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Financial Structure

INDUSTRIAL banking companies, as has been pointed out, are most effectively differentiated from other consumer credit agencies by reference to the sources of their working funds. As between industrial banking companies and commercial banks, however, a distinction must rest rather upon a comparison of the uses to which these two types of institutions devote their assets. A study of the asset and liability structure of industrial banking companies serves to clarify this aspect of operation, and also provides the basis for an explanation of the profitability record of these companies.

SOURCES OF FUNDS

The financial structures of industrial banking companies have shown a marked change as these companies have matured into established institutions. At the present time, while there is scarcely any real uniformity, there is a considerable degree of similarity, at least within certain groups of companies. For all companies the chief sources of funds are equity account (capital, surplus and undivided profits), deposit and investment certificate accounts, and bank borrowings. These vary in relative importance, however, from one firm to another.

For a study of the evolution of the financial structures of industrial banking companies the best available data are those compiled by The Morris Plan Corporation of America. These data, presented in Table 1, cover the years 1920-37,

TABLE 1

SOURCES OF FUNDS OF REPORTING MORRIS PLAN BANKING COMPANIES, 1920–37, IN PERCENT OF TOTAL ASSETS[a]

Year	*Number of Companies*	*Source of Funds*			*Total Assets*[c]
		Equity Account[b]	Deposits and Certificates	Borrowings and Rediscounts	
1920	87	42.7	31.2	19.9	$ 31,148
1921	85	40.2	38.4	15.1	34,837
..[d]	..	..	..	..	..
1925	98	24.2	62.0	7.7	88,408
..[d]	..	..	..	..	..
1929	107	20.7	63.9	8.9	138,273
1930	103	21.2	66.4	6.5	143,043
1931	105	22.7	66.8	4.3	127,616
1932	100	23.5	68.4	1.1	109,288
1933	97	23.7	68.0	1.5	99,120
1934	95	23.6	67.8	1.8	106,536
1935	95	21.4	69.5	1.4	122,903
1936	93	18.7	71.3	1.6	143,716
1937	91	17.3	72.4	2.5	157,365

[a] Based on year-end data supplied by The Morris Plan Corporation of America. The percentages do not add to 100; the difference represents reserves and miscellaneous liabilities.
[b] Capital, surplus and undivided profits.
[c] In thousands of dollars.
[d] Data for 1922-24 and 1926-28 are not available.

and although the number of companies represented changes from year to year, the coverage of Morris Plan institutions is so complete that the principal tendencies revealed by these figures may be considered reliable. One of the more significant of these trends is the dwindling relative importance of the equity items. In 1920 and 1921 these items accounted for somewhat more than two-fifths of total liabilities. Their relative weight dropped sharply between 1921 and 1925, and by 1929 they contributed little more than one-fifth. In 1937 equity funds amounted to only 17.3 percent of the total assets of the companies covered. Another trend worth noting is the decline in borrowings; in the early 1920's these represented almost one-fifth of total liabilities, whereas in the years 1932-36 they accounted for less than 2 percent, though they rose slightly in 1937.

While both borrowings and equity funds were declining sharply during the years 1920-25, there was a noteworthy increase in the relative importance of time and demand deposits and investment certificates, which rose from 31 to 62 percent in this period. Thereafter the gain was slow but fairly consistent: in 1937 deposits and certificates amounted to almost three-fourths of the total liabilities of the reporting Morris Plan institutions.

Data from other sources cover a shorter period of time, but they lend support to the findings presented in Table 1. Thus the decline in the relative importance of equity funds and borrowings, and the rise in that of time deposits (unhypothecated), are corroborated by figures supplied by the Federal Deposit Insurance Corporation, covering all industrial banking companies insured by that agency in the years 1934-38. These figures, presented in Table 2, show that the equity funds of this group of companies fell from 17 percent of total assets in 1934 to 12 percent in 1938. In dollar volume, however, the equity items rose from $17,517,000 to $20,-562,000, an increase due in part to the fact that in 1938 there were 71 insured industrial banking companies whereas in 1934 there were only 60. For this increasing number of companies, borrowings, expressed in percent of total assets, declined in these years from 1.9 to 0.1 percent.

It is to be noted that in the FDIC data time deposits are classified as either unhypothecated or hypothecated. The former, being a clear liability of the company, can properly be considered a source of funds; hypothecated deposits can-

TABLE 2

SOURCES OF FUNDS OF INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, IN PERCENT OF TOTAL ASSETS[a]

Source of Funds	*1934*	*1935*	*1936*	*1937*	*1938*
Equity account[b]	17.1	15.1	13.3	11.6	12.1
Time deposits					
Unhypothecated	56.3	57.7	60.9	60.5	60.0
Hypothecated	18.3	17.6	17.2	18.4	18.2
Demand deposits	1.8	2.2	2.4	3.6	4.7
Borrowings	1.9	1.7	1.0	.9	.1
Number of companies	60	62	63	69	71
Total assets[c]	$102,755	$123,342	$146,129	$175,263	$169,492

[a] Based on year-end data supplied by the Federal Deposit Insurance Corporation. The percentages do not add to 100; the difference represents reserves and miscellaneous liabilities.
[b] Capital, surplus and undivided profits.
[c] In thousands of dollars.

not be so regarded, however, since they represent loan repayments which have not yet been directly applied to the loans themselves. In these data there is, of course, no mention of investment certificates, for all the insured industrial banking companies enjoy the deposit-taking privilege and therefore do not need to sell certificates. From Table 2 it appears that unhypothecated time deposits have been the most important source of funds for these insured institutions; in relation to total assets they amounted to 56 percent in 1934 and rose to 60 percent by 1938. Demand deposits, although they have increased in relative importance, have not been very significant, probably because many states have legal prohibitions against industrial banking companies assuming liabilities of this sort. Supplementary figures on this group of insured companies indicate that the sources of funds were substantially the same, over the period 1934-38, for the larger as for the smaller companies.

Additional data on 64 Morris Plan institutions[1] reveal a current situation similar to that shown in Table 2. They also serve to supplement the data presented in that table, since only 38 of the 71 industrial banking companies admitted to insurance by the FDIC by April 1939 were connected with the Morris Plan. As of December 31, 1938, the equity items of these 64 Morris Plan banks and companies, though comparatively unimportant, were nevertheless far more significant than the borrowings—13.2 percent of total assets as compared with 0.2 percent. In the deposit data on this group of companies there is unfortunately no separation of hypothecated and unhypothecated deposits, demand deposits and investment certificates outstanding. The figure for all these items amounts to 71.8 percent of the total assets —more than five times the figure for equity funds and borrowings combined.

Some state reports provide information concerning industrial banking companies, and data from this source are presented in Table 3, for 1938. They tell much the same story as the figures already cited. In almost all the states represented either investment certificates or time and demand deposits are the most important sources of working funds; borrowings, where reported separately, are relatively slight. Five of these states[2] give data also for 1930 and 1933, again corroborating, for the period 1930-38, the finding that deposits and certificates have tended to rise and borrowings to decline in relative significance as a source of funds for industrial banking companies.

It will be remembered that there are a good many companies which, though they are members of the American

[1] Data obtained from Polk's *Bankers' Encyclopedia* (March 1939 edition). Balance sheets were not available for Morris Plan companies in Iowa, Massachusetts or Minnesota, or for those in the following cities: Kansas City, Los Angeles, Nashville, Tampa, York.

[2] Connecticut, New Hampshire, North Carolina, Rhode Island and West Virginia.

TABLE 3

SOURCES OF FUNDS OF INDUSTRIAL BANKING COMPANIES IN 15 STATES, 1938, IN PERCENT OF TOTAL ASSETS[a]

State	*Number of Companies*	*Source of Funds*				*Total Assets*[c]
		Equity Account	Time and Demand Deposits[b]	Investment Certificates	Borrowings	
Connecticut[d]	12	55.1	.0	33.8	3.2	$ 5,549
Florida[e]	6	28.6	65.5	.0	.2	2,543
Indiana[f]	8	18.5	.0	69.8	5.1	5,033
Maine	1	33.2	.0	62.3	.0	491
Maryland	1	15.8	74.1	3.5	.0	2,344
Nebraska[g]	5	21.2	.0	71.6	1.1	1,343
New Hampshire[e]	1	5.1	92.0	.0	.0	1,248
New York	15	14.2	78.8	.0	.3	57,726
Michigan	7	11.5	82.0	.0	.0	23,550
North Carolina	33	31.1	.0	60.0	2.4	13,408
Ohio[e]	8	15.9[h]	66.4	.0	.0	20,512
Rhode Island	5	27.0	.2	63.3	.1	6,077
Utah[e]	4	54.4	28.0	.0	11.0	599
Virginia[f]	19	49.4	1.8	37.4	6.3	4,682
West Virginia[e]	17	53.2	.0	33.2	6.0	5,641

[a] Based on reports of state banking departments. Unless otherwise noted, data are for December 31, 1938. The percentages do not add to 100; the difference represents reserves and miscellaneous liabilities.
[b] Exclusive of hypothecated deposits.
[c] In thousands of dollars.
[d] As of August 30, 1938.
[e] As of June 30, 1938.
[f] As of December 31, 1937.
[g] As of June 30, 1937.
[h] Includes reserves.

Industrial Bankers Association, do not accept deposits or sell investment certificates, and therefore do not conform with the definition of an industrial banking company, as established in this study. The data presented in Table 4 would seem to lend support to the classification used here, for they

TABLE 4

SOURCES OF FUNDS OF INVESTMENT AND NON-INVESTMENT TYPES OF INDUSTRIAL BANKING COMPANIES, 1936, IN PERCENT OF TOTAL ASSETS[a]

Source of Funds	*Investment Companies*	*Non-Investment Companies*
Equity account	*30.4*	*70.1*
Common stock	16.9	46.6
Preferred stock	4.8	13.2
Surplus and undivided profits	8.7	10.3
Borrowings	*9.4*	*20.1*
Long-term debt	.0	4.1
Short-term debt[b]	9.4	16.0
Time and demand deposits and investment certificates	*48.7*	*.0*
Number of companies	25	21
Total assets[c]	$10,456	$3,708

[a] Based on year-end data supplied by the American Industrial Bankers Association. The percentages do not add to 100; the difference represents corporate reserves and miscellaneous liabilities.
[b] Includes an unknown amount for accounts payable; this amount, however, is presumably insignificant and approximately the same for both types of companies.
[c] In thousands of dollars.

show quite clearly how the financial structures of companies which derive funds from these sources differ from the structures of non-investment firms. The latter, instead of depending primarily on deposits and investment certificates, draw their funds mainly from equity account and borrowings.

But even though the institutions here defined as industrial banking companies do not, in general, rely on borrowings to any important extent, there are some firms in this category that do make use of bank loans as a source of funds. A number of these firms offer Christmas Club savings plans to their borrowers, and it is not unusual for them to meet seasonal withdrawals of such deposits by borrowing from banks. Data on the cost of borrowing funds from commercial banks are limited in coverage and refer mainly to relatively small companies. These data indicate, however, that the smaller industrial banking companies borrow from banks at rates varying from 4 to 6 percent; larger companies borrow currently at rates as low as 2½ percent.

A few industrial banking companies are financed in part by the sale of collateral trust receipts. One group of firms operating in the southern states has worked out an arrangement whereby their notes can be pledged, through a rediscount corporation, as security against collateral trust receipts sold by that corporation. The arrangement requires that any pledged note which becomes delinquent shall be withdrawn and replaced by a non-delinquent note. The corporation borrows up to 80 percent of the face value of the collateral and lends to the individual companies. By this financing arrangement it is possible for companies to obtain working funds more economically than they could if they were either to borrow directly from banks or to sell investment certificates.

The rates paid by industrial banking companies as return for investment certificates and deposits have tended to decline in recent years, and are now between 2 and 4 percent. On investment certificates some institutions offer graduated rates, whereby the notes running for the longest period bear the highest rate of return. Companies whose deposits are insured by the FDIC and those that are members of the Federal Reserve System are, of course, governed by the regulations of these agencies as to the maximum return payable on deposits.

The trend of the average rate of interest paid by the larger industrial banking companies on time and savings deposits is roughly indicated in data provided by the FDIC. On total time and savings deposits the average rate of payment fell from $1.95 per $100 in 1935 to $1.50 in 1938. Total deposits, however, include some that are hypothecated against borrowers' loans, and on these the practice of banks in regard to the payment of interest is not known. If interest rates are computed on total time and savings deposits minus hypothecated accounts, the average rate of payment is found to have fallen from $2.56 per $100 in 1935 to $1.95 in 1938. Since some of the reporting banks do pay interest on hypothecated deposit accounts it may be concluded that in these years the actual average rate on total deposits was between the two pairs stated. This downward trend is corroborated by data on insured commercial banks that are not members of the Federal Reserve System. The average rate of interest paid on time and savings deposits by this group of banks fell from $2.28 per $100 of total time and savings deposits in 1935 to $1.82 in 1938.[3]

On time deposits some companies offer an interest schedule graduated according to the amount held. The Morris Plan Bank of Virginia, for example, put into effect on December 1, 1939, a plan whereby 2½ percent is paid on amounts from $10 to $2500, 1½ percent on amounts from $2501 to $5000, and 1 percent on amounts from $5001 to $7500; no interest is paid on that amount of a time deposit that is in excess of $7500, and no interest is paid on deposits of any bank, firm or corporation operated for profit.[4] The rate of 2½ percent had previously been paid on amounts between $10 and $5000, and the bank states that 94.1 percent of its regular savings customers were not affected by the change.[5] The inference that this statement carries concerning the average size of savings deposits is supported by year-end data, for the period 1934-38, on industrial banking

[3] Federal Deposit Insurance Corporation, *Annual Report,* for the year ended December 31, 1938, p. 57.

[4] Morris Plan Bank of Virginia, *Annual Report to the Stockholders,* for the year 1939, p. 6.

[5] *Ibid.,* pp. 6-7.

companies insured by the FDIC.[6] In these companies savings accounts averaged $189 in 1934, $233 in 1935, $275 in 1936, $323 in 1937 and $357 in 1938. The average savings account in the Morris Plan Bank of Virginia amounted to $511 at the end of 1939.

USES OF FUNDS

Industrial banking companies, like personal finance and sales finance companies, keep the greatest part of their assets in loans and discounts, that is, in the outstanding consumer receivables which arise from their lending operations. For insured industrial banking firms, as can be seen from Table 5, loans and discounts account for roughly two-thirds to three-fourths or more of total assets, regardless of the company's size. Securities and cash balances account for most of the remainder, in proportions that vary somewhat, though apparently without consistency, as between companies of different sizes. At the end of 1934 insured industrial banking companies held, on the average, a relatively high proportion of their total assets in securities, the average having been raised mainly by the large security holdings—over 30 percent of assets—of the 3 companies in the largest size class. In 1935, however, the proportion of assets held in securities dropped precipitately for these largest companies, possibly because a fourth company was added to the group, possibly because of the rapid increase in consumer lending in 1935, ending the decline that had begun in 1930.[7] The latter possibility is given weight by the fact that the smaller companies too, though less notably, held lower proportions of their as-

[6] Both sets of data exclude Christmas savings and other similar accounts. The number of companies represented in the FDIC data varied from 60 in 1934 to 71 in 1938; for particulars see Table 5, p. 67.

[7] See National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38,* by Duncan McC. Holthausen, in collaboration with Malcolm L. Merriam and Rolf Nugent (1940) pp. 29-32.

TABLE 5

PERCENTAGE DISTRIBUTION OF TOTAL ASSETS OF INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY SIZE OF COMPANY AND TYPE OF ASSET[a]

Year	Size of Company[b]	Number of Companies	Type of Asset: Loans and Discounts	Securities	Cash	Miscellaneous	Total[c]	
1934	Under $100	18	70.4	13.9	11.3	4.4	100.0%	$ 5,490
	100– 200	22	69.1	17.9	9.5	3.5	100.0	14,304
	200– 300	8	75.7	7.8	6.0	10.5	100.0	6,121
	300– 500	5	81.9	4.9	8.8	4.4	100.0	7,497
	500– 1000	4	78.7	8.1	9.8	3.4	100.0	16,245
	1000 & over	3	58.1	30.4	8.0	3.5	100.0	53,098
1935	Under $100	18	68.8	11.6	16.3	3.3	100.0	6,227
	100– 200	22	71.0	16.4	9.4	3.2	100.0	19,265
	200– 300	10	77.3	8.4	7.9	6.4	100.0	8,200
	300– 500	5	83.8	3.7	8.4	4.1	100.0	8,667
	500– 1000	3	85.8	7.2	5.1	1.9	100.0	16,473
	1000 & over	4	75.7	14.2	7.1	3.0	100.0	64,510
1936	Under $100	17	72.8	8.3	12.7	6.2	100.0	5,741
	100– 200	20	73.5	15.0	8.6	2.9	100.0	17,783
	200– 300	13	73.6	11.9	10.1	4.4	100.0	15,333
	300– 500	5	84.4	2.9	9.3	3.4	100.0	9,407
	500– 1000	4	82.8	5.8	9.8	1.6	100.0	22,831
	1000 & over	4	75.6	13.9	6.9	3.6	100.0	75,034
1937	Under $100	20	77.4	6.9	11.3	4.4	100.0	6,985
	100– 200	20	73.7	11.9	11.9	2.5	100.0	19,764
	200– 300	16	73.3	12.1	11.2	3.4	100.0	23,383
	300– 500	5	82.3	3.2	11.3	3.2	100.0	10,600
	500– 1000	3	80.7	8.0	8.3	3.0	100.0	14,233
	1000 & over	5	75.1	11.4	11.1	2.4	100.0	100,298
1938	Under $100	21	74.0	7.7	13.9	4.4	100.0	7,685
	100– 200	19	69.4	12.1	16.2	2.3	100.0	19,233
	200– 300	17	73.9	6.3	16.8	3.0	100.0	25,141
	300– 500	7	66.7	16.0	14.4	2.9	100.0	14,197
	500– 1000	2	86.8	2.4	7.0	3.8	100.0	5,174
	1000 & over	5	73.4	11.7	12.7	2.2	100.0	98,062

[a] Based on year-end data supplied by the Federal Deposit Insurance Corporation.
[b] As measured by total equity account (capital, surplus and undivided profits), in thousands of dollars. Each level is inclusive of the lower figure and exclusive of the higher.
[c] Dollar figures in thousands.

sets in securities in 1935. In the subsequent years security holdings, on the whole, continued to decline in relative importance, and cash balances tended to increase. Table 7 shows that the latter represented, for all insured industrial banking companies, a higher proportion than the former in 1938—13.7 as compared with 10.9 percent of total assets.

That this allocation of funds is fairly characteristic of industrial banking companies in general is suggested by fragmentary supplementary data. Thus balance-sheet figures on 1937 or 1938, available from 15 state banking department reports,[8] show no state in which loans and discounts fall below 60 percent of total assets, and one state in which they amount to as much as 94.7 percent; in most of the reporting states they fall between 70 and 80 percent. As for the Morris Plan companies, it may be estimated[9] that at the end of 1938 loans and discounts accounted for 78.2 percent of their total assets, and securities for 8.3 percent. Two years earlier, at the end of 1936, the proportion of total assets outstanding in loans and discounts was somewhat higher—around 90 percent—for companies affiliated with the American Industrial Bankers Association, as is evident from Table 6. It will be noted that non-investment members of the association—those companies that do not obtain funds through deposits or the sale of certificates—allocate their funds to the various indicated uses in almost exactly the same proportion as do firms that conform with the definition of industrial banking company which is used in this study.

In their characteristic distribution of total assets industrial banking companies are notably different from commercial banks. This fact is of primary importance in explaining the divergences in the profitability records of these two types

[8] The states covered are Connecticut, Florida, Indiana, Maine, Maryland, Michigan, Nebraska, New Hampshire, New York, North Carolina, Ohio, Rhode Island, Utah, Virginia and West Virginia.

[9] From data in Polk's *Bankers' Encyclopedia.*

TABLE 6

PERCENTAGE DISTRIBUTION OF TOTAL ASSETS OF REPORTING MEMBERS OF AMERICAN INDUSTRIAL BANKERS ASSOCIATION, 1936, BY TYPE OF COMPANY[a]

Type of Company[b]	*Number of Companies*	*Type of Asset* Loans and Discounts	Cash	Bonds and Securities[c]	Real Estate[d]	Other Assets	Total[e]	
Investment	25	90.2	5.5	1.6	.4	2.3	100.0%	$10,456
Non-investment	21	88.0	3.4	3.6	1.1	3.9	100.0	3,708

[a] Based on year-end data supplied by the American Industrial Bankers Association.
[b] Investment companies are those companies that accept deposits or sell certificates.
[c] Including bonds of the federal government.
[d] Other than bank building and furniture.
[e] Dollar figures in thousands.

of financial institutions. Data are presented in Table 7 on the asset structure of all industrial banking companies and commercial banks whose deposits are insured by the FDIC, the industrial banking companies that are represented being the same as those that were classified according to size in Table 5. The data cover about one-half the estimated total assets of all industrial banking companies, and nearly all of the assets of commercial banks.

It is clear that the outstanding asset difference between the two types of institutions lies in the relative importance of loans and discounts. While for insured industrial banking companies this item fluctuated, in the period 1934-38, between two-thirds and three-fourths of total assets, for commercial banks it varied narrowly from more than one-quarter to less than one-third. The relative importance of securities

TABLE 7

PERCENTAGE DISTRIBUTION OF TOTAL ASSETS OF INSURED INDUSTRIAL BANKING COMPANIES AND COMMERCIAL BANKS, 1934–38, BY TYPE OF ASSET[a]

Type of Asset	1934		1935		1936		1937		1938	
	Industrial Bank. Cos.	Commercial Banks[b]	Industrial Bank. Cos.	Commercial Banks[c]	Industrial Bank. Cos.	Commercial Banks[d]	Industrial Bank. Cos.	Commercial Banks[e]	Industrial Bank. Cos.	Commercial Banks[e]
Loans and discounts	66.6	31.5	76.9	28.9	76.9	28.4	75.7	30.9	72.9	28.2
Securities	20.8	39.1	12.2	39.5	11.5	39.7	10.6	37.8	10.9	37.8
Cash	8.6	24.1	7.7	27.2	8.3	28.0	11.0	27.5	13.7	30.2
Miscellaneous assets	4.0	5.3	3.2	4.4	3.3	3.9	2.7	3.8	2.5	3.8
TOTAL[f]	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	$102,755	$46,439,270	$123,342	$50,917,563	$146,129	$54,221,369	$175,263	$54,212,416	$169,492	$56,800,254
Number of institutions	60	14,137	62	14,123	63	13,975	69	13,795	71	13,659

[a] For industrial banking companies based on year-end data supplied by the Federal Deposit Insurance Corporation. For commercial banks based on sources as indicated.
[b] Federal Deposit Insurance Corporation, *Annual Report,* for the year ended December 31, 1935, p. 37.
[c] *Ibid.,* for the year ended December 31, 1936, p. 48.
[d] *Ibid.,* for the year ended December 31, 1937, p. 35.
[e] *Ibid.,* for the year ended December 31, 1938, p. 44.
[f] Dollar figures in thousands.

also differs considerably as between the two types of agencies. For industrial banking companies this item amounted to slightly more than one-tenth of total assets for all years except 1934, when it was over two-tenths, but for commercial banks it was practically four-tenths, throughout the period.

While both types of institutions evinced a tendency to maintain an increasing part of their assets in cash over this period, the proportion of industrial banking company assets held in idle cash balances was, in 1937 and 1938, less than one-half the proportion of commercial bank assets kept in this form, and in the earlier years it was one-third or less.