Volume Title: Trends and Cycles in the Commercial Paper Market

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Volume Publisher: NBER

Volume ISBN: 0-87014-399-9

Volume URL: http://www.nber.org/books/seld63-1

Publication Date: 1963

Chapter Title: Commercial Paper as a Source of Finance-Company Funds

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Chapter URL: http://www.nber.org/chapters/c1921

Chapter pages in book: (p. 44 - 60)

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Commercial Paper as a Source of Finance-Company Funds

In this chapter I shall examine the role of commercial paper as a source of finance-company funds. This will be done by analyzing finance company balance sheets over varying periods to ascertain trends and cross-sectional differences in their use of commercial paper. The nature of the demand for commercial paper funds by finance companies and the reasons for their increased reliance on this source of short-term money are discussed in Chapter 5.

In studying finance-company use of commercial paper, several bodies of data are available. Primary reliance will be placed on year-end data furnished the National Bureau by forty-two sales finance and twenty-eight personal loan companies for the period 1946-60. These seventy firms will be designated the NBER sample. No attempt has been made to estimate precisely the relationship between this group of firms and the universe of finance companies. However, the sample includes the half dozen or so largest firms in each category, as well as most of the medium-size firms and a number of smaller companies. It appears that the forty-two sales finance companies have held 80 to 90 per cent, and the twenty-eight personal loan companies 90 to 95 per cent, of outstanding credit in their respective universes as here defined.

The other bodies of data used in this analysis are:

1. Two Federal Reserve surveys of finance companies, one as of mid-1955, the other as of mid-1960.
2. Data on twenty-one personal loan companies for the period 1949-58, gathered by the National Consumer Finance Association.

3. Data on forty-eight sales finance companies for the period 1934-38, assembled by Chapman and associates.
4. Data on finance subsidiaries for the period 1946-60, gathered by Victor L. Andrews.
5. The finance and loan company ratios published by the First National Bank of Chicago since 1935.

Various commercial paper statistics derived from these sources may be found in Appendixes D, E, and F.

Sales Finance Companies

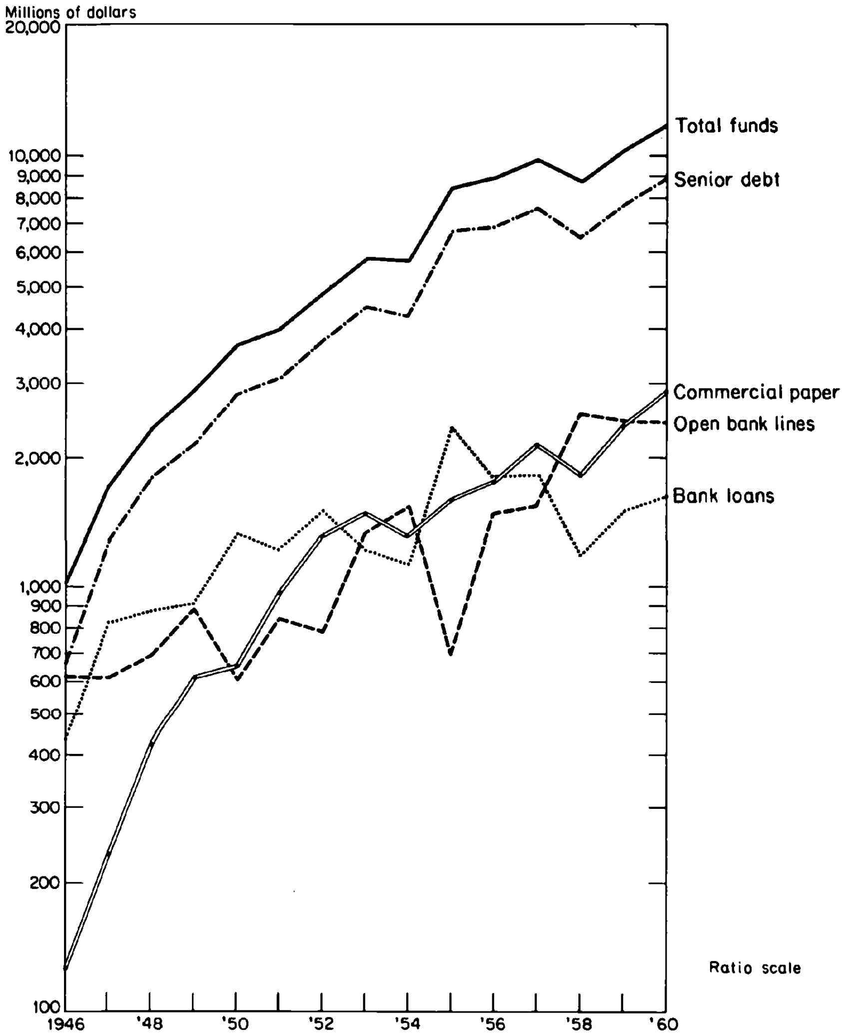
Commercial paper debt of sales finance companies increased by roughly twenty-three-fold, compared with an eleven-fold increase in total finance company funds (i.e., total debt plus net worth), between 1946 and 1960. Over this period commercial paper doubled in importance as a source of sales finance funds: in 1960 $1 of every $4 of these funds was obtained from commercial paper. Paper has outranked bank loans as a source of funds since 1953, except during 1955-56, and it has exceeded open credit lines since 1950, except for 1954, 1958, and 1959. Next to long-term senior debt, commercial paper has become the largest source of sales finance funds, being more than twice as large as subordinated debt and nearly twice as large as bank debt and net worth.[1]

These facts are presented in Chart 6 and Tables 12 and D-1. Chart 6 makes it clear that the rate of growth in sales finance commercial paper was much higher during 1946-52 than in the subsequent period. In fact, 1952 was the high-water mark for commercial paper as a component of sales finance balance sheets: it was 27.7 per cent of total funds, 32.5 per cent of total debt, and 35.4 per cent of senior debt in that year, compared with only 24.9 per cent, 28.5 per cent, and 32.7 per cent, respectively, in 1960 (Table D-1). Only as a component of short-term debt was paper more important in 1960 than in 1952.

[1] Since the early 1950's all commercial paper has been unsecured. The collateral trust note (see p. 32 above), on which sales finance companies had relied so heavily four decades ago, was gradually superseded during the 1930's and 1940's, as finance companies succeeded in establishing strong credit positions.

CHART 6

Selected Items of Debt, Forty-Two Sales Finance Companies, End of Year, 1946-60



Source: NBER finance-company sample.

TABLE 12

COMPOSITION OF TOTAL FUNDS OF SALES FINANCE COMPANIES, NBER SAMPLE FIRMS, BY SIZE CLASSES, 1948, 1953, AND 1960
(per cent)

Year and Item	42 Firms	6 Very Large Firms	6 Large Firms	13 Medium Firms	17 Small Firms
1948					
Bank loans	37.8	34.6	63.3	63.1	62.7
Commercial paper	18.1	20.0	3.0	4.1	3.1
Other short-term debt	1.8	1.9	0.5	0.5	1.1
Total short-term debt	57.7	56.5	66.8	67.7	66.9
Long-term senior debt	19.8	21.6	4.0	4.0	—
Subordinated debt	2.9	2.6	9.6	5.6	3.0
Total debt	80.4	80.7	80.3	77.3	69.9
Net worth	19.6	19.3	19.7	22.7	30.1
Total funds	100.0	100.0	100.0	100.0	100.0
1953					
Bank loans	20.8	16.7	54.6	60.2	61.9
Commercial paper	25.8	28.0	6.6	6.1	2.2
Other short-term debt	0.9	0.8	3.6	0.4	1.0
Total short-term debt	47.5	45.5	64.8	66.7	65.1
Long-term senior debt	29.8	32.4	7.8	4.6	1.8
Subordinated debt	9.5	9.4	10.7	9.3	10.9
Total debt	86.7	87.3	83.3	80.5	77.8
Net worth	13.3	13.7	16.7	19.5	22.2
Total funds	100.0	100.0	100.0	100.0	100.0
1960					
Bank loans	13.9	11.0	32.8	41.5	45.0
Commercial paper	24.9	26.1	20.9	9.7	6.1
Other short-term debt	2.6	2.7	2.4	2.2	1.8
Total short-term debt	41.4	39.8	56.1	53.4	52.9
Long-term senior debt	34.7	37.1	16.6	15.6	12.0
Subordinated debt	11.1	11.0	11.8	12.8	11.6
Total debt	87.2	87.8	84.5	81.8	76.5
Net worth	12.8	12.2	15.5	18.2	23.5
Total funds	100.0	100.0	100.0	100.0	100.0

NOTE TO TABLE 12

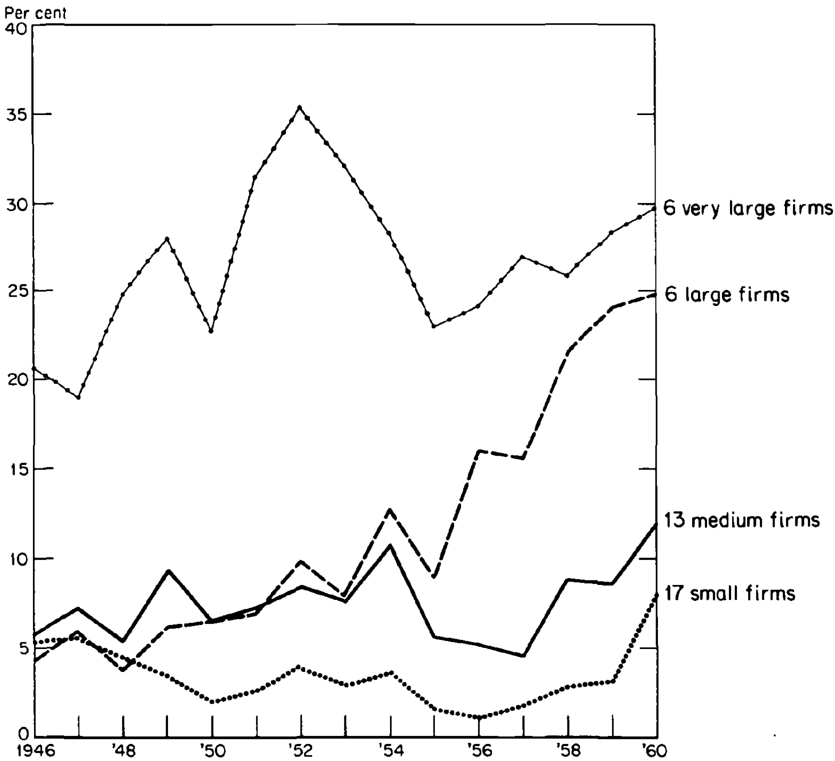
SOURCE: Finance company reports to NBER. See notes to Table D-1. Companies were classified on the basis of their net consumer receivables (including wholesale or "floor plan" paper) in 1953. The class limits are: very large, $100 million or more; large, $25-$100 million; medium, $10-$25 million; and small, under $10 million.

The relationships just described refer to all forty-two sales finance companies in the NBER sample. However, the role of commercial paper has been strikingly different among firms of different size, as Tables 12 and D-1 and Charts 7 and 8 indicate. In these tables and charts the forty-two firms have been classified as very large, large, medium, and small on the basis of their net consumer receivables (including wholesale receivables) in 1953. Because the six very large firms, with receivables of $100 million or more, have such a large share of all sales finance assets and liabilities, their commercial paper ratios cannot differ greatly from those already cited for all companies. Nevertheless, the ratios of paper to total funds, total debt, senior debt, and short-term debt are consistently higher for these six firms than for all forty-two firms. This implies, of course, much lower ratios for most of the remaining firms. For instance, while commercial paper was 26.1 per cent of assets among the very large firms in 1960, it was only 20.9 per cent for the six large firms (receivables of $25-$100 million), 9.7 per cent for the 13 medium firms (receivables of $10-$25 million), and 6.1 per cent for the 17 small firms (receivables under $10 million). Even these disparate ratios are less dissimilar than those of 1948 (20.0, 3.0, 4.1, and 3.1 per cent, respectively). Between that year and 1960 the share of commercial paper in sales finance assets doubled for the small class, more than doubled for the medium class, and rose seven fold for the large class, while increasing by only one-quarter for the very large class.

The year 1952, which stands out as the pivotal point in time for the six very large firms (Chart 7), had no particular significance for smaller sales finance companies. In the three smallest classes commercial paper accounted for a larger share of total debt in 1960 than in any earlier postwar year. The ratio of commercial paper to bank loans was also at a postwar high in 1960, and for the six very large

CHART 7

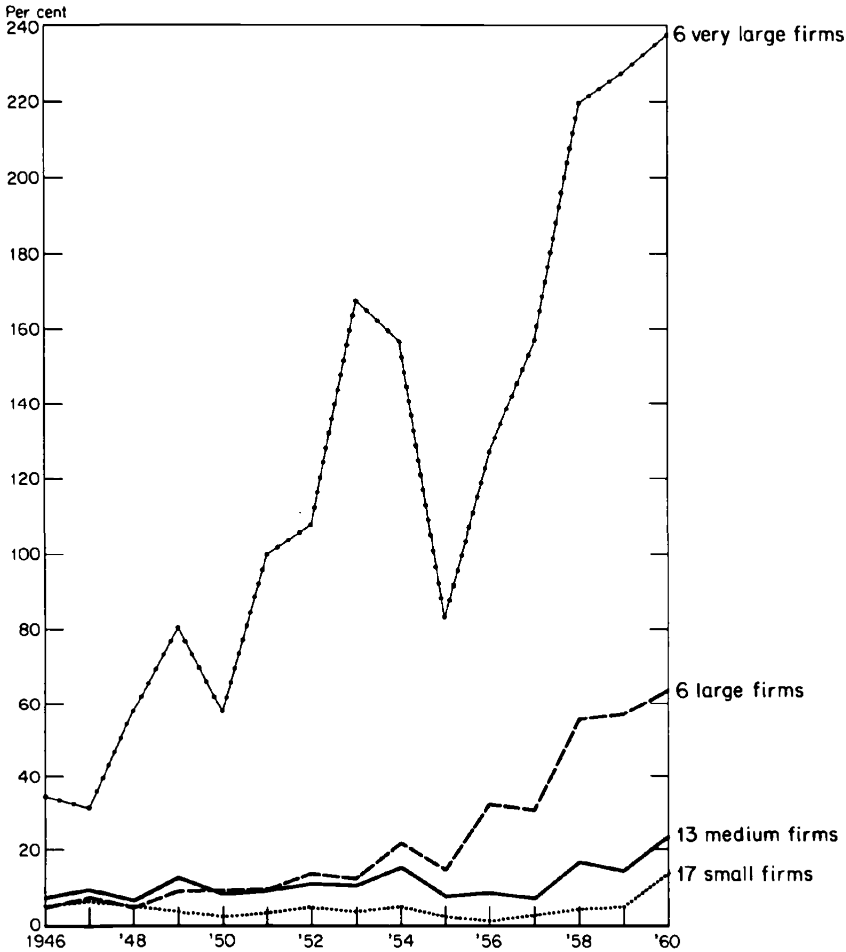
Commercial Paper as Percentage of Total Debt, Sales Finance Companies, by Size Classes, 1946-60



Source: NBER finance-company sample.

CHART 8

Commercial Paper as Percentage of Bank Loans, Sales Finance Companies, by Size Classes, 1946-60



Source: NBER finance-company sample.

firms as well (Chart 8). By 1960 paper was almost 2.5 times bank loans for the very large group, 63 per cent of bank loans for the large firms, and 23 and 13 per cent for the medium and small groups. Nevertheless, despite the substantial substitution that finance companies have made between commercial paper and bank debt during the last decade and a half, banks remain much the most important source of short-term funds for all but the largest sales finance companies.

There is a sharp difference between the very large group and the others in at least one other respect—the relationship between commercial paper and open credit lines at banks (Table D-1). The smaller firms, both in the aggregate and individually, have kept their outstanding paper well within the limits of open credit lines throughout the postwar period, although the margins have narrowed in recent years.[2] In contrast, the recession years, 1954 and 1958, have been the only occasions since 1950 when this has been true for the very large group.

Tables D-2 to D-5 contain a great deal of additional information on the role of commercial paper in sales finance company operations. Table D-2 offers a picture of conditions before World War II, although it covers only 1934-38, for forty-eight sales finance companies, and 1937-38 by size groupings. These data indicate that commercial paper was equal to 38.0 per cent of sales finance debt in 1934, substantially above the highest postwar figure (32.5 per cent in 1952) in Table D-1. However, as a percentage of total funds, commercial paper was at about the same level throughout 1934-38 as in the postwar period, because of the greater reliance on net worth before the war. Commercial paper declined relative to total debt after 1934 and reached levels characteristic of the postwar period by 1938. It is interesting that local firms were obtaining approximately as much of their debt funds from commercial paper as the three national firms in 1937-38. This is sharply different from the postwar situation.

Table D-3 presents information on commercial paper as a source of funds for finance subsidiaries, many of which are business finance companies, over the period 1946-60. In general, the ratios of commercial paper to total funds and total debt have been about the same for these companies as for the forty-two NBER sample firms. However, the sub-

[2] The apparent exceptions for the small firms in 1946-49 occurred because several companies that did not borrow commercial paper funds borrowed from banks in these years without benefit of lines of credit. Because of this, bank loans exceeded credit lines in the small class during 1946-48 and nearly did so in 1949.

sidiaries have obtained somewhat more of their short-term funds from banks, and less from paper, in the last few years than have the NBER firms. Many of these firms, of course, did not use paper at all.

The data from the Federal Reserve surveys of finance companies made in 1955 and 1960, shown in Table D-4, are interesting for students of commercial paper because they cover virtually the entire industry, and because the size breakdowns among the smaller firms are much more detailed than in other tabulations.[3] Earlier, from Table D-1, it was shown that degree of reliance on commercial paper as a component of short-term, senior, and total debt increases with firm size. The 1960 data in Table D-4 show the same tendency for the three largest size classes, but the opposite tendency in the remaining classes. Thus, the relation between reliance on commercial paper and firm size would appear to be described by a U-shaped curve when very small firms are included in the analysis.

This conclusion may well be doubted, however. The Federal Reserve concept "commercial paper and other short-term notes payable" includes a substantial amount of debt other than commercial paper—debt such as investment certificates, loans from employees, savings and loan shares of finance-company subsidiaries, and so forth. These forms of debt are more important for very small firms than for firms of medium or large size. Furthermore, it is known that commercial paper borrowers are preponderantly large firms. Of the 327 borrowers in 1960, only six had a net worth of less than $1 million, and only two of the six were

[3] When the mid-1955 debt ratios for all companies are compared with the year-end figures in Table D-1, it is found that the latter are somewhat below the former in every case. One would expect this for two reasons. First, the numerator of the ratios computed from the Federal Reserve survey results is "commercial paper and other short-term notes payable," a concept that is somewhat broader than that employed in the NBER sample calculations. Second, there is a seasonal decline in paper (and a corresponding rise in bank debt) at the end of each year. The same pattern exists in both sets of 1960 data as well. However, the differences are smaller in 1960, and the NBER data show commercial paper as a larger component of short-term debt than do the Federal Reserve data (60.0 and 57.4 per cent, respectively). The reason for this discrepancy can be found in business cycle developments during 1960. The Federal Reserve data represent conditions close to the May 1960 cycle peak; finance companies tend to rely more on bank debt and less on commercial paper at such times because paper rates are high relative to bank borrowing costs and there is little advantage in borrowing on the open market. By the end of the year, paper rates were well below bank rates, and there was ample incentive for borrowers to make relatively greater use of commercial paper and less of bank loans.

finance companies.[4] Yet most, if not all, firms reporting net consumer receivables of under $1 million (the four smallest Federal Reserve classes) had net worth no larger than $1 million. Some of these companies may have placed paper directly with individuals or others, but it is certain that they did not borrow through dealers. This comment probably applies to the next size class ($1 million to $2.499 million) as well. It seems likely, therefore, that my earlier conclusion is the correct one: that reliance on commercial paper increases with firm size over the entire size range.

A final body of data relating to sales finance companies, the composite ratios prepared by the First National Bank of Chicago, is presented in Table D-5. For the postwar period these ratios tell much the same story as the NBER and other data examined earlier.[5] They reveal a strong trend toward greater use of long-term debt and less use of short-term debt, with commercial paper rising modestly in importance but bank debt still three times as large, despite its declining importance. But the most interesting feature of these data is that they cover 1935-41 as well as the postwar years. In general, they confirm the evidence in Table D-2, which indicated that commercial paper was a considerably larger fraction of total debt before the war, and that net worth was then a much more important source of sales finance funds than now.

Personal Loan Companies

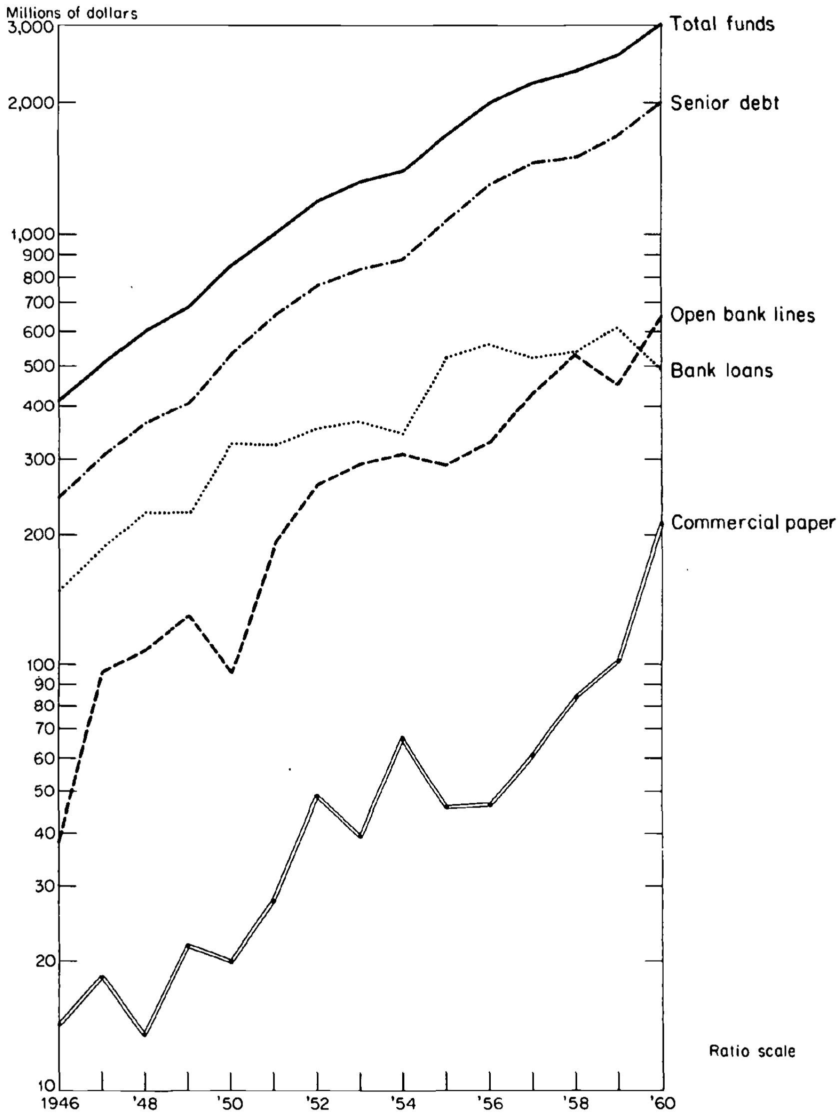
Charts 9, 10, and 11 and Tables 13 and E-1 reveal interesting contrasts between the debt patterns of personal loan and sales finance companies. Total funds of personal loan companies have grown somewhat less rapidly, but more steadily, than sales finance total funds. There is only the slightest hint of a retardation in their growth since the early postwar years. Senior debt, of course, is less important for these firms but still

[4] Data derived from records of the National Credit Office.

[5] The composite ratios are unweighted averages of ratios for an undisclosed number of individual sales finance companies. Thus the largest and smallest firms included have the same impact on the ratios. See notes to Table D-5 for other problems in these data. Quite obviously the levels of these ratios should not be compared with those in Tables 12 and D-1. However, changes over time should be broadly similar in the two sets of ratios.

CHART 9

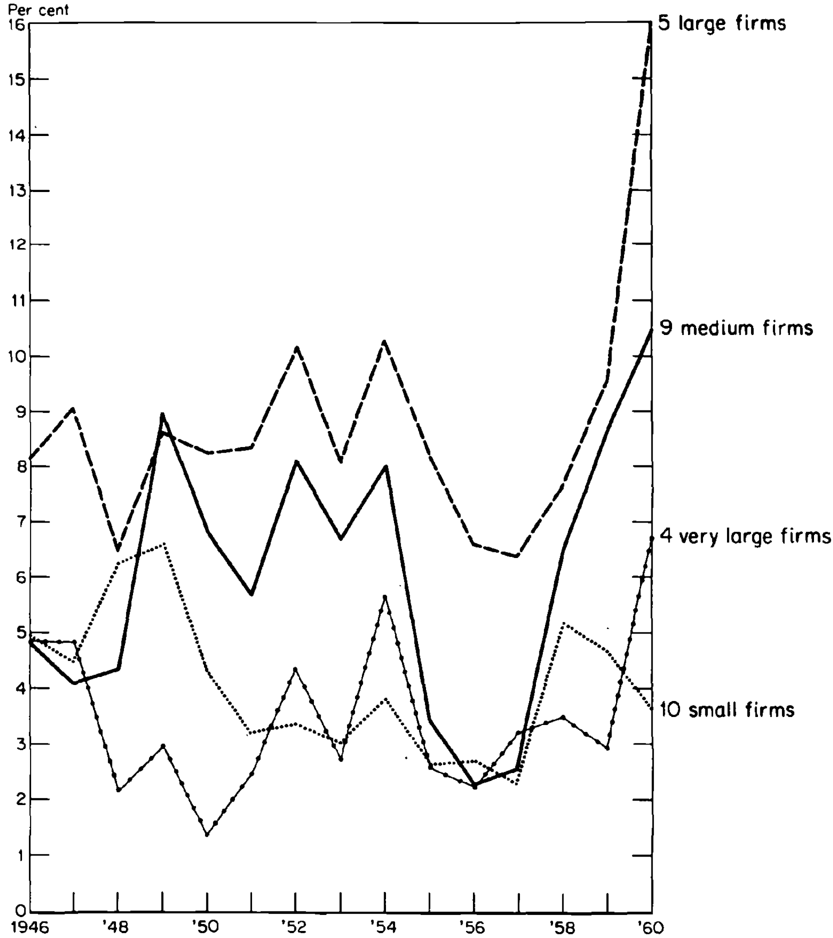
Selected Items of Debt, Twenty-Eight Personal Loan Companies, End of Year, 1946-60



Source: NBER finance-company sample.

CHART 10

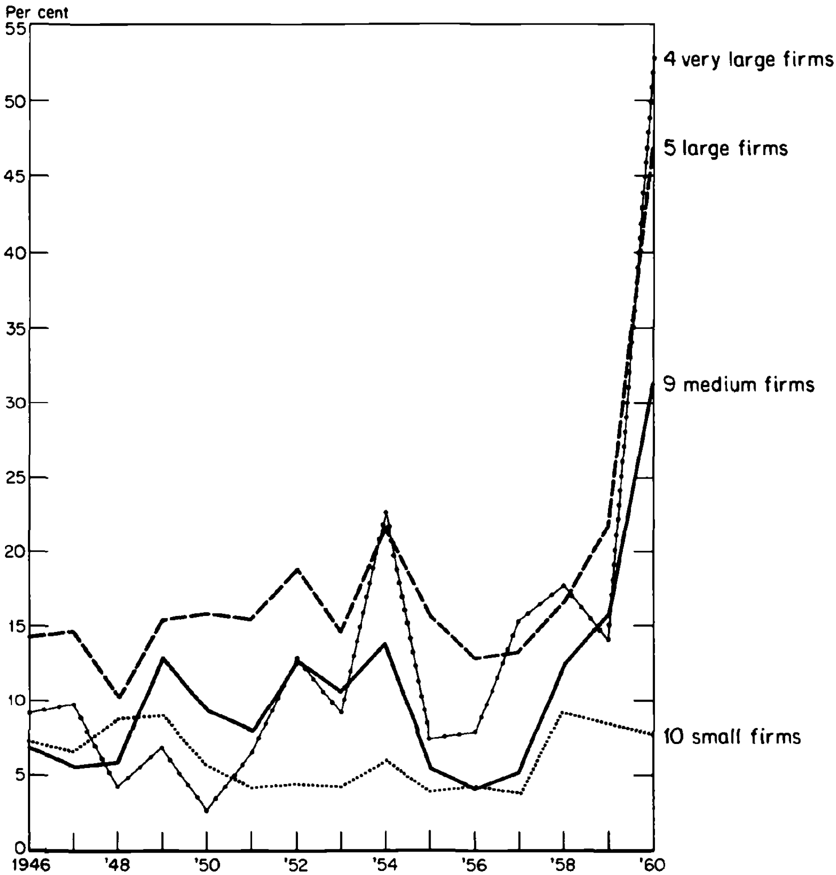
Commercial Paper as Percentage of Total Debt, Personal Loan Companies, by Size Classes, 1946-60



Source: NBER finance-company sample.

CHART 11

Commercial Paper as Percentage of Bank Loans, Personal Loan Companies, by Size Classes, 1946-60



Source: NBER finance-company sample.

TABLE 13

COMPOSITION OF TOTAL FUNDS OF PERSONAL LOAN COMPANIES, NBER SAMPLE FIRMS, BY SIZE CLASSES, 1948, 1953, AND 1960
(per cent)

Year and Item	28 Firms	4 Very Large Firms	5 Large Firms	9 Medium Firms	10 Small Firms
1948					
Bank loans	35.9	28.7	45.4	55.7	54.4
Commercial paper	1.9	0.8	4.7	3.2	4.6
Other short-term debt	0.5	0.3	0.5	0.4	5.2
Total short-term debt	38.3	29.9	50.6	59.3	64.2
Long-term senior debt	20.8	29.5	11.2	2.0	0.7
Subordinated debt	6.4	2.3	16.5	12.5	9.8
Total debt	65.5	61.7	72.2	73.9	74.7
Net worth	34.5	38.3	27.8	26.1	25.3
Total funds	100.0	100.0	100.0	100.0	100.0
1953					
Bank loans	25.6	15.8	42.1	45.8	51.9
Commercial paper	2.7	1.3	6.1	4.8	2.2
Other short-term debt	0.7	0.6	0.5	0.5	3.1
Total short-term debt	29.0	17.7	48.7	51.1	57.2
Long-term senior debt	33.4	45.1	13.1	9.9	3.0
Subordinated debt	6.3	2.8	13.9	11.7	11.5
Total debt	68.7	65.7	75.8	72.6	71.7
Net worth	31.3	34.3	24.2	27.4	28.3
Total funds	100.0	100.0	100.0	100.0	100.0
1960					
Bank loans	16.4	9.3	27.0	25.8	36.4
Commercial paper	7.1	4.9	12.6	8.1	2.8
Other short-term debt	2.4	2.3	2.0	3.3	3.3
Total short-term debt	25.9	16.5	41.6	37.2	42.5
Long-term senior debt	40.3	49.9	24.8	27.5	22.3
Subordinated debt	9.4	7.2	12.7	12.9	12.3
Total debt	75.6	73.6	79.2	77.6	77.2
Net worth	24.4	26.4	20.8	22.4	22.8
Total funds	100.0	100.0	100.0	100.0	100.0

SOURCE: Finance-company reports to NBER. See notes to Table D-1. For class limits, see notes to Table 12.

the largest part of total funds. Bank loans have been much more important than commercial paper throughout the period; however, the gap has narrowed dramatically since 1956 and may disappear altogether in a few more years. At the end of 1960 the ratio of commercial paper to total debt was 9.4 per cent, in contrast to 28.5 per cent for sales finance companies (Table E-1). Paper was only 43 per cent of bank loans for personal loan companies in 1960, compared with 178.7 per cent for sales finance companies. Note that open bank lines have far exceeded commercial paper in every year and have grown at about the same rate (Chart 9).

Further contrasts are apparent with respect to the size-class data. Until 1954 large personal loan companies relied on commercial paper to a greater extent than did sales finance companies of similar size; the same was true of small personal loan companies until 1960 (Table E-1). The very large firms, on the other hand, have not made great use of commercial paper; even in 1960, the peak year, their ratio of paper to total debt was only 6.7 per cent. Also, while there has been a sharp increase in this ratio among small and large sales finance companies since 1954, these groups of personal loan companies have recorded much smaller increases.

When commercial paper is related to bank debt, rather than to total debt, the same general picture emerges: until the mid-1950's commercial paper was more important among personal loan companies in the three smallest size classes than among sales finance companies in these classes. In fact, the medium personal loan companies still have a somewhat higher ratio of paper to bank loans. The very large firms have at all times used far less paper relative to bank loans than their sales finance counterparts. Nevertheless, all size classes displayed a significant shift away from bank debt and into commercial paper in the last two or three years.

These results are confirmed by the data in Table E-2, which were compiled by the National Consumer Finance Association (NCFA) from financial statements of twenty-one personal loan companies for the period 1949-58. The NCFA size groupings are useful in that data for the two largest firms in the industry are broken out; these firms, of course, are members of the very large grouping in the NBER sample. From a comparison of the NCFA and NBER figures it is clear that the two largest firms make decidedly less use of commercial paper than the third and fourth largest firms. For example, in 1958 commercial paper was 3.5 per cent of total debt for the four very large personal loan companies

(Table E-1) but only 0.9 per cent for the two largest firms (Table E-2). One may infer from these figures that for the third and fourth largest firms commercial paper was 6 per cent or more of total debt in 1958.

Commercial paper ratios for the NCFA's seven moderately large firms are quite close to those for the five large firms in the NBER sample; the same is true of the NCFA's four medium firms and the nine NBER medium firms. On the other hand, the eight small NCFA firms did not borrow commercial paper funds at all during 1949-58, in contrast to the ten small NBER firms. The contrast is more apparent than real, however. Seven of the ten small NBER firms did not use commercial paper at any time during 1946-60. The three firms that did use paper made fairly heavy use of it: in 1958 their paper was 9 per cent of total debt and 13 per cent of short-term debt.

As in the case of sales finance companies, there are additional data on personal loan company debt from the Federal Reserve mid-1955 and mid-1960 surveys of finance companies and from the composite ratios of the First National Bank of Chicago. The composite ratios (Table E-5) are broadly consistent with the evidence already examined, and since they add little information they will not be analyzed here. The Federal Reserve data consist of separate tabulations for "consumer finance companies" (Table E-3) and "other personal finance companies" (Table E-4).

Both in 1955 and 1960, the Federal Reserve data suggest a much greater use of commercial paper by personal loan companies of both types than the NBER and NCFA data. This is true regardless of firm size; the differences are particularly large for the "other personal finance companies," for whom "commercial paper and other short-term notes payable" was 29.2 per cent of short-term debt in 1960 and 59.1 per cent in 1955. The explanation of these differences is the same for personal loan companies as for sales finance companies—the inclusion of debt other than commercial paper in the Federal Reserve category "commercial paper and other short-term notes payable." Such items of short-term debt are known to be particularly important for firms assigned to the "other personal finance companies" class.

Business Finance Companies

Evidence on the role of commercial paper in business finance company operations is scanty indeed, consisting only of data from the Federal Reserve mid-1960 survey (Table F-1). Business finance companies lie between sales finance and personal loan companies both in aggregate volume of paper ($479 million) and in degree of reliance on paper. In 1960 commercial paper was 30.2 per cent of total debt for sales finance companies, 18.3 per cent for business finance companies, 15.5 per cent for consumer finance companies, and 14.0 per cent for other personal finance companies (Tables D-4, E-3, E-4, and F-1). As in the case of sales finance companies, the largest firms made the greatest use of paper.