This PDF is a selection from an out-of-print volume from the National Bureau of Economic Research

Volume Title: Industrial Banking Companies and Their Credit Practices

Volume Author/Editor: Raymond J. Saulnier

Volume Publisher: NBER

Volume ISBN: 0-870-14463-4

Volume URL: http://www.nber.org/books/saul40-1

Publication Date: 1940

Chapter Title: Operating Methods and Collection Experience

Chapter Author: Raymond J. Saulnier

Chapter URL: http://www.nber.org/chapters/c5008

Chapter pages in book: (p. 98 - 118)

# Operating Methods and Collection Experience

THE ways in which industrial banking companies obtain and handle business are fundamentally similar to those followed by other consumer credit agencies. Since many industrial banking companies are engaged in a more diversified type of lending, and offer in addition certain non-lending services to their customers, their problems differ somewhat from those of other agencies. But like other comparable institutions they are required to conduct an effective promotional campaign to insure maximum employment of their lending capacity; out of the total number of loan applications filled out by prospective borrowers they must select a group to whom loans will be made; because their selection must be speedy as well as careful, they must develop procedures that will facilitate their choice of risks. These various practices will be discussed in this chapter, and in the concluding section their adequacy will be measured by a body of data covering collection experience on accepted loans.

# METHODS OF OBTAINING AND HANDLING BUSINESS

## Advertising Techniques

In industrial banking, as in other fields of consumer credit, the so-called "repeat" borrower is an important source of loan volume, but what proportion of the industrial lending

business is to be ascribed to loans to old customers cannot be ascertained exactly. The fact that most of the firms circularize those who have proved to be reliable risks is in itself indicative. Replies to a questionnaire distributed by the American Industrial Bankers Association indicate that somewhat more than half of the loan volume of the reporting companies came from former borrowers.<sup>1</sup> These data, however, cover only a small proportion of the total volume of industrial lending, and they make no distinction between investment and non-investment types of agencies.

In their endeavor to attract new borrowers, and to win over the clients of competitors, industrial banking companies must engage in various forms of advertising. It is not possible to say with any definiteness how much is spent for this purpose. One figure frequently mentioned as a standard is 1/2 to 1 percent of total loan volume, with the qualification that a new company is likely to spend more and an old company less. According to information supplied by the American Industrial Bankers Association, reporting members in 1937 carried an average advertising budget of from  $\frac{1}{3}$  to 1 percent of the total volume of their loans during that year. In 1936 the members of the association reported that advertising expenses amounted, on the average, to about 21/2 percent of gross income. As far back as 1925 the advertising outlays of 25 reporting members of the Morris Plan Bankers Association amounted to 4.8 percent of gross expense and 3.6 percent of gross income.<sup>2</sup> A year later 19 New England Morris Plan companies reported that their outlays for advertising amounted to 5.6 percent of their gross expense and 4.4 percent of their gross income.<sup>3</sup>

<sup>1</sup> Myron R. Bone, "Industrial Banks Loan Many Millions Yearly" in American Industrial Banker, vol. 4, no. 6 (December 1938) p. 7. <sup>2</sup> Walter D. Brown, "Comparative Statistics for the Year 1925" in Morris

Plan Banker (January 1926) pp. 17-21. <sup>3</sup> Walter D. Brown, "Average Income and Expense Figures, 19 Morris Plan

Companies" in ibid. (May 1927) p. 113.

These proportions have remained substantially constant, as is indicated by the fact that in 1937 companies reporting to the Morris Plan Bankers Association were allocating 5.9 percent of their total expenses to advertising.<sup>4</sup>

While many types of advertising are used, there seems to be a general tendency for companies to concentrate on newspapers and direct mailing as means of reaching potential borrowers. Other media are billboards, posters, window cards, radio, personal canvass, advertisements in street cars or directories or on moving picture screens, and the multitude of items distributed free of charge.

The advertising problem of industrial banking companies differs somewhat from that of most other businesses in that industrial lenders are concerned with attracting only acceptable applicants, since the cost of making loans is augmented when a company has to examine and reject poor risks. From this point of view direct mail advertising has much to commend it, for it reaches a select group, whereas radio programs, billboard posters or other non-selective forms of advertising may interest large numbers of applicants of whom the majority may have to be rejected.

Except when they are engaged in launching a new service, industrial banking firms tend to emphasize the most profitable types of loans in their advertising. In general, they follow a schedule of advertising copy designed to fit the different periods of the year, sometimes employing the services of outside advertising agencies. Many companies have succeeded to some extent in determining which of their advertising techniques is most productive by asking the new customer the reasons for his choice of company. The replies may be somewhat unreliable, but they usually indicate that references from old customers yield more new business than any of the forms of commercial advertising employed.

<sup>4</sup> Derived from data supplied by the Morris Plan Bankers Association.

# Office Organization

Broadly speaking, the office organization of an industrial banking company is set up along the lines of the firm's principal activities-extending credit, receiving payments, keeping records and collecting accounts. It varies, however, with the size of the firm, the amount of business handled and the assortment of services offered. Small companies are similar in office organization to the independent personal finance companies; the staff usually consists of a manager, an assistant and a secretary. At the other extreme are the very large firms that have a much larger and more specialized corps of workers. One large company, for example, has a department for receiving applications, a women's department, a special organization of committees to pass on loan applications, departments for receiving hypothecated and unhypothecated deposits, a checking account division, a sales finance section, and adjustment, legal, auditing and accounting, insurance, purchasing, advertising, personnel and real estate departments.

One way of measuring the efficiency of an office organization is to determine how many loans are made per year per employee. Although such data are fragmentary at best, it seems reasonably safe to say that for industrial banking companies the average number of outstanding loan accounts per employee is in the neighborhood of 300. A study made in 1935, covering 16 Pennsylvania companies with average outstandings of about \$120,000, showed that the average number of loans outstanding per full-time employee was 303.<sup>5</sup> Somewhat more than half the member companies reporting to the American Industrial Bankers Association over the period 1935-39 had in those five years an average of 200 to 500 loan accounts outstanding per employee.<sup>6</sup> The figure

<sup>&</sup>lt;sup>5</sup> Harry R. Hickox, "Volume, Losses and Costs Studied in Pennsylvania" in American Industrial Banker, vol. 1, no. 2 (June 1935) p. 6. <sup>6</sup> Data supplied by the American Industrial Bankers Association.

of 300 loan accounts outstanding per employee is regarded as a rough standard of efficiency.<sup>7</sup>

# Credit Procedure

The procedures followed in the granting of loans, the investigation of credit and the collection of payments vary for different types of loans and for companies of different sizes. Large firms tend, on the whole, to adopt a more highly standardized and routinized procedure than do small firms. In a relatively small office the procedure is fairly simple. The applicant is first interviewed by the manager or his assistant. Then he fills out the usual loan application blank and arranges to present collateral security, or to obtain the signature of comakers, or to have his car or household chattels inspected. The applicant's credit record is then checked. If he is a regular customer the checking is quickly accomplished. If he is not, various sources of credit information must be consulted, the type of credit investigation depending in large part on the facilities available.

First, the office may have its own credit file containing published notes on suits, judgments, foreclosures and the like. Second, there is almost always some kind of mercantile credit agency in the community, from which reports on prospective borrowers may be purchased. These reports in some instances relate exclusively to open-book accounts; in

<sup>7</sup> Data on "loan accounts per employee" must be examined with great care. Sometimes they refer to average loan accounts outstanding, sometimes to loans made during the year, and in either case there is usually some doubt as to the number of employees to be included in the calculation; the latter difficulty arises particularly from the fact that there are often part-time as well as full-time workers. Furthermore, it is necessary to take account of the fact that an industrial banking company has savings as well as loan accounts, which must be handled by the same working force, and that there may be variation among companies in regard to the frequency of instalment payments made on loans; some companies make loans that are repayable on a weekly basis, thus increasing the number of transactions to be handled by the working force. Considerations such as these doubtless explain the wide variations in reports on "number of loan accounts per employee."

others they cover retail instalment credit as well. For loans of \$1000 or more the company may buy a more exhaustive credit report, as well as a legal report on suits and judgments in which the applicant may have been involved. Finally, there may be a central lenders' credit bureau from which information may be obtained as to the applicant's present status and past record with cash lending and sales financing firms. In some instances the credit bureau serves only as a clearing agency, in which case the lender has to make a special inquiry of the firms to which he is referred. The credit bureaus differ in scope and reliability from one locality to another. In some cities all lenders, regardless of type, cooperate in exchanging information; in others intense competition may lead to a complete breakdown of the system.

In addition to seeking information from whatever organized credit bureaus or exchanges are available, the company makes its own check of the applicant's employment, income, residence and family indebtedness. In most cases this amounts only to verification, by telephone, of information given by the applicant. Some lenders in the smaller cities hold regularly scheduled weekly meetings at which the delinquent accounts of all lenders are reviewed and discussed. It is rarely the case that a company will utilize all of these sources of credit information, for some are considered more useful than others and each tends to increase the cost of credit investigation.

If the loan is made on the security of a chattel mortgage on household furniture an appraiser is sent to visit the home and to make a general inspection of the household. Since foreclosures on household chattels are relatively rare,<sup>8</sup> the chief purpose of the home inspection is to impress the bor-

<sup>&</sup>lt;sup>8</sup> See National Bureau of Economic Research (Financial Research Program), Personal Finance Companies and Their Credit Practices, by Ralph A. Young and Associates (1940) Table 18, p. 77.

### INDUSTRIAL BANKING COMPANIES

rower with the desirability of prompt payment and to judge from the atmosphere and upkeep of the household whether the risk is likely to be a good one. If the loan is made on automobile collateral, the car is carefully inspected and valued.

When all of the relevant information has been assembled and written on or attached to the loan application, a decision is made on the extension of the credit. In a small office the entire loan procedure may be handled by one person, whereas in the larger firms it involves a highly systematized division of labor, with the loan officers passing only on credits, and the interviews and investigation conducted by others. In some cases there is a hierarchy of loan officers; thus in one large company the less experienced men are permitted to extend loans up to \$360, the next group up to \$540, the next to \$1200, and loans for more than \$1200 are usually passed by the principal officer of the firm. Another common practice is the pooling of the responsibilities of two officers, who may together examine an application and grant a loan equal to the sum of their separate credit authorities.

An important element in the credit granting organization is the group referred to as the "discount committee" or the "loan committee." Where there are several loan officers, applications are routed through the desks of all the officers, the committee thus operating continuously. For very large loans the committee may be composed of a selection of loan officers, the president of the company and several directors, the group meeting only at regular intervals.

It is difficult to assemble adequate statistical data on the proportion of credit applications accepted by industrial banking firms. One company operating a series of offices reports that about one-third of the requests for loans are rejected without the applicant's reaching the point of making out a formal blank; of those actually made out, between

one-quarter and one-half are finally accepted. An officer of one of the largest industrial banking companies has stated that during 1938 his firm extended 40,000 loans out of 60,000 or more applications.<sup>9</sup> Another firm states that it rejected 10 percent of the applications received during the year 1939.<sup>10</sup> A survey made in 1938 by the American Industrial Bankers Association, covering the practice of member companies, revealed that approximately 75 percent of all loan applications received by all the reporting firms were finally accepted; but some companies reported acceptances amounting to 80 or 90 percent, others a much smaller proportion, and one firm stated that it granted only 35 percent of the number of loans requested.<sup>11</sup>

The initial steps in the sales financing operations of an industrial banking company differ substantially from those described above.<sup>12</sup> Because the company wishes to avoid repossession problems it will make the same careful credit examination in such cases as it does for cash loan applications, but its relations with the dealer who is the original source of the financing paper introduces new problems, and the documents required to protect the lender's interest in the collateral are quite different. It is essential in this type of business to secure protection against such hazards as duplicate or triplicate financing, excessive dealer payments, illegal sale of merchandise or overvaluation of collateral in transactions involving used commodities. While these hazards are well known to experienced operators, the fact

<sup>9</sup> Stephen B. Clark, "People and Profits in Personal Loans" in American Industrial Banker, vol. 5, no. 1 (February 1939) p. 14.

<sup>10</sup> Morris Plan Bank of Virginia, Annual Report to the Stockholders, for the year 1939, p. 3.

<sup>11</sup> Myron R. Bone, "Industrial Banks Loan Many Millions Yearly" in American Industrial Banker, vol. 4, no. 6 (December 1938) p. 8.

<sup>12</sup> In this type of financing the procedures followed by industrial banking companies are necessarily similar to those current among sales finance companies. For a discussion of the latter see National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by W. C. Plummer and R. A. Young (1940) pp. 104-21.

that financing agencies frequently run afoul of them is proof of the necessity for constant caution. When companies undertake to finance the time sale of merchandise directly with the customer, rather than through the dealer, the procedure is more nearly similar to that described above for the making of cash loans, though special adjustments have to be made to take account of the nature of the merchandise security.

Whatever the methods may be that are employed in judging a risk, the lending company cannot disregard the need for speed and for the maintenance of confidential relations with the borrower. Both of these factors introduce important elements of hazard into the business of granting credit, but the exigencies of competition require that they be recognized.

### Collection Procedure

When a loan is made, a number of office records are prepared. Whether payments are to be direct or hypothecated in a special account, the dates when they are due are scheduled on the ledger card. In many offices loans are numbered according to due dates so that delinquency can be easily detected. The first two digits of the number 302614, for example, indicate that payments are due on the 30th of the month, while the remainder stand for the serial number of the loan. Other symbols may be added to the number to indicate the type of loan and other significant characteristics.

For collecting delinquent payments most companies employ a basically uniform method. First they send out form notices at appropriate intervals. Then, at a fairly early stage, they telephone the delinquent borrower, or perhaps send him a special letter signed by the manager, requesting payment or a consultation on the matter of a possible refinancing or extension of the loan. In some cases the adjustment

involves only a shifting of the due date or a change in the frequency of instalments.

Not all firms employ outside collecting agents. Nor do they all follow the same procedure with regard to comakers involved in delinquency. Some companies communicate with the comaker only when payment is long overdue, while others issue an early warning in order to protect themselves against complaints from this source. As in the transactions of other consumer credit agencies, the borrower's note generally contains an acceleration clause giving the lender the right, in case of default, to demand full payment before the contractual maturity date. When this privilege is exercised, legal action is usually necessitated.

#### **COLLECTION EXPERIENCE**

The collection experience of industrial banking companies is measured by data on delinquencies and losses. Charge-offs on loans are the primary source of loss but losses arise also from dealings in other types of assets. Delinquencies are expressed by a figure representing, for a particular date, the volume of loans delinquent for a specified length of time in percent of total loans outstanding on that date. The definition of what constitutes delinquency has never been standardized, though certain efforts have been made in this direction. Both The Morris Plan Corporation of America and the Morris Plan Bankers Association have urged Morris Plan companies to use a definition according to which "a loan is delinquent when no payment has been made for 4 weeks or more after due date." Some companies provide more detailed information by classifying delinquent accounts according to whether the period since due date was 30 to 60 days, 60 to 90 days, or 90 days or more. Since industrial banking companies invariably discount their loans, they are not confronted, as are personal finance companies, with the problem of distinguishing delinquency on principal from delinquency on charges.

The success of an industrial banking company in making collections on its loans depends to a considerable extent upon the management's ability to keep its delinquency record favorable. To the extent that this task calls for very skilful operation, the chances that competitive pressure will so increase as to reduce rates and profits are greatly diminished. It is of course impossible to measure statistically the differences in management ability in different firms, but some indication of such differences is contained in comparative figures on various companies' proportions of outstandings which, at a particular date, have been delinquent for a specified period of time. Such figures are presented in Table 19, for 29 members of the American Industrial Bank-

#### TABLE 19

DISTRIBUTION OF 29 INDUSTRIAL BANKING COMPANIES, DECEMBER 31, 1939, BY DELINQUENCY PERCENTAGE ON LOANS DELINQUENT 60 TO 90 DAYS AND 90 DAYS OR MORE<sup>8</sup>

Delinquency	On Loans Delinquent	On Loans Delinquen
Percentage <sup>b</sup>	60 to 90 Days	90 Days or More
Under 1.6	13	13
1.6- 3.2	5	6
3.2- 4.8	3	3
4.8- 6.4	1	2
6.4- 8.0	2	0
8.0- 9.6	1 .	0
9.6-11.2	2	1
11.2 & over	2	4
TOTAL	29	29

<sup>a</sup> Based on data supplied by the American Industrial Bankers Association.

<sup>b</sup> Year-end outstandings on loans delinquent for specified period, in percent of total year-end loan outstandings. Delinquency is measured by the number of days from date payment was due. Each level is inclusive of the lower figure and exclusive of the higher.

ers Association; these 29 companies include "non-investment" as well as "investment" firms, but for the present purpose the distinction between the two types is not significant. Although the wide disparity in delinquency experience revealed by this table may be partly due to reporting methods, it is unlikely that this factor explains the full range of the distribution. In spite of the diversity of experience here recorded, however, it is noteworthy that nearly half of the companies reported less than 1.6 percent of their total loans outstanding at the end of 1939 as having been delinquent for 60 to 90 days, and that the same number of companies reported this low percentage for loans delinquent 90 days or longer.

Table 20 supplies data on delinquency, and also on net charge-offs on loans, for 10 Morris Plan institutions during the period 1929-38. It is noteworthy that while delinquency percentages (pertaining to loans on which no payment was made for 4 weeks or more) were relatively high during the depression years, they had declined by 1935, and thereafter, to well under 2 percent. Net loan charge-offs (annual volume of loan charge-offs, minus recoveries), expressed in percent of the total annual loan volume, stood consistently at less than 1 percent. Supplementary data show that in the years 1933-35 loan volume increased about \$13,500,000, but despite this increase net charge-offs declined from their peak of 0.97 to the very small figure of 0.08 percent, rising thereafter to slightly less than 0.3 percent in 1938. There is no consistent relation between year-to-year changes in net loan charge-offs and in delinquency, nor is there perceptible any close coordination between the net loan charge-off percentage for any one year and the delinquency percentage for the preceding year. It is true, however, that the year of highest delinquency, 1932, was followed by the year of greatest charge-offs.

These data are, on the whole, corroborated by the figures

DELINQ	UENCY	AND	ΝE	t Charg	E-OFF I	<b>ERCENTAG</b>	ES ON
LOANS	MADE	BY	10	Morris	Plan	BANKING	Сом-
PANIES,	1929-	38ª					

Year	Delinquency Percentage <sup>b</sup>	Net Charge-off Perceniage®
1929	3.83	.34
1930	4.12	.53
1931	3.43	.70
1932	4.38	.61
1933	3.21	. 97
1934	2.28	. 55
1935 <sup>-</sup>	1.71	.08
1936	1.60	.17
1937	1.18	. 29
1938	1.45	. 28

<sup>a</sup> Based on data supplied by The Morris Plan Corporation of America. <sup>b</sup> Year-end outstandings on delinquent loans in percent of total year-end loan outstandings. A delinquent account is defined as one on which no payment has been made for 4 weeks or more after due date. Total outstandings for each year were estimated by computing, for 20 companies in which these 10 are included, the ratio of year-end outstandings to the volume of loans made during the year, and using this figure as a multiplier for the volume of loans made during each year by the 10 companies.

of loans made during the year, and using this figure as a multiplier for the volume volume of loans made during each year by the 10 companies. Delinquency percentages, expressed as above, are available also, for the years 1922-25 and 1929-32, on all Morris Plan banking companies. These figures, however, while of wider coverage, have not the advantage of pertaining to a single, unchanging group of firms:

1922	1.89	1929	2.46
1923	1.58	1930	2.93
1924	1.53	1931	3.43
1925	1.49	1932	4.89

° Volume of loan charge-offs made during the year, minus recoveries, in percent of the year's volume of loans made.

in Table 21, which shows, for 1930-36, the distribution of 26 members of the American Industrial Bankers Association, by net charge-off percentage on loans. In all years the majority of the companies had net charge-offs amounting to less than 1.6 percent of loan volume; on the other hand, a considerable number of companies had a higher proportion,

TABLE 21

Net Charge-off Percentage <sup>b</sup>	1930	1931	<b>1932</b>	1933	1934	1935	1936
Under .0º	3	_	_	_	3	2	4
.08	13	16	6	10	7	14	13
.8-1.6	6	3	10	7	9	5	6
1.6-2.4	4	3	2	3	3	1	2
2.4–3.2	-	3	3	1	-	2	
3.2-4.0	_	1	3 -	3	2	_	_
4.0-4.8		-	2	-	-	-	-
4.8-5.6		-		1	-	1	-
5.6 & over	-	-	-	1	2	1	1
TOTAL	26	26	26	26	26	26	26

DISTRIBUTION OF 26 INDUSTRIAL BANKING COMPANIES, 1930–36, BY NET CHARGE-OFF PERCENTAGE ON LOANS<sup>a</sup>

<sup>a</sup> Based on data supplied by the American Industrial Bankers Association. <sup>b</sup> Volume of loan charge-offs made during the year, minus recoveries, in percent of the year's volume of loans made. Each level is inclusive of the lower figure and exclusive of the higher.

<sup>c</sup> A net charge-off percentage of less than zero indicates that the year's recoveries exceeded the year's volume of charge-offs.

some of them reaching as high as 5.6 percent or more. Further data from this group of companies indicate that on the majority of loans charged off the outstanding balance was between \$50 and \$125.

Data on gross as well as net charge-offs on loans, classified according to size of company, are to be found in Table 22, which has been prepared from reports made to the Federal Deposit Insurance Corporation by insured industrial banking companies. In this table, however, loan charge-offs are computed on the basis of total year-end outstandings in loans and discounts (net of repayments on instalment loans). As a result the percentages are higher than they would be if they were computed, as in Tables 20 and 21, on the basis of annual volume. It will be noted that, even with allowance

GROSS AND NET CHARGE-OFF PERCENTAGES ON LOANS MADE BY INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY SIZE OF COMPANY<sup>a</sup>

Size of Company <sup>b</sup>	1934	1935	1936	1937	1938
Under \$100,000					
Number	18	18	17	20	21
Gross charge-off percentage	2.28	1.83	.86	. 44	. 59
Net charge-off percentage	1.72	1.26	.55	. 27	.42
\$100,000-200,000					
Number	22	22	20	20	19
Gross charge-off percentage	2.67	1.55	1.22	.79	1.18
Net charge-off percentage	2.30	1.23	.64	. 41	.62
\$200,000-300,000					
Number	8	10	13	16	17
Gross charge-off percentage	2.57	1.63	1.02	1.10	1.42
Net charge-off percentage	1.72	. 68	.44	.44	1.06
\$300,000-500,000					
Number	5	5	5	5	7
Gross charge-off percentage	1.09	.84	. 81	.86	.79
Net charge-off percentage	. 57	.24	. 02	. 28	.43
\$500,000-1,000,000					
Number	4	3	4	3	2
Gross charge-off percentage	1.75	.95	.95	. 88	.64
Net charge-off percentage	.78	. 30	. 42	. 29	.46
\$1,000,000 & over					
Number	3	4	4	5	5
Gross charge-off percentage	2.67	1.57	1.18	.78	.70
Net charge-off percentage	1.31	. 50	26	.09	.18
All Companies					
Number	60	62	63	69	71
Gross charge-off percentage	2.31	1.42	1.09	.82	.86
Net charge-off percentage	1.33	.60	.09	.21	. 40

Based on data supplied by the Federal Deposit Insurance Corporation.
Figure on gross charge-offs represents volume of loan charge-offs made during the year, in percent of total year-end outstandings in loans and discounts (net of repayments on instalment loans). Figure on net charge-offs represents gross charge-offs minus recoveries, in percent of same total.
As measured by total equity account (capital, surplus and undivided profits). Each level is inclusive of the lower figure and exclusive of the higher.

for this upward bias, the net charge-off percentages of the entire group of insured companies were in 1934 and 1935 considerably higher than might be expected from the data given in Table 20, and that in 1936 and 1937, in spite of their upward bias, they were actually lower than the corresponding figures in Table 20. This suggests that in 1934 and 1935, the first years after their admission to insurance, these companies followed a strict policy in writing off questionable loans, and subsequently made a high proportion of recoveries on the borderline paper.

This table indicates that in general the companies in the \$100,000-300,000 groups (size measured by equity funds) had higher-than-average proportions of both gross and net loan charge-offs in all five years of the period 1934-38, and that companies in the \$300,000-1,000,000 groups had lowerthan-average proportions. The experience of the very small companies—those under \$100,000—was, on the whole, better than average on gross charge-offs but worse than average on net charge-offs. In 1934-36 the largest companies—those of \$1,000,000 or over—recorded gross charge-offs in higher proportion than all companies combined, but in all five years their net charge-off percentages were lower than average; in fact, in 1936 they had a negative percentage, indicating that in that year the volume of loan charge-offs was exceeded by the volume of recoveries.

Reserves against charge-off losses on loans vary considerably from one company to another. Information pertaining to the practice of 20 members of the American Industrial Bankers Association in 1937, and to that of 22 companies in 1938, shows that for the majority of these companies loss reserves were for amounts up to 1.5 percent of outstanding loans. Such a reserve is roughly in line with the average loss experience on loans.

Loss data on assets other than loans are presented in Table 23 for the same group of insured companies and the same

GROSS AND NET LOSS PERCENTAGES ON ASSETS OTHER THAN LOANS HELD BY INSURED INDUSTRIAL BANKING COMPANIES, 1934–38, BY SIZE OF COMPANY<sup>a</sup>

Size of Company <sup>b</sup>	1934	1935	1936	1937	1938
Under \$100,000					
Number	18	18	17	20	21
Gross loss percentage	4.18	2.21	5.88	7.16	4.31
Net loss percentage	3.51	. 51	. 27	3.31	2.72
\$100,000-200,000					
Number	22	22	20	20	19
Gross loss percentage	2.04	3.15	4.16	6.01	11.06
Net loss percentage	1.04	.08	.09	3.26	9.70
\$200,000-300,000					
Number	8	10	13	16	17
Gross loss percentage	.75	1.59	5.86	3.95	5.39
Net loss percentage	-2.26	48	3.82	2.59	-1.37
\$300,000-500,000					
Number	5	5	5	5	7
Gross loss percentage	12.54	7.42	11.37	4.72	1.70
Net loss percentage	3.73	1.95	9.95	1.18	. 50
\$500,000-1,000,000					
Number	4	3	4	3	2
Gross loss percentage	5.93	1.60	7.84	10.47	8.49
Net loss percentage	— . <b>6</b> 0	-3.83	-1.41	10.01	.94
\$1,000,000 & over					
Number	3	4	4	5	5
Gross loss percentage	4.05	7.03	7.99	8.21	5.44
Net loss percentage	2.33	4.78	5.72	6.32	1.76
All Companies					
Number	60	62	63	69	71
Gross loss percentage	4.00	5.25	7.11	7.37	5.64
Net loss percentage	1.93	2.52	3.86	5.48	2.36

<sup>a</sup> Based on data supplied by the Federal Deposit Insurance Corporation. Figure on gross loss represents the year's volume of charge-offs on assets other than loans, losses on assets sold or exchanged (mainly investment securities) and additions to valuation allowances, in percent of total securities owned at the end of the year. Figure on net loss represents gross losses minus recoveries on charge-offs of assets other than loans, profits on assets sold or exchanged and reductions in valuation allowances, in percent of same total.

<sup>b</sup> As measured by total equity account (capital, surplus and undivided profits). Each level is inclusive of the lower figure and exclusive of the higher.

period. These figures show a record of collection experience quite different from that indicated in Table 22. With only two or three exceptions the smaller companies—all those having less than \$300,000 in equity funds—had in all five years lower than average loss percentages on assets other than loans, both gross and net. The \$300,000-1,000,000 companies show a very inconsistent record, and those of \$1,000,000 and over were above average in all years except 1938. The type of loss covered in this table has greater significance for the group of insured companies than for most industrial banking companies, because the former have a larger proportion of their total assets invested in securities.

Table 24 provides, in regard to loans and all other assets, a comparison of the loss experience of three groups of institutions: insured industrial banking companies; insured commercial banks, not members of the Federal Reserve System, that have deposits of \$2,000,000 or less; and all insured non-member commercial banks. The comparison of the first two groups is particularly important because the banking institutions they comprise are of about the same size and operate under similar legal conditions. The table reveals that of these two groups the industrial banking companies had-in every year except 1938, when there was very little difference-the lower net losses on loans (losses per \$100 of total assets). In regard to net losses on assets other than loans the comparative experience of these two types of institutions was not so consistent. As for the group of smaller commercial banks in comparison with the entire group of insured non-member commercial banks, their total losses, both gross and net, were roughly similar in all years except 1935, when the smaller banks had substantially higher losses, per \$100 of total assets, than were experienced by the entire group.

The importance of losses in relation to total expenses is indicated in Table 25, for insured industrial banking com-

TOTAL GROSS AND NET LOSSES PER \$100 OF TOTAL ASSETS FOR THREE GROUPS OF BANKING INSTITUTIONS, 1934–38ª

TearType of Institution $p/Insti-$ OnAllAllTotal1034All insured industrial banking companies60\$1.26\$.68\$1.941035Insured non-member commercial banks with deposits7,004* $1.62$ $1.53$ $3.19$ 1035All insured non-member commercial banks with deposits7,004* $1.62$ $1.53$ $3.19$ 1035All insured non-member commercial banks with deposits7,508 $.90$ $.53$ $1.43$ 1935All insured non-member commercial banks with deposits7,568 $.90$ $.53$ $1.43$ 1936All insured non-member commercial banks with deposits7,666 <sup>4</sup> $2.27$ $2.09$ $4.35$ 1936All insured non-member commercial banks with deposits7,666 <sup>4</sup> $2.27$ $2.09$ $4.137$ 1937All insured non-member commercial banks with deposits7,005 $.56$ $.61$ $1.17$ 1937All insured non-member commercial banks with deposits7,005 $.56$ $.61$ $1.17$ 1937All insured non-member commercial banks7,005 $.56$ $.61$ $1.17$ 1938All insured non-member commercial banks7,005 $.56$ $.61$ $1.17$ 1938All insured non-member commercial banks7,015 $.56$ $.61$ $1.17$ 1938All insured non-member commercial banks7,055 $.56$ $.61$ $1.17$ 1938All insured non-member commercial banks7,055 $.56$ $.61$ $.1.15$ 1938 <t< th=""><th></th><th></th><th>Number</th><th>G</th><th>Gross Losses<sup>b</sup></th><th>és<sup>b</sup></th><th>, <b>1</b></th><th>Net Losses<sup>o</sup></th><th>9</th></t<>			Number	G	Gross Losses <sup>b</sup>	és <sup>b</sup>	, <b>1</b>	Net Losses <sup>o</sup>	9
All insured industrial banking companies60\$1.26\$.68\$Insured non-member commercial banks7,004*1.621.59nisured non-member commercial banks7,004*1.621.58All insured non-member commercial banks62.90.53All insured non-member commercial banks62.90.53All insured non-member commercial banks7,066 t2.272.09All insured non-member commercial banks7,568.98.84All insured non-member commercial banks63.69.61All insured non-member commercial banks63.69.61All insured non-member commercial banks7,508.98.84All insured non-member commercial banks7,005.56.61All insured non-member commercial banks7,005.56.61All insured non-member commercial banks7,005.56.61All insured non-member commercial banks7,005.56.61All insured non-member commercial banks7,005.51.69All insured non-member commercial banks7,005.51.69All insured non-member commercial banks7,005.51.61All insured non-member commercial banks7,005.51.56All insured non-member commercial banks7,331.39.37All insured non-member commercial banks71.51.51All insured non-member commercial banks71.51.51All insured non-member commercial banks<	Year	Type of Institution	of Insti- tutions	On Loans	All Other <sup>d</sup>	Total	On Loans	On All Loans Other <sup>d</sup> T	Total
Insured non-member commercial banks with deposits $7,004^{\circ}$ $1.61$ $1.58$ All insured non-member commercial banks $7,379$ $1.61$ $1.58$ All insured non-member commercial banks $62$ $.90$ $.53$ Insured non-member commercial banks with deposits $7,0664^{\circ}$ $2.27$ $2.09$ $of$ \$2,000,000 or less $7,508$ $.98$ $.84$ All insured non-member commercial banks $7,0664^{\circ}$ $2.27$ $2.09$ All insured non-member commercial banks with deposits $63$ $.69$ $.68$ $of$ \$2,000,000 or less $63$ $.69$ $.68$ All insured non-member commercial banks with deposits $7,005$ $.56$ $.61$ $of$ \$2,000,000 or less $7,005$ $.61$ $.76$ All insured non-member commercial banks with deposits $7,005$ $.61$ $.76$ All insured non-member commercial banks with deposits $7,005$ $.56$ $.61$ $of$ \$2,000,000 or less $7,351$ $.49$ $.78$ All insured non-member commercial banks with deposits $7,351$ $.49$ $.78$ $of$ \$2,000,000 or less $71$ $.51$ $.54$ $.51$ All insured non-member commercial banks with deposits $7,351$ $.49$ $.78$ $of$ \$2,000,000 or less $.71$ $.51$ $.51$ $.56$ All insured non-member commercial banks $7,351$ $.37$ $.37$ $of$ \$2,000,000 or less $.71$ $.51$ $.57$ All insured non-member commercial banks $71$ $.51$ $.51$ <td>1934</td> <td>All insured industrial banking companies</td> <td>60</td> <td>\$1.26</td> <td>\$ .68</td> <td>\$1.94</td> <td>\$ .73</td> <td>\$.73 \$.33</td> <td>\$1.06</td>	1934	All insured industrial banking companies	60	\$1.26	\$ .68	\$1.94	\$ .73	\$.73 \$.33	\$1.06
All insured industrial banking companies62.90.53Insured non-member commercial banks with deposits7,5062.272.09of \$2,000,000 or lessAll insured non-member commercial banks7,508.98.84All insured non-member commercial banks with deposits7,508.98.65.61of \$2,000,000 or lessAll insured non-member commercial banks with deposits63.69.68All insured non-member commercial banks7,005.56.61.76All insured non-member commercial banks7,005.56.61.76All insured non-member commercial banks with deposits7,005.56.61.76All insured non-member commercial banks with deposits7,351.49.78.78Insured non-member commercial banks with deposits69.51.64.61of \$2,000,000 or lessAll insured non-member commercial banks with deposits7,351.49.78All insured non-member commercial banks with deposits7,351.39.78.71.51.50All insured non-member commercial banks with deposits7,231.39.97.72.72.72All insured non-member commercial banks77,231.39.97.72.72All insured non-member commercial banks7.72.72.50.51.50All insured non-member commercial banks7.72.37.87.72All insured non-member commercial banks7.72.72		Insured non-member commercial banks with deposits of \$2,000,000 or less All insured non-member commercial banks	7,004• 7,379	$1.62 \\ 1.61$	$1.59 \\ 1.58$		1.46 1.48	$1.20 \\ 1.11$	2.66 2.59
Insured non-member commercial banks7,066 t2.272.09of \$2,000,000 or lessAll insured non-member commercial banks7,508.98.84All insured non-member commercial banks6.3.69.68All insured non-member commercial banks with deposits7,005.56.61of \$2,000,000 or lessAll insured non-member commercial banks7,460.61.76All insured non-member commercial banks with deposits7,460.61.76All insured non-member commercial banks with deposits6.9.51.64All insured non-member commercial banks with deposits7.351.49.78All insured non-member commercial banks with deposits7.1.51.50All insured non-member commercial banks7.231.39.97All insured non-member commercial banks7.231.39.97	1935	All insured industrial banking companies	62	06.	.53	1.43	.38	.25	.63
All insured industrial banking companies63.69.68Insured non-member commercial banks with deposits7,005.56.61 $\sigma(\mathbf{x}_2,000,000 \text{ or less}$ 7,005.56.61All insured non-member commercial banks7,005.51.64Insured non-member commercial banks with deposits69.51.64All insured non-member commercial banks with deposits6,848.43.68All insured non-member commercial banks with deposits6,848.43.68All insured non-member commercial banks with deposits6,734.37.68All insured non-member commercial banks with deposits6,734.37.87All insured non-member commercial banks with deposits6,734.37.87All insured non-member commercial banks with deposits6,734.37.87All insured non-member commercial banks7,231.39.97		Insured non-member commercial banks with deposits of \$2,000,000 or less All insured non-member commercial banks	7,066 <i>t</i> 7,508	2.27 98	2.09 .84	4.35 1.82	1.83 84	.53	2.36 .99
Insured non-member commercial banks with deposits7,005.56.61of \$2,000,000 or less7,460.61.76All insured non-member commercial banks7,460.61.76All insured non-member commercial banks with deposits69.51.64Insured non-member commercial banks with deposits6,848.43.68All insured non-member commercial banks7,351.49.78All insured non-member commercial banks7,351.49.78All insured non-member commercial banks7,351.49.78All insured non-member commercial banks7,351.39.50All insured non-member commercial banks with deposits6,734.37.87All insured non-member commercial banks7,231.39.97All insured non-member commercial banks7,231.39.97	1936	All insured industrial banking companies	63	.69	.68	1.37	.06	.37	.43
All insured industrial banking companies69.51.64Insured non-member commercial banks with deposits69.51.64of \$2,000,000 or less6,848.43.68All insured non-member commercial banks7,351.49.78All insured non-member commercial banks with deposits71.51.50Insured non-member commercial banks with deposits6,734.37.87All insured non-member commercial banks with deposits6,734.37.87All insured non-member commercial banks7,231.39.97		Insured non-member commercial banks with deposits of \$2,000,000 or less All insured non-member commercial banks	7,005 7,460	.56	.61 .76	$1.17 \\ 1.37$	.39 .38	+ 12 + 09	.27
Insured non-member commercial banks with deposits 6,848 .43 .68 1 of \$2,000,000 or less 7,351 .49 .78 1 All insured non-member commercial banks 7,351 .49 .78 1 All insured non-member commercial banks with deposits 6,734 .37 .87 1 of \$2,000,000 or less 1 and 1 insured non-member commercial banks 7,231 .39 .97 1 All insured non-member commercial banks 7,231 .39 .97	1937	All insured industrial banking companies	69	.51	.64	.1.15	.13	.48	.61
All insured industrial banking companies 71 .51 .50 1 Insured non-member commercial banks with deposits 6,734 .37 .87 1 of \$2,000,000 or less 7,231 .39 .97 1 All insured non-member commercial banks 7,231 .39 .97		Insured non-member commercial banks with deposits of \$2,000,000 or less All insured non-member commercial banks	6,848 7,351	.43	.68 .78	$1.11 \\ 1.27$	.24	.26	.50
th deposits 6,734 .37 .87 1 7,231 .39 .97 1	1938	All insured industrial banking companies	71	.51	.50	1.01	.24	.21	.45
		Insured non-member commercial banks with deposits of \$2,000,000 or less All insured non-member commercial banks	6,734 7,231	.37	.87 .97	$1.24 \\ 1.36$	.21	. 48 . 44	.69 .68

116

۱

INDUSTRIAL BANKING COMPANIES

panies of different sizes. On the whole, in each year of the period 1934-38, the ratio of losses to total expenses declined from the smallest companies to a low for those in the \$300,000-500,000 size group (size measured by equity funds); the largest companies had the highest ratio in all years except 1938. In 1936-38 the ratios of the smallest companies were about as low as those of the \$300,000-500,000 group, and in 1938 that of the companies with equity funds of \$1,000,000 or over was approximately average. Except for these latter companies, losses on loans were far higher, during 1934-35, than those on other assets; after 1935 the differences between these two sources of expense were less conspicuous, in several instances the losses on loans even amounting to less than those on assets other than loans. In general, this table indicates very clearly that while losses may represent a relatively small proportion of the total volume of business handled, they are far from negligible as an element of expense, and that they might, if not kept at low levels, seriously impair a company's profitability.

• For industrial banking companies based on data supplied by the Federal Deposit Insurance Corporation. For commercial banks based on Federal Deposit Insurance Corporation, Annual Report, for the respective years, as follows: 1934, pp. 198 and 238; 1935, pp. 176 and 200; 1936, p. 168; 1937, p. 146; 1938, p. 218. For 1934 and 1935 data on banks with deposits of \$2,000,000 or less had to be estimated, because in these years the number of banks in the various size groups that reported on losses differed from the number that reported on total assets. Estimates were derived by calculating, for each size group up to \$2,000,000, the average loss for banks reporting on losses, and multiplying by the number of banks in that size group that reported on assets; the sums of the totals thus obtained were then related to the total assets of all banks having deposits of \$2,000,000 or less. Data on commercial banks pertain only to those banks that were in operation during the entire year.

<sup>b</sup> Gross charge-offs, losses on assets sold or exchanged and additions to valuation allowances.

<sup>e</sup> Gross losses minus recoveries on charge-offs, profits on assets sold or exchanged and reductions in valuation allowances.

<sup>d</sup> Mainly investment securities.

• Represents number of banks reporting on losses; 7,300 banks reported on assets.

<sup>4</sup> Represents number of banks reporting on losses; 7,275 banks reported on assets.

TOTAL GROSS LOSSES OF INSURED INDUSTRIAL BANK-ING COMPANIES IN PERCENT OF TOTAL EXPENSES, 1934– 38, by Size of Company<sup>a</sup>

Size of Company <sup>b</sup>	1934	1935	1936	1937	1938
Under \$100,000					
Losses on loans	16.9	16.0	8.2	4.5	6.0
All other losses	6.1	3.2	6.5	6.6	4.6
Total	23.0	19.2	14.7	11.1	10.6
\$100,000-200,000					
Losses on loans	18.8	12.8	11.6	8.1	9.8
All other losses	3.7	6.1	8.1	9.9	16.0
Total	22.5	18.9	19.7	18.0	25.8
\$200,000-300,000					
Losses on loans	20.0	14.8	9.0	10.2	12.9
All other losses	.6	1.6	8.4	6.1	4.2
Total	20.6	16.4	17.4	16.3	17.1
\$300,000-500,000					
Losses on loans	8.2	7.0	8.6	8.8	7.3
All other losses	5.6	2.8	4.1	1.9	3.7
Total	13.8	9.8	12.7	10.7	11.0
\$500,000-1,000,000					
Losses on loans	13.2	9.5	9.1	7.4	6.5
All other losses	4.6	1.3	5.3	8.8	2.3
Total	17.8	10.8	14.4	16.2	8.8
\$1,000,000 and over					
Losses on loans	15.6	13.5	11.1	• 7.7	6.9
All other losses	12.4	11.4	13.8	12.4	8.5
Total	28.0	24.9	24.9	20.1	15.4
All Companies			0		
Losses on loans	15.4	12.5	10.3	8.0	8.2
All other losses	8.3	7.3	10.1	10.1	8.0
Total	23.7	19.8	20.4	18.1	16.2

\* Based on data supplied by the Federal Deposit Insurance Corporation. Total gross losses comprise gross charge-offs, losses on assets sold or exchanged and addition to valuation allowances. Total expenses comprise total gross losses plus total current operating expenses. The dollar volumes of these companies' total expenses are given in Table 44, pp. 156-57.

<sup>b</sup> As measured by total equity account (capital, surplus and undivided profits). Each level is inclusive of the lower figure and exclusive of the higher.