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Expenses and Income

AN ANALYSIS of the cost structure of personal finance companies is of particular interest because of the fact that lenders so frequently stress the high costs of retailing credit. Assertions to this effect are advanced to support the contention that relatively high rates are essential to profitable operation. In this business, however, earnings too are relatively high, ranging during 1929-36 from 7 to 12 percent of "average employed assets."[1] A record of earnings computed on this basis is not completely satisfactory, yet in the absence of more direct measures it serves as an indication of the profitability of personal finance company operations.

In view of the importance of these aspects of the personal finance business, data are presented in this chapter on the cost structure of personal finance companies, the ratios of gross expenses and income and net income to average employed assets, and the earnings and expenses in loan offices of different sizes and different organizational structures. The next chapter will deal with the related question of costs incurred on loans of various sizes.

EXPENSES

A typical distribution of expenses in the personal finance business is shown in Table 30, which is based on averages of annual data compiled from state banking department and accountants' reports for 1934, 1935 and 1936. Salaries, bad-debt loss, advertising, taxes and rent are the major items of expense in the personal finance business, all other items

[1] The meaning of this term is explained on page 109.

TABLE 30

PERCENTAGE DISTRIBUTION OF EXPENSES INCURRED BY PERSONAL FINANCE COMPANIES, 1934-36[a]

Item	*Percent*
Salaries	38.6
Bad debts and insurance against loss	13.3
Advertising	10.7
Sundry other expenses	9.9
Taxes and license fees	9.4
Rent	5.7
Printing, stationery, postage, telephone and telegraph	4.2
Travel	2.5
Legal fees	2.1
Auditing	1.2
Depreciation on furniture and fixtures	1.1
Insurance and bonding	1.0
Recording and acknowledging fees	.3
TOTAL	100.0

[a] Based on annual reports of state banking departments or, for states in which such reports are not published, on accountants' reports prepared for state associations of personal finance companies from data filed with the state banking department. Data cover 17 states in 1934, 14 in 1935 and 17 in 1936. Expenses do not include interest on borrowed funds or amortization of financing costs and bond discounts.

together accounting for less than one-fourth of total expenses. Salaries, including those of officers, executives, managers, clerical workers and other "inside" men, and also those of "outside" men or credit investigators, are the largest source of expense to the lender, accounting for about 39 percent of the total. Second in size is the item of bad debts and insurance against loss, which, after the subtraction of collections on accounts previously charged off, approximates 13 percent of aggregate expenses. The proportion for bad debts in Table 30, although an average for 1934-36, is probably understated because recoveries were being made in this period on loans charged off during the preceding depression years.

Advertising, the third most important item, absorbed about

11 percent of total expenses, an amount almost equal to that for bad-debt loss. Although personal finance companies engage in widespread advertising in order to attract new customers, a large part of their advertising expenditure is incurred primarily to educate the public in the purposes and functions of the small loan business, and to counteract the frequent attempts to reduce the legal charge for small loans.

The remaining 37 percent of expenses are variously distributed among other cost categories. Taxes, including license fees as well as federal, state and local taxes, averaged 9 percent of total expenses, and rent 6 percent. Personal finance lenders have not the tax-exemption privileges of credit unions, and therefore they contend that their charges must include some provision for the payment of taxes. It is probably for this reason that they report all taxes, including income taxes, as a part of their cost structure.

The only available measure of personal finance company expenses over a period of years is on the basis of "average employed assets." This concept was developed by the Russell Sage Foundation because of the lack of complete data either on entrepreneurial investment (the sum of the balance sheet values of common stock, preferred stock and surplus) or on total investment (the sum of net worth and long-term borrowing). It is computed by multiplying the average of net loan balances[2] outstanding at the beginning and at the end of the year by 1.15 (allowing 0.05 points for cash balances, 0.02 points for furniture and fixtures, 0.02 points for other tangible assets and 0.06 points for cost of development).[3]

In Table 31 the reported items of expense of small loan licensees are expressed as percentages of estimated average

[2] Loan balance minus reserve for bad debts as of the same date.

[3] The multiplier represents a conservative estimate of assets other than loans receivable. This is apparent from M. R. Neifeld's estimates of the balance sheet of personal finance companies, as of December 31, 1936, in which the ratio of assets to loans receivable was 1.25 (*Personal Finance Comes of Age*, 1939, p. 209).

TABLE 31

EXPENSE ITEMS OF PERSONAL FINANCE COMPANIES, 1929-36, IN PERCENT OF AVERAGE EMPLOYED ASSETS[a]

Expense Items	*1929*	*1930*	*1931*	*1932*	*1933*	*1934*	*1935*	*1936*
Salaries	7.46	7.09	6.69	6.80	7.42	7.38	7.41	7.00
Bad debts and insurance against loss	1.81	1.96	2.44	4.27	3.86	3.13	2.41	1.94
Advertising	1.78	1.51	1.69	1.32	1.55	1.87	2.01	2.11
Sundry other expenses	1.67	1.40	1.73	1.69	1.42	1.91	1.61	2.04
Taxes and license fees	1.43	1.29	1.15	1.29	1.62	1.48	1.74	2.07
Rent	1.04	1.06	1.06	1.15	1.22	1.12	1.11	1.01
Printing, stationery, postage, telephone and telegraph	.69	.73	.74	.75	.83	.70	.88	.76
Travel	.38	.45	.44	.44	.50	.39	.54	.48
Legal fees	.20	.34	.31	.31	.43	.41	.42	.36
Auditing	.63	.66	.45	.36	.38	.26	.25	.19
Depreciation on furniture and fixtures	.19	.20	.19	.22	.23	.22	.20	.18
Insurance and bonding	.14	.15	.12	.17	.21	.17	.23	.17
Recording and acknowledging fees	.09	.05	.05	.04	.06	.06	.06	.06
TOTAL[b]	17.51	16.89	17.06	18.81	19.73	19.10	18.87	18.37

[a] Data for 1929-33 based on *Expenses of Small Loan Licensees, 1929-1933*, compiled under the direction of Rolf Nugent, director of the Department of Remedial Loans of the Russell Sage Foundation; data for 1934-36 based on annual reports of state banking departments or on accountants' reports made available to us by the Russell Sage Foundation.

[b] Expenses do not include interest on borrowed funds or amortization of financing costs and bond discounts. The totals listed here differ slightly from "total expenses" in Table 32; the reason is that the present table is based on slightly fewer states, since not all the states included in Table 32 provided a breakdown of expenses.

employed assets over the period 1929-36. Total expenses were fairly steady at about 17 percent during 1929-31, reached their high point of almost 20 percent in 1933 and then gradually decreased to 18.4. Rent followed the same general trend, but remained throughout the period at about 1 percent. Salaries varied slightly around 7 percent throughout the period. Expenses for advertising fell from 1.8 percent in 1929 to 1.3 in 1932, and increased each subsequent year to 2.1 in 1936, suggesting that advertising varies in the same direction as the volume of business but with somewhat greater amplitude. Bad debts and insurance against loss displayed the greatest variation of all the expense items, rising from 1.8 percent in 1929 to 4.3 in 1932, but thereafter declining steadily to only 1.9 in 1936. The item "taxes and license fees" varied irregularly between 1 and 2 percent, reaching its highest point (2.1) in 1936.

The expense items listed in Tables 30 and 31 do not include any provision for interest paid by personal finance companies on their borrowed funds. This expense necessarily varies according to the proportion of total funds obtained by borrowing and the rate of interest that is charged for the use of such funds. Data from 10 selected states show that interest paid by personal finance companies in 1937 ranged from a twentieth to a fifth of all other expenses. If these limited data are representative, and if expenses other than interest typically approximate 18 percent of employed funds—the average indicated by Table 31—then it appears that interest expense in 1937 ranged from 0.9 percent to 3.6 percent of employed assets. Thus it may fairly be inferred that wide variations in the rate of interest paid on borrowed funds have proportionately a much smaller effect on total expenses, including interest, than on earnings, and that therefore personal finance company charges to customers are not particularly responsive to changes in money rates.

GROSS AND NET INCOME

The gross income of personal finance companies is governed primarily by the volume of funds invested in loans and the rates that customers pay for their use. But though these are the basic they are not the only determinants of gross income; failure to make collections on outstanding loans, recoveries on loans previously charged off, legally authorized fee collections and interest on bank balances also affect the gross income of the licensed lender.

By far the major component of gross income is the charges collected on loans. This item varies narrowly among states; in 1937 it averaged, for 15 states, 97.5 percent of gross income.[4] Collections on accounts previously charged off[5] constituted 2 percent of gross income for that year, and interest on bank balances, authorized fees and "other income" accounted for the remaining 0.5 percent.[6]

In Table 32 gross income is expressed in percent of average employed assets. From 1929 through 1933 the ratio declined, mainly, it would appear, because of the increased difficulty during these depression years of collecting all charges due on loans;[7] rate competition among lenders may also have contributed to the reduction in the gross income percentage but data for assessing the importance of this factor are not available. In any event gross income in relation to average employed assets began to rise again in 1934.

Net income in percent of average employed assets, as shown in Table 32, does not indicate return on entrepreneurial

[4] According to Neifeld's estimates (*ibid.*, p. 210) this relationship was 97 percent for all licensed lenders in 1936.

[5] This item is not included in gross income in Table 32 because in computing total expenses it was deducted from the expense item "bad debts and insurance against loss."

[6] These data covering 15 states are based on annual reports of state banking departments or, for states in which such reports are not published, on accountants' reports prepared for state associations of personal finance companies from data filed with the state banking department.

[7] See Neifeld, *op. cit.*, pp. 223-24.

TABLE 32

GROSS INCOME, TOTAL EXPENSES AND NET INCOME OF PERSONAL FINANCE COMPANIES, 1929–36, IN PERCENT OF AVERAGE EMPLOYED ASSETS[a]

Year	*Gross Income*	*Total Expenses*[b]	*Net Income*
1929	28.6	16.9	11.7
1930	27.8	16.4	11.4
1931	27.3	17.0	10.3
1932	26.5	18.8	7.7
1933	26.0	19.3	6.7
1934	26.9	19.1	7.8
1935	27.9	18.8	9.1
1936	27.3	18.3	9.0

[a] Data for 1929–33 based on L. N. Robinson and Rolf Nugent, *Regulation of the Small Loan Business* (1935) pp. 241–42; data for 1934–36 based on annual reports of state banking departments or on accountants' reports made available to us by the Russell Sage Foundation.

[b] Expenses do not include interest on borrowed funds or amortization of financing costs and bond discounts. The figures for total expenses differ slightly from the totals in Table 31; the reason is that Table 31 is based on slightly fewer states, since not all the states included in the present table provided a breakdown of expenses.

investment in personal finance lending; it does indicate, however, the magnitude and direction of fluctuations in the profits derived from this type of credit business. The net income percentages in this table have been derived by subtracting the percentages for total expenses from those for gross income; thus the fluctuations in the net income figures may be understood from the other two items.[8] During 1929 through 1933, when the gross income percentage declined, that for total expenses tended to increase; in 1934 and 1935, when the gross income percentage rose, that of total expenses fell. The result, of course, was a decline in the net income percentages during the former period, and an increase during the latter. It has already been indicated that the decrease in the gross income percentages during the depression was

[8] In state reports interest on borrowed funds is not included among expense items, and therefore net income percentages are to that degree overstated.

probably due primarily to a current decline in the ratio of charges collected to charges earned; as was shown in Table 31, the increase in the expense percentages during this period was due principally to a rise in the loss from bad debts and to some extent, during 1933, to an increase in salary expense. In 1934-35, on the other hand, collections improved and at the same time bad-debt losses were considerably reduced.

In 1936, although the total expense percentage continued to fall, there was a slight decline in that for net income. This is traceable to the interesting fact that in 1936 the gross income percentage, for the first time since 1930, moved in the same direction as that for expenses. It is significant to note that the general tendency of the gross income and expense percentages to move in opposite directions has the effect of augmenting the movement of the net income percentage: when it decreases it falls more, and when it increases it rises more, than it would if gross income and expense moved in a more direct relationship with each other.

SIZE AND TYPE OF LOAN OFFICE AS FACTORS IN EARNINGS AND EXPENSES

The relative profitability of offices of different sizes, measuring size by total assets employed, may be examined in Tables 33 and 34 for the two industrial states of Illinois and New Jersey. The net return, in percent of year-end employed assets, tends to vary directly with size of office. In New Jersey this was true for offices of all sizes up through $400,-000, though those with employed assets over this amount showed a slightly lower net return than did those with assets between $300,000 and $400,000. In Illinois the only offices that contradicted the trend were those of less than $10,000 assets and those of $75,000-100,000. This tendency for profits to increase with size is doubtless due in part to the operating economies that are associated with larger volume, and it justi-

fies the emphasis placed on volume by personal finance lenders. There is confirmation, however, of the chain lenders' contention that the business has not yet clearly established an optimum or most profitable size of office.

To account further for this relation between profitability and office size the relation between the gross earnings percentage and office size should be noted. In Illinois this percentage rose fairly steadily from 23 for offices in the $10,000-25,000 class to 31 for offices having assets above $400,000; in New Jersey it rose from 14 for the $25,000-50,000 offices to 27 percent for those in the $300,000-400,000 class, but it was only 21.5 for larger offices. In New Jersey, however, the smallest offices ($10,000-25,000) showed a higher gross earnings percentage than did the next larger offices, and in Illinois the smallest offices (under $10,000) had the best record in this respect of any offices except those over $400,000. The favorable earnings record shown by very small offices may be due to the fact that such offices are frequently operated as adjuncts to one or more other businesses, such as real estate or automobile financing.

Along with the general tendency for the gross earnings percentage to increase is a corresponding and more pronounced tendency toward a decline in total expenses in percent of gross earnings. Although there is some variation in their behavior, salary and bad-debt loss percentages tend to decrease as size of office increases. Miscellaneous other expenses tend to decline to medium-size offices, then increase, and decline again for the larger offices.

In Illinois offices of all sizes showed a profit return on total year-end assets employed, the lowest yield being 3.9 percent for $10,000-25,000 offices. In New Jersey this group (the smallest size class in the state) had a net deficit of 8.5 percent. The next three size classes (offices from $25,000 to $100,000) showed net returns ranging from 1.7 to 2.0 percent in New Jersey but from 5.9 to 8.7 percent in Illinois. This differential

TABLE 33

EARNINGS AND EXPENSES OF 103 PERSONAL FINANCE LICENSEES IN NEW JERSEY, 1937, BY SIZE OF OFFICE[a]

Size of Office[b]	*Gross Earnings in % of Employed Assets*[b]	*Expenses in % of Gross Earnings*				*Net Return in % of Employed Assets*[b]	*% Distribution*	
		Total	Salaries	Bad Debts	All Other[c]		Number of Offices	Employed Assets[b]
$ 10,000– 25,000	16.7	150.9	91.8	...	59.1	−8.5	1.0	.1
25,000– 50,000	14.4	93.9	48.2	4.8	40.9	1.7	18.4	3.8
50,000– 75,000	18.9	89.7	44.6	7.1	38.0	1.9	12.6	4.5
75,000–100,000	17.5	88.7	41.6	4.9	42.2	2.0	8.7	4.2
100,000–200,000	22.5	66.8	26.3	6.8	33.7	7.4	27.2	23.0
200,000–300,000	23.7	62.4	24.4	5.4	32.6	9.2	13.6	18.7
300,000–400,000	27.4	52.6	18.4	4.2	30.0	10.2	10.7	20.2
Over $400,000	21.5	57.4	17.4	7.7	32.3	9.2	7.8	25.5
TOTAL	22.8	62.5	23.6	6.0	32.9	8.1	100.0	100.0

[a] Based on individual reports of small loan licensees in the New Jersey *Annual Report of Commissioner of Banking and Insurance* (1937) pp. 90–101. The total year-end employed assets of the 103 offices was $18,410,284.
[b] Total employed assets as of December 31st.
[c] Exclusive of interest.

TABLE 34

EARNINGS AND EXPENSES OF 358 PERSONAL FINANCE LICENSEES IN ILLINOIS, 1937, BY SIZE OF OFFICE[a]

Size of Office[b]	*Gross Earnings in % of Employed Assets*[b]	*Expenses in % of Gross Earnings*				*Net Return in % of Employed Assets*[b]	*% Distribution*	
		Total	Salaries	Bad Debts	All Other[c]		Number of Offices	Employed Assets[b]
Under $ 10,000	27.4	75.4	35.8	5.3	34.3	6.7	7.5	.4
10,000– 25,000	23.1	83.2	42.4	9.5	31.3	3.9	17.3	2.6
25,000– 50,000	26.1	77.3	39.7	9.8	27.8	5.9	18.2	5.4
50,000– 75,000	26.2	67.0	31.9	9.6	25.5	8.7	12.3	6.5
75,000–100,000	26.2	69.9	35.2	9.2	25.5	7.9	7.5	5.6
100,000–200,000	25.6	66.5	25.5	7.8	33.2	8.6	15.1	19.1
200,000–300,000	27.3	64.3	25.8	7.1	31.4	9.8	10.3	21.8
300,000–400,000	26.5	59.3	19.8	7.1	32.4	10.8	7.3	21.2
Over $400,000	31.3	65.1	28.7	6.8	29.6	10.9	3.1	17.0
Total single-office reports	27.2	65.4	27.1	7.6	30.7	9.4	98.6	99.6
Consolidated reports	35.5	73.4	40.0	6.8	26.6	9.4	1.4	.4
TOTAL	27.2	65.5	27.2	7.6	30.7	9.4	100.0	100.0

[a] Based on Illinois, Division of Small Loans, *Analysis of Reports Filed by Personal Finance Companies, 1937*, Schedule I, p. 16. The total year-end employed assets of the 358 offices was $41,350,573.

[b] Total employed assets as of December 31st.

[c] Exclusive of interest.

between the two states is apparently due to higher ratios of expense to gross earnings in New Jersey, primarily higher salary percentages. Possibly in New Jersey a larger proportion of offices of these sizes are independents and pay out earnings in the form of salaries to owner-managers rather than as profits to parent chain companies. Net return on total assets (and also the gross earnings percentage, with a single slight exception for $300,000-400,000 offices) is consistently lower in New Jersey than in Illinois, for offices of all sizes, though for offices of more than $100,000 assets the differential between the states is much reduced. In this connection it is significant to note that for $100,000-200,000 offices total expenses, and especially salaries, take only a slightly higher percentage of gross earnings in New Jersey than in Illinois, and that for offices of more than $200,000 assets they take a considerably lower proportion than in Illinois. Doubtless one reason for the consistency of the differential between the states in regard to net return is that lower legal rates obtain in New Jersey.

In view of the greater profitability of larger offices it is not surprising to find that they control a substantial share of the total business. In Illinois 36 percent of the offices had total assets of more than $100,000 and controlled 79 percent of all assets employed in the business. In New Jersey loan offices of this size constituted 59 percent of the total number and held 87 percent of total personal finance company assets.

Chain offices usually have upwards of $50,000 in employed assets and therefore they fall in the more profitable size groups, showing a higher ratio of net return to total employed assets than do any other types of offices except partnerships. Data for the various types of lenders in Indiana, given in Table 35, show that chain lenders have, on the whole, the largest offices and enjoy the highest ratio of gross earnings to total employed assets. Also they show a lower ratio of expenses to earnings than any other type except partnership offices.

TABLE 35

EARNINGS AND EXPENSES OF 274 PERSONAL FINANCE LICENSEES IN INDIANA, 1937, BY TYPE OF LICENSEE[a]

Type of Licensee	*Gross Earnings in % of Employed Assets*[b]	*Expenses in % of Gross Earnings*				*Net Return in % of Employed Assets*[b]	*% Distribution*		*Average Size of Office*[b]
		Total	Salaries	Bad Debts	All Other[c]		Number of Offices	Employed Assets[b]	
Independent individuals	25.2	77.5	42.9	9.4	25.2	5.7	11.3	3.2	$ 19,562
Partnerships	25.4	57.2	34.4	2.5	20.3	10.8	3.6	1.3	24,264
Independent corporations	22.1	72.2	33.1	11.9	27.2	6.1	28.1	18.4	45,400
Indiana chains	27.6	64.7	26.6	6.8	31.3	9.7	46.4	51.4	76,770
Outside chains	28.7	64.7	20.6	10.6	33.5	10.1	8.4	21.2	175,259
Affiliated companies	24.0	66.1	22.1	8.8	35.2	8.1	2.2	4.5	143,901
TOTAL	26.5	66.1	26.6	8.5	31.0	9.0	100.0	100.0	69,303

[a] Based on Indiana, Department of Financial Institutions, *Annual Report, July 1, 1937, to June 30, 1938*, pp. 139–40. The figures refer only to loan operations in Indiana; the total year-end employed assets of the 274 licensees was $18,988,998.

[b] Total employed assets as of December 31st.

[c] Exclusive of interest.

The latter, next to the smallest in average size, have the lowest ratio of expenses and the highest net return on employed assets.

As to the individual expense items, the ratio of salaries to gross earnings is highest for independent lenders, and successively lower for partnerships, independent corporations, local Indiana chains and outside chains. The bad-debt loss percentage shows wide variation; it is lowest for partnerships and highest for independent corporations and outside chains. Other expenses, combined, show a substantially higher percentage for chain and affiliated companies than for the other types.

In considering these figures it should be borne in mind that there are considerable differences in accounting practices, and that therefore the data for the various types of licensees are not rigidly comparable. Also certain specific circumstances undoubtedly affect the data in each case. For example, the notably high net return percentage of partnerships seems to result largely from their notably low bad-debt percentage, and this in turn may be due to specific policies or practices not statistically measurable, rather than to the organizational structure of the licensees, for only a handful of lenders come under this classification. And again, the higher salary percentage and the low net return percentage of independent individual lenders are undoubtedly due partly to the fact that earnings are paid out to owner-managers directly as salaries rather than being retained in the business and distributed periodically as profits. The comparatively favorable position of the chain companies is probably a justified deduction, however, especially in view of the corroborative evidence from the analysis of office size.