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Equipment Financing Market

THE MARKET SERVED by equipment financing agencies can be described in two ways, in terms of the types of equipment financed and of the size and industrial characteristics of the concerns acquiring equipment on an instalment payment basis. Since the financing agencies often have only indirect dealings with the ultimate purchasers of equipment, it will be necessary also to describe the sources from which these agencies acquire instalment sales contracts.

The task of formulating a factual description of the characteristics of this market is particularly difficult because only a limited amount of information can be obtained directly from financial institutions; available data provide only a general picture of the types of equipment financed on this basis. It is even more difficult to obtain data describing the chief characteristics of businesses purchasing equipment on an instalment basis. However, some inferences can be made as to the kinds of concerns that make up the demand side of the market; these inferences are drawn from information made available by several financing agencies, from a special study based on the mercantile credit reports of Dun & Bradstreet, Inc., and from the nature of the equipment itself.

Types of Equipment Financed

The great diversity of types of equipment financed by instalment financing agencies is indicated by the following data, based upon detailed reports submitted by seven commercial banks and one large commercial finance company as of the middle of 1941. The data are best described as a classification of "deals," where a deal is a continuing arrangement between a financing agency and a vendor of income-producing equipment whereby the former purchases instalment contracts arising out of instalment sales by the

	Source of Instalment Paper	
	Manufacturers' Deals	Distributors' Deals
Hotel, restaurant, bar, fountain and store fixtures	12	13
Commercial refrigeration and air conditioning	5	16
Barber and beauty parlor equipment	2	18
Road building, construction, excavation and farm machinery	3	9
Transportation equipment (busses, trailers, trucks, barges)	7[a]	2
Cleaning, laundry, and pressing machinery	1	7
Diesel engines	4	2
Medical, dental and surgical equipment	1	4
Baking machinery	0	3
Dairy and poultry farm equipment	3	1
Diners	3	0
Garage and service station equipment	0	2
Machine tools	0	3
Bowling and billiard equipment	1	1
Printing machinery	0	2
Other machinery and equipment	8	2
TOTAL	50	85

[a] Includes 4 deals unspecified as to source.

latter. The largest number of deals for the reporting agencies was in equipment sold to various kinds of service enterprises; of 135 separate deals, equipment and fixtures for stores, hotels, restaurants, bars and soda fountains provided 25 accounts, while 20 accounts arose out of sales of equipment for barber shops and beauty parlors. Another important type of financing is that arising out of installations of commercial refrigeration and air conditioning equipment. Unfortunately it is not possible to discuss the relative importance of these several types of business since there are no data on the dollar volume of paper arising from sales of the different types of equipment.

Information provided by two commercial finance companies does make it possible to rank the various types of equipment according to dollar volume of outstandings. It should be cautioned at this point, however, that generalizations as to the kinds of equipment paper held by equipment finance companies cannot be drawn from the experience of any two companies; a substantial volume of outstandings can be built up by one company out of a special contract with some one manufacturer, covering a type of equipment paper not available in any great volume to other financing concerns. It is the diversity of equipment paper held even by individual financing agencies, and the change in distribution that occurs over short periods that are of principal interest in the following materials.

One of the finance companies reported a percentage distribution of outstanding instalment equipment paper as follows:[1]

	1940	*1937*
Furniture	19.8%	7.2%
Automatic refrigeration	13.7	6.2
Airplanes	10.0	2.3
Automatic phonographs	7.1	9.5
Theater and sound equipment	6.3	8.3
Coin operated dispensers	5.8	..
Automatic coal stokers	5.8	26.6
Beauty parlor equipment	3.5	9.8
Traffic controls	3.3	2.8
Laundry and dry cleaning machinery	2.9	.6
Busses	2.5	1.3
Printing machinery	2.5	1.9
Bakery equipment	1.7	.5
Store fixtures	1.7	5.6
Air conditioning equipment	1.0	1.3
Office appliances	.9	..
Miscellaneous machinery and equipment[a]	6.2	8.2
Consumer goods and unclassified equipment	5.3	7.9
TOTAL	100.0%	100.0%
	$5,923,000	$6,565,000

[a] Includes the following in approximately equal proportions: industrial trailers, miscellaneous machinery, vulcanizing and garage equipment, road building machinery, packing house equipment, industrial cutting and sewing machinery, textile machinery, medical equipment, elevators.

The holdings of instalment industrial lien notes of the other finance company, classified by the type of product on which a lien was held, are shown in Table 6.

That this wide diversity of types of equipment financed under the instalment plan has been characteristic of the business for over a decade is evidenced in an address by H. B. Lewis, Vice-President of Commercial Credit Company, before the American Management Association in November 1931.[2] Mr. Lewis listed the follow-

[1] Based on reports to the Securities and Exchange Commission. Data are for year ends.

[2] H. B. Lewis, *Installment Selling of Industrial Equipment* (American Management Association, Industrial Marketing Series, I. M. 17), p. 4.

Table 6—PERCENTAGE DISTRIBUTION OF NOTE HOLDINGS OF A COMMERCIAL FINANCE COMPANY, 1936, 1938-40, BY TYPE OF EQUIPMENT FINANCED[a]

Equipment	*1940*	*1939*	*1938*	*1936*
Printing machinery	28.0%	20.9%	27.5%	20.5%
Hotel furnishings	25.1	11.6	..	..
Dry cleaning equipment	13.7	17.4	15.5	6.1
Laundry machinery	12.9	14.9	22.2	21.1
Bottling machinery	4.5	5.7	3.9	..
Vending machinery	4.1	..	..	..
Textile and knitting machinery	3.7	7.1	6.0	12.6
Store and fountain equipment	2.6	..	..	..
Lithographing equipment	..	10.6	10.7	6.7
Bakery equipment	..	3.4	3.3	..
Box-making equipment	..	2.0	..	..
Metal stamping machinery	..	..	2.2	..
Folding machinery	..	..	..	12.8
Brewery equipment	..	..	..	11.8
Miscellaneous	5.4	6.4	8.7	8.4
TOTAL	100.0%	100.0%	100.0%	100.0%
	$1,863,000	$1,345,000	$1,271,000	$1,220,000

[a] Year-end data from reports to the Securities and Exchange Commission.

ing as types of industrial equipment which were being sold at that time on an instalment payment basis and being financed by Commercial Credit Company:

> automotive equipment, amusement equipment, bakers' and confectionery equipment, barber and beauty parlor equipment, boilers and tanks, bookbinding machinery, bottling and glass machinery, butchers' equipment, canning machinery, cigar and cigarette machinery, combustion equipment, concrete mixing machinery, contractors' equipment, dairy equipment, Diesel engines, dental equipment, electrical appliances, electric furnaces, electric motors, floor waxing machinery, gas and oil engines, filing machinery, foundry and steel machinery, hotel equipment, hat blocking machinery, hoists, cranes and conveyors, excavating machinery, flour mill equipment, heating systems, ice machinery, irrigating equipment, laundry machinery, machine tools, marine equipment, mill supplies, mining equipment, oil burners, oil well equipment, package wrapping equipment, paper mill machinery, musicians' equipment, printing machinery, projecting and sound reproducing equipment, pumps and compressors, refrigerators, road machinery, rubber specialty machinery, sewing machinery, shoe manufacturing and repairing machinery, soda fountains, fumigating and spraying equipment, store fixtures, stoves and ranges, textile machinery and wood working machinery.

From this evidence one generalization can be made as to types of products entering into equipment financing, namely that they are usually movable and do not become part of the purchaser's real estate. This is an important consideration because it affects the security interest of the financing agency. There are exceptions, of course, in which the equipment, or major parts of it, become a part of the real property of the plant or store in which it is installed, for example, heating and air conditioning installations and automatic power piping and sprinkler systems. While installations of this type may not be readily removable, their acquisition on an instalment payment basis becomes feasible if they are a critical part of the plant's operating process and can be easily rendered unworkable by the financing agency in the event of default. This can be done with even the heaviest Diesel electric-generating plants; as another example, the nozzles can be taken from an automatic sprinkler system and, since the insurance rate payable on the property increases immediately, this exerts considerable pressure on the debtor to correct the default. The possibility of making partial repossessions of this sort is clearly important in widening the range of installations that can be financed on an instalment payment basis.

Finally, it should be indicated that equipment purchased on an instalment payment basis is sometimes acquired not as a single unit but as a collection of items. This is frequently the case with sales of garage and service station equipment; a number of items of equipment are incorporated into a single conditional sales contract and a single instalment note or series of notes. This has the advantage, for the buyer, of identical terms on all items and, for the financing agency, of greater economy in collection. However, in the great majority of cases the instalment equipment paper represents the purchase of a single piece of equipment.

Types of Concerns Acquiring Equipment on an Instalment Payment Basis

Credit officers experienced in equipment financing contend that all types of concerns from the smallest to the very largest are actual or potential instalment buyers of income-producing equipment. While this is no doubt true, most instalment sales are confined to a limited variety of types of concerns. At any rate, the frequency with which this credit device is utilized is much higher in some lines of business than in others.

Our principal source of information on the types of concerns acquiring equipment on an instalment basis was a study of the financial statements of a large sample of business enterprises. The study was based on 6,181 credit reports prepared by Dun & Bradstreet, Inc., referring to December 31, 1939, or to a date within six months earlier or later, and covering five major industrial divisions: manufacturing, wholesale trade, retail trade, construction and service.[3]

In this analysis the most direct information that could be obtained on equipment financing consisted of statements in the credit reports showing whether the individual concerns were indebted on a chattel mortgage or conditional sales contract basis, or were using equipment under a bailment lease arrangement.

The principal defect of these data is that they may include certain debts not incurred for the purpose of acquiring income-producing equipment on an instalment payment basis and thus not within the scope of our definition. It is quite possible that some of the chattel mortgages reported accompany debts entered into for the purpose of general financing. However, that this is not a major source of error has been indicated by a supplementary investigation which showed that of the 444 cases in the Dun & Bradstreet reports only 17 were chattel mortgages covering assets other than equipment or automobiles and trucks. Thus the data can be used for a rough indication of the market for equipment financing.

Three main conclusions may be drawn from Table 7 concerning the types of concerns most likely to acquire commercial and industrial equipment on an instalment payment basis. First, this type of credit is extended most frequently to concerns in service industries; retail trade is the industrial group showing the next highest frequency of use, and manufacturing next. Second, a larger percentage of concerns with a low credit rating than of concerns with a high rating have been extended credit of this sort. Third, in general, a larger proportion of small concerns than of large concerns obtained income-producing equipment on this basis. The

[3] The procedures followed in selecting the sample and analyzing the balance-sheet data are discussed in an unpublished study of the National Bureau of Economic Research (Financial Research Program), *Industrial and Commercial Debt—A Balance Sheet Analysis, 1939,* by Carl Kaysen (ms. 1942) pp. 3-10.

Table 7—Total Number of Reporting Concerns and Percent Using Equipment Financing Facilities, by Main Industry Groups, Size of Concern and Credit Rating[a]

Credit Rating—by Industry	Asset Size of Concern[b]									
	Less than $25,000		*$25,000–250,000*		*$250,000–5,000,000*		*$5,000,000 and Over*		*All Concerns*	
	No.	%	No.	%	No.	%	No.	%	No.	%
Manufacturing										
High	254	5.5%	907	5.3%	731	2.3%	207	.0%	2,099	3.8%
Low	108	25.0	232	13.4	118	5.1	12	.0	470	13.6
Total	362	11.3	1,139	6.9	849	2.7	219	.0	2,569	5.6
Retail Trade										
High	595	8.7	423	2.4	11	.0	0	.0	1,029	6.0
Low	386	24.1	160	12.5	1	.0	0	.0	547	20.7
Total	981	14.8	583	5.1	12	.0	0	.0	1,576	11.1
Wholesale Trade										
High	177	5.1	585	3.1	149	1.3	6	.0	917	3.2
Low	26	11.5	151	9.9	20	.0	0	.0	197	9.1
Total	203	5.9	736	4.5	169	1.2	6	.0	1,114	4.2
Service										
High	126	13.5	118	7.6	11	.0	0	.0	255	10.2
Low	115	34.8	60	23.3	7	28.6	3	.0	185	30.3
Total	241	23.7	178	12.9	18	11.1	3	.0	440	18.6
Construction										
High	109	5.5	124	.8	11	.0	2	.0	246	2.8
Low	52	13.5	23	4.3	1	.0	0	.0	76	10.5
Total	161	8.1	147	1.4	12	.0	2	.0	322	4.7

[a] Based upon analysis of Dun & Bradstreet credit reports relating to dates within the 12-month period July 1939 to June 1940; the bulk of reports were for December 31, 1939. Concerns were counted as using equipment financing facilities if they were indebted on a conditional sales contract, bailment lease or chattel mortgage basis.

[b] Each size class is inclusive of the lower limit and exclusive of the upper.

last conclusion applies to each of the major industrial groups, but it should be pointed out that even the relatively large concerns in the service industries are quite frequently users of equipment financing facilities. There are, of course, certain relationships between these characteristics. For example, concerns in the service industries are mostly small and groups of small concerns tend to have a higher proportion of low credit ratings than groups of large concerns. (See also Chart 2.)

The information assembled in connection with the Dun & Bradstreet study was examined by minor industrial groupings as a supplement to the analysis presented in Table 7. When the subdivisions of the manufacturing group are studied with respect to the use of chattel mortgage credit, it is found that in only six of the minor industrial groups were 8 percent or more of the concerns indebted on a chattel mortgage basis. These subdivisions were as follows: printing and publishing (28 percent); paper boxes, etc. (14 percent); baking (11 percent); beer and alcoholic beverages (9 percent); stone (9 percent); saw and planing mills (8 percent). Among the minor subdivisions of the retail trade group, the following were the most frequent users of chattel mortgage credit: restaurants (45 percent); grocery and meat (27 percent); drug stores (23 percent); grocers (21 percent); filling stations (12 percent).

The manufacturing and retail trade samples assembled in connection with this study were sufficiently diversified to cover all principal phases of these major industrial groupings, but only five branches of the service industry were analyzed. These subdivisions and the percentages of concerns within them using equipment financing credit were as follows: cleaners and dyers (33 percent); laundries (25 percent); funeral directors (13 percent); year-round hotels (12 percent); garages (10 percent). In no one of the subdivisions of wholesale trade or of the construction industry were more than 10 percent of the concerns using equipment financing.

Sources of Instalment Equipment Receivables

In equipment financing the instalment receivables are customarily acquired by the financing agency directly, that is, through a relationship established with the manufacturer or distributor rather than

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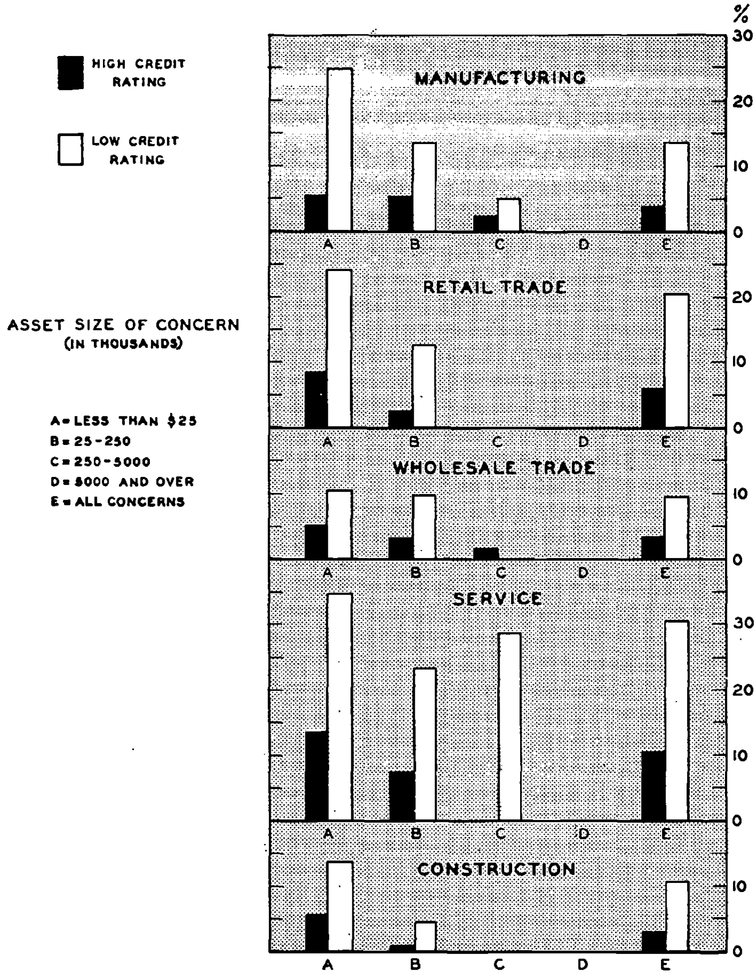
PERCENT OF CONCERNS IN SPECIFIED INDUSTRY, SIZE AND CREDIT-RATING CLASSES USING EQUIPMENT FINANCING FACILITIES[a]



[a] BASED ON SAMPLE STUDY OF DUN AND BRADSTREET CREDIT REPORTS. FOR DATA SEE TABLE 7.

directly with the buyer. Earlier in this chapter we saw that in some lines both manufacturers and distributors are important as sources of contracts, while in other lines contracts are purchased almost exclusively from one or the other. Considerable importance is attached to the relationship between the vendor of equipment and the financing agency. First, it is through this relationship that the financing agency hopes to acquire a sufficiently steady and sizable volume of business to make its operations profitable. Second, through this relationship the financing agency frequently obtains additional security by means of some kind of recourse arrangement with the vendor. Equipment financing of the direct type occurs where loans, secured by equipment, are made by financing agencies, in this case usually commercial banks, to purchasers of equipment. Where a bank prefers to do its financing directly with the buyer of equipment, this is generally on the grounds of being able to select credits more discriminatingly while avoiding being dependent for business on possibly tenuous relationships with dealers or manufacturers.

Some information on the size (in total assets) of the manufacturers and distributors providing instalment contracts was assembled with the cooperation of seven commercial banks and one commercial finance company. The data show that the manufacturers supplying instalment contracts range in size of total assets from $30 thousand to approximately $75 million. As would be expected, the largest manufacturers were found to be those selling heavy industrial machinery. The range in the sizes of distributors was also wide, varying from a low of $8 thousand (in total assets) to a maximum of $4 million. The largest distributor reported was in the service industry equipment line, a concern with around $4 million of assets, while the largest distributor of industrial machinery and equipment had only $2 million of assets. This result may, however, be accidental and due to the relatively small size of the sample of distributors studied.

It is to be expected that the average size of distributors originating instalment equipment receivables would be substantially smaller than the average size of manufacturers. Thus, the reporting commercial banks and commercial finance companies indicated purchases of contracts from 39 manufacturers, of which almost half had total assets of between $100 thousand and $500 thousand. In contrast, approximately 50 percent of the distributors had assets of between $50 thousand and $250 thousand.

This information on the size of manufacturers and distributors discounting their instalment contracts with financing agencies should not be taken, of course, as setting a maximum limit on the size of concerns utilizing this type of credit service. Available statistical information does not cover the whole field but it is known that the very largest manufacturing companies discount their instalment sales contracts, sometimes under established financing plans which are arranged with commercial finance companies or commercial banks. Furthermore, there are other types of financing, essentially similar to the commercial and industrial equipment type of credit arrangement discussed above, through which relationships are established between commercial banks and distributors or manufacturers of machinery and equipment. An example of this is the arrangement by which vendors pledge instalment liens as collateral on which to borrow. Some of the very largest corporations are borrowers on this basis. Finally, it is important to note that while it is through these equipment financing arrangements that relatively *small* concerns obtain the credit necessary to acquire income-producing equipment, this end is accomplished through an arrangement which relates the financing agency to a relatively large or medium-sized corporation.