instalment sales contract. One national sales finance company has recently qualified most of its Pennsylvania offices under the Consumer Discount Act of that state. By this action the company enables itself to compete directly with industrial banking companies in making cash loans up to $5000 in size.

The commercial bank is a more recent rival of the industrial banking company than either the small loan or the sales finance company, yet it is considered by many industrial lenders to be the most important of all competitors. A comparison of the small-loan customers served by industrial banking companies and by commercial banks reveals certain broad similarities. In a sample of 1,260 personal loans made by commercial banks 12 percent of the borrowers had incomes of $1200 or less, and in a much smaller sample of loans made by industrial banking companies 16 percent of the borrowers were in this income group.[16] Thus both samples indicate a predominant reliance on the higher income classes of borrowers, though these comparisons must be regarded as very rough measures, since the sample of industrial banking company loans is extremely small and therefore subject to considerable sampling error. A comparison of these loan samples according to amount of note shows that the two types of agencies make loans of approximately the same size, each writing about 50 percent of its notes in amounts of less than $200.[17]

Equally fragmentary are the data for comparing the occupational groups served by industrial banking companies and by commercial banks, in their personal lending. What evidence can be had suggests that the commercial banks draw larger proportions of their borrowers from clerical workers and smaller proportions from wage-earners than do industrial banking companies. Both agencies depend to about the same extent on the professional classes.[18]

Thus, with the qualification that the markets served by individual institutions may vary widely from the general markets sketched above, it may be said that, in their personal lending, industrial banking companies and commercial banks compete for the patronage of substantially the same group of borrowers. A suggestion of the close identity of their consumer markets is contained in the fact that in Massachusetts a case was reported in 1937 and another in 1938 of a commercial bank that had purchased a Morris Plan company as a preliminary to its establishment of a personal loan

[16] See Table 33, p. 136; also National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit*, by John M. Chapman and Associates (1940) Table 34, p. 128.

[17] See Table 34, p. 138; also John M. Chapman and Associates, *op. cit.*, Table 37, p. 133.

[18] See Table 30, p. 131; also John M. Chapman and Associates, *op. cit.*, Table 31, p. 124.

department;[19] similar cases, involving companies not members of the Morris Plan system, are known to have occurred in Pennsylvania and West Virginia. It has also been reported that in other regions commercial banks have substantial stockownership in industrial banking companies, although there is no published evidence on this sort of relationship.

In most states commercial banks have a competitive advantage over industrial banking companies in that besides making personal loans they offer consumers a complete line of banking services. An industrial banking company can offer an equally wide variety of services only if it is operated on a general bank charter or under liberal industrial loan legislation. It is important to note that industrial banking companies which do enjoy the deposit-taking privilege are at present developing a number of non-lending features which place them in virtually the same category as commercial banks.

The making of commercial loans is an aspect of the competitive relations between industrial banking companies and commercial banks that is of growing importance in some centers. It was shown in Chapter 4 that of the 1938 year-end loan-and-discount outstandings of 71 FDIC-insured industrial banking companies, 11.7 percent (over $11,800,000) were classified as "commercial and industrial loans."[20] Since this category excludes personal or instalment loans to individuals other than loans for business purposes, and includes all business loans to individuals, partnerships and corporations, it would appear that at least these insured industrial banking companies are substantial competitors of commercial banks for this type of credit business, just as commercial banks are becoming increasingly important rivals of industrial banking companies in the extension of personal loans.

[19] Massachusetts, *Annual Report of the Bureau of Loan Agencies,* for the license year ended September 30, 1937, p. 2, and *ibid.,* for the year ended September 30, 1938, p. 3.

[20] Table 9, p. 78.

This situation has been mentioned by the Board of Governors of the Federal Reserve System: ". . . there has been an increasing tendency on the part of commercial banks to enter the personal loan field and on the part of Morris Plan banks to accept deposits subject to check as well as time and savings deposits and to make commercial loans."[21] It is worth noting, however, that of the 1938 year-end loan-and-discount outstandings of 961 commercial banks only 3.7 percent ($188,306,000) were classified as personal loans.[22]

A large part of the controversy concerning commercial banks' and industrial banking companies' competition for consumer cash loans and sales financing services centers around the question of the cost of making and collecting loans. This problem is complicated by the fact that consumer loans constitute the main part of the total outstandings of industrial banking companies and only a relatively small proportion of the loans and discounts of commercial banks. As a consequence, when an industrial banking company seeks to determine the cost of making consumer loans it must take into consideration all the expenses, overhead and direct, which are involved in its business, whereas a commercial bank with unused lending capacity, ready personnel and available office space may undertake to make personal loans without allocating any overhead costs to this branch of its activities. Whether the commercial bank will choose to follow this procedure, or will prorate what it considers a full share of overhead expenses to its personal loan department, is an aspect of managerial policy.

It is clear, however, that an industrial banking company is placed at a disadvantage if its commercial bank competitors calculate consumer loan costs without taking account of general bank overhead, and determine their customer charges

[21] Federal Reserve System, *Twenty-fifth Annual Report of the Board of Governors,* covering operations for the year 1938, p. 74.

[22] John M. Chapman and Associates, *op. cit.,* Table 5, p. 36.

in the light of this cost computation. Little is known at present concerning the practice of commercial banks in this matter. Questionnaire returns have revealed that many banks do not attempt to allocate general bank overhead to their personal loan departments, but that an increasing number of banks are making this effort, particularly those operating the larger personal loan departments.[23]

Only very fragmentary information is available concerning the actual rates charged by industrial banking companies; this evidence suggests that, in communities where they compete with commercial banks, their charges are either equal to or slightly higher than commercial bank rates on comparable loans. It should not be forgotten, however, that competition assumes many non-price forms. Such factors as the variety of services offered, the speed with which loans are made, the maturity and other terms of lending, provide possibilities of competition, quite apart from the charge made for the loan or financing service. Like all other consumer credit agencies, industrial banking companies are alert to these possibilities.

Finally, it should be noted that some industrial banking company officials hold the opinion that the participation of commercial banks in the consumer lending field has improved the position of the industrial banking company. This opinion is based on the belief that commercial banks bring to consumer instalment financing a certain prestige that reflects advantageously on the activities of competitors.

COOPERATIVE RELATIONS AMONG INDUSTRIAL BANKING COMPANIES

There are two national trade associations of industrial banking companies—the Morris Plan Bankers Association and

[23] See *ibid.*, pp. 164-66, for a discussion of commercial bank cost accounting procedure.

the American Industrial Bankers Association. The latter organization has one Morris Plan company among its members, but no company outside the Morris Plan system belongs to the Morris Plan Bankers Association.

The older of these two organizations, the Morris Plan Bankers Association, was formed in 1919 and now has its headquarters in Washington, D. C. On October 1, 1939, it had 80 regular and 2 associate members.[24] Its functions appear to consist mainly of gathering and disseminating statistical information, conducting management surveys, representing the legislative and other interests of members and arranging annual meetings at which members convene to discuss their mutual problems. Morris Plan banking companies are organized also in sectional associations, and these have functions similar to those of the national association.

Published information concerning the activities of the Morris Plan Bankers Association is available only in incomplete reports of conventions, published in the *United States Investor*. The two publications of the association—the *Morris Plan Banker* and the *President's News Letter*—are usually avaliable only to its members. In an address to the 1936 convention President Ralph W. Pitman outlined a course of action for the association which throws some light on its activities. He urged the fostering of national advertising, assistance in the development of more Morris Plan banking companies and the encouragement of desired legislation.[25] At its most recent convention it was reported to the membership that legislative activities were being continued and that management surveys had been conducted in 22 companies.[26]

In the early 1930's the Morris Plan Bankers Association was active in arranging an emergency loan plan with the voluntary cooperation of member companies. Each subscriber

[24] *United States Investor,* October 21, 1939, p. 1740(58).
[25] *Ibid.,* October 3, 1936, p. 1435(3).
[26] *Ibid.,* October 21, 1939, p. 1740(58).

to the arrangement was to be prepared to advance an allotted quota of funds, not exceeding a total of 2 percent of its capital, surplus and undivided profits, to a common pool which was to provide emergency loans to members. If a Morris Plan banking company were to suffer an unusually large volume of withdrawals, it might inform national headquarters of its need. An official would be sent to make an examination, and his recommendations to headquarters would be communicated to all members of the pool. Each member would then be directed to send its quota to a trustee appointed for the occasion. The advance of funds would involve little risk to the members, since the borrowing company was to pledge notes of its own customers as security and the payments on these notes would soon cancel the loan.[27] This sort of assistance was not often invoked, but many companies regarded its availability as a great advantage.

The American Industrial Bankers Association is of much more recent origin, having been formed in 1934. At present its members number approximately 150, membership being open to companies which have been approved by the Membership Committee. The by-laws, as now amended, contain the following definition of eligibility: "An industrial bank (except those so chartered by law) shall be defined as an incorporated company 51 percent or more of whose loan business is the lending of money and discounting of contracts repayable in weekly, semi-monthly or monthly instalments; and which may or may not issue to the borrower simultaneously with the loan transaction its own written evidence of debt, and whose average total charges on personal loans . . . shall not exceed the maximum amount prescribed for each state by resolution adopted by the Board of Directors of this Association."[28]

[27] *Ibid.*, March 26, 1932, pp. 406(6)-407(7).
[28] "A.I.B.A. By-Laws Approved as Amended" in *American Industrial Banker*, vol. 2, no. 4 (December 1936) p. 13.

The present requirements for membership differ from those originally prescribed. In the beginning the by-laws stated merely that membership was to be limited to "reputable industrial banks."[29] This original position was subsequently modified to require that members should have 90 percent of their loan business in instalment cash loans, and that the average total charge on such loans might not exceed 12 percent per year discounted in advance or 2 percent per month calculated on the unpaid monthly balance.[30] In November 1936 the present "51 percent" requirement was adopted. Since consumer credit agencies which do not take deposits or issue instalment investment certificates are regarded as eligible for membership, the association has some members which cannot be classified as industrial banking companies under the definition adopted in this volume.

The association's activities have broadened rapidly in scope. An important legislative activity has been the formulation of a proposed uniform industrial banking law,[31] and the association also maintains a legislative committee which keeps members informed of current developments. Each year a fairly detailed questionnaire concerning operating methods and credit experience is sent to the membership of the association. The results are tabulated and the data are published in the proceedings of the annual convention.

The association publishes the *American Industrial Banker*, a bimonthly magazine containing articles by persons prominent in industrial lending and allied fields. It has also sponsored the organization of several state and regional associations of industrial banking companies.

[29] "By-Laws, American Industrial Bankers Association" in *ibid.*, vol. 1, no. 1 (November 1934) p. 11.
[30] "Industrial Bank Defined at Institute" in *ibid.*, vol. 2, no. 2 (June 1936) p. 6.
[31] See Chapter 2, pp. 54-56.