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Volume Author/Editor: Wilbur C. Plummer and Ralph A. Young

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Chapter Author: Wilbur C. Plummer, Ralph A. Young

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Organization and Financial Structure

A FEW sales finance companies are organized under the partnership or individual form of business enterprise, but the great majority are corporations. In most jurisdictions incorporation is effected under the general corporation law, but in some states, as in New York, sales finance companies are incorporated under special laws covering this type of business.

Local, comparatively small companies, of which there are a large number, typically have simple corporate structures, but as the territory served increases and more kinds of business are handled, the structures tend to become more complex. Some of the largest organizations comprise a number of operating companies controlled by a holding company. Certain specialized activities, such as factorage, insurance underwriting and making small loans, are often carried on in separately organized operating companies. Complicated structures may result simply from amalgamations, or in some states they may be due in part to the fact that it is necessary under the law to have separate corporations for different lines of activity. A company's organization may appear on the surface, however, to be more complicated than the legal form actually is. Thus in many companies a small-loan or used-car department may be given an individual name and separate address, even though it operates under the same corporate charter as the parent company.

An illustration of multiple corporate interrelationship is the Commercial Investment Trust Corporation and its subsidiaries. The operations of this organization spread over the entire United States and Canada, and include such varied types of activity as automobile financing, open accounts receivable financing, industrial and home equipment financing, textile factoring, insurance brokerage and a general surety business. The parent company, Commercial Investment Trust Corporation, has approximately thirteen wholly owned direct subsidiaries and it has a substantial majority interest in two others. These direct subsidiaries in turn own all the outstanding stock of approximately thirty-two indirect subsidiaries of the parent company, and two of the indirect subsidiaries have one subsidiary each. The corporate structure thus comprises some fifty charters, one for the parent company, fifteen for the direct subsidiaries and thirty-four for the indirect subsidiaries.

TYPES OF SALES FINANCE COMPANIES

Sales finance companies may be classified in a number of ways. One is according to the degree of specialization in financing particular types of commodities, that is, "automobile," "diversified" or "mixed." The automobile finance company purchases at retail from the automobile dealer the note and title retention instrument received from the buyer, and also lends at wholesale to enable dealers to purchase their stock in trade. The diversified finance company specializes in the financing of instalment sales of one or more articles other than automobiles, such as electric appliances, radios, furniture or industrial equipment. The so-called mixed finance company handles both automobile paper and that based on other articles.

A second classification of finance companies is according to whether a company is factory-related, that is, factory-controlled or factory-preferred, or independent. Recently manufacturer association with sales finance companies in the automobile industry (whether such association take the form of ownership, affiliation or preference) has been under attack by the United States Department of Justice; this action will be discussed in Chapter 11. In the financing of consumer purchases of automobiles (as contrasted with purchases of trucks and cabs) the only factory-controlled company today is General Motors Acceptance Corporation, which is a wholly owned subsidiary of General Motors Corporation and confines its operations to wholesale and retail transactions of dealers handling General Motors products. Factory relationship is more frequent in the diversified field; in recent years financing subsidiaries or departments have been formed by such manufacturers as General Electric, Westinghouse, Johns Manville, Kelvinator and Berkey and Gay.

Until recently the principal factory-preferred companies in the automobile field were Universal Credit Corporation, Commercial Investment Trust Corporation and Commercial Credit Company. Universal Credit Corporation, controlling interest in which was purchased in 1933 by Commercial Investment Trust Corporation from Ford Motor Company, confined its operations to the wholesale and retail financing of Ford cars. Commercial Investment Trust Corporation had, in addition to its indirect relationship with Ford, special financing arrangements with other motor manufacturers. Commercial Credit Company was affiliated with Chrysler Motor Corporation, which owned stock in it from 1934 to 1938. Both Commercial Investment Trust Corporation and Commercial Credit Company have made a practice of serving dealers of other motor manufacturers who had no preferred relations with them, and for years both have conducted sales finance operations in appliance and other lines on a preferred or non-preferred basis. Antitrust prosecution by the United States Department of Justice of the Chrysler, Ford and General Motors companies and their affiliated finance companies resulted late in 1938 in consent decrees under which the Chrysler and Ford companies agreed to discontinue special preference for the services of affiliated finance companies. These decrees have materially affected preferred relationships between manufacturer and finance company, at least in the automobile field.[1]

The so-called independent finance company has no affiliation with, or preference from, any particular manufacturing company. It discounts instalment paper arising from the sales of various dealers in automobiles and other articles, and endeavors to build up close relations with the dealers.

A third classification of finance companies is according to the area of their operation. There are three large companies operating on a national basis—General Motors Acceptance Corporation, Commercial Investment Trust Corporation, including Universal Credit Corporation, and Commercial Credit Company. There are five large regional companies, each with offices in eight or more states: Associates Investment Company, of South Bend, Indiana; National Bond and Investment Company, of Chicago; Pacific Finance Corporation of California, Los Angeles; Bankers Commercial Corporation, of New York; and the latter's subsidiary, Maytag Acceptance Corporation, of Chicago. Local finance companies confine their operations to one community or a relatively small area, but may cover as much as several states.

The degree to which the national companies dominate

[1] The decrees are contingent, however, on the outcome of the prosecution by the Department of Justice of General Motors Corporation and General Motors Acceptance Corporation. A verdict of guilty was returned against the defendants in the fall of 1939, but notice has been filed of intention to appeal, thus leaving the issues of the case still pending. For a discussion of this action see Chapter 11.

TABLE 5

DISTRIBUTION OF ASSETS OF 48 SALES FINANCE COMPANIES, DECEMBER 31, 1937, BY TYPE OF COMPANY[a]

Type of Company	*Total Assets* (in millions)
National Companies	*$1,470.5*
General Motors Acceptance Corporation	582.2
Commercial Investment Trust Corporation[b]	544.6
Commercial Credit Company	343.7
Regional Companies	*201.2*
Associates Investment Company	79.7
National Bond and Investment Company	54.5
Pacific Finance Corporation of California	43.8
Bankers Commercial Corporation	16.3
Maytag Acceptance Corporation	6.9
40 Local Companies[c]	*166.0*
TOTAL	1,837.7

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market.
[b] Including Universal Credit Corporation but not National Surety Company.
[c] The assets of these companies ranged from $651,000 to $15,197,000.

the field is illustrated in Table 5, which shows the distribution of total assets in 1937 among forty-eight companies that use the commercial paper market. The year-end assets of the three national companies, at $1,470,500,000, were more than seven times as great as those of the five regional companies, and nearly nine times as great as those of forty of the largest local companies. The commanding position of the national companies is further indicated by the fact that in 1937 they handled 68 percent of the retail automobile credit and 79 percent of the wholesale automobile credit extended by a group of 424 sales finance companies that accounted for more than 95 percent of all automobile financing conducted by such companies.[2] Their capital and

[2] See Chapter 11, Table 67. The national companies are there designated as "factory-related."

TABLE 6

ASSETS OF SELECTED SALES FINANCE COMPANIES, 1924–39, IN PERCENT OF 1929[a]

Year-End	*National Companies*[b]	*Regional Companies*[c]	*Local Companies*[d]
1924	18.9	31.3	31.4
1925	35.3	53.9	39.0
1926	48.4	55.2	48.2
1927	51.4	56.6	45.9
1928	68.1	69.1	66.2
1929	100.0	100.0	100.0
1930	84.8	67.2	62.6
1931	69.6	67.8	67.7
1932	43.1	43.5	54.3
1933	47.3	51.7	61.9
1934	62.3	62.8	77.6
1935	84.2	99.3	108.8
1936	122.2	150.7	137.4
1937	146.3	172.6	171.0
1938	97.1	118.0	117.8
1939	110.3	116.2	115.1

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market.
[b] General Motors Acceptance Corporation, Commercial Investment Trust Corporation and Commercial Credit Company for all years, and Universal Credit Corporation from inception in 1928.
[c] Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California and Bankers Commercial Corporation for all years; Maytag Acceptance Corporation from inception in 1927.
[d] A sample of 13 for all years, selected according to availability of data.

surplus probably represented as much as half of the total of all units of the sales finance business.[3]

But the national companies' preponderance, great as it is, has been decreasing for nearly a decade. Between 1924 and 1929, as indicated in Table 6, the assets of the national

[3] In 1933 their capital and surplus ($179,500,000) represented 63 percent of the total of all sales finance companies reporting their net worth to Dun and Bradstreet. See National Recovery Administration, *Hearing on a Code of Fair Practices and Competition for the Finance Company Industry* (October 26, 1933) Exhibit H.

companies grew more than those of the regional or local companies, and in 1930 they contracted less. In 1931, however, the assets of both regionals and locals rose slightly, in percent of 1929, while those of the nationals continued to fall, and in no subsequent year did the national companies' assets reach so high a proportion of their 1929 level as did those of the other two types of companies.[4] The local companies represented in this table are a very small sample, and there is no way of knowing if they are typical of all such companies; the present data would indicate, however that in the period since 1929 the local companies have for the most part maintained their competitive position as well as, and in some years notably better than, the larger companies.

SOURCES OF FUNDS

The rapid rise of sales finance companies after the first World War undoubtedly reveals that there was in the American economy a latent demand for consumer credit. This latent demand developed as the national income increased to a point permitting the mass ownership and operation of durable consumer goods, particularly automobiles, and it became effective with the invention of a technique by which mass credit could be granted safely and expeditiously. It is perhaps an historical accident, to be accounted for largely by legal and institutional inhibitions, that this new technique of mass credit was inaugurated and developed by new specialized financial institutions, such as sales finance com-

[4] Federal Trade Commission data for five years in the period 1927-37, covering the same national companies (designated as "factory-related" companies, and including Universal Credit Corporation for the years 1935-37) and twelve "independent" companies, show the same general trend: in 1937 the total capital employed by the factory-related companies was two and one-half times what it had been in 1927, but that of the independents was four and one-half times its earlier figure. See Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) (76th Congress, 1st Session, House Document No. 468) p. 937.

panies, rather than by the already widespread and firmly established commercial banking mechanism. These inhibitions, however, applied solely to commercial banks' direct participation in the granting of sales finance credit. Indirectly commercial banks have participated heavily from the early days of the business. In fact, the extremely rapid growth of sales finance companies in the United States could not have taken place in the absence of highly developed capital and credit markets, markets which were both able and willing to make funds available to these new institutions provided only that they were in a position to offer paper conforming in general type and character to the kinds which our markets were accustomed to absorb.

The balance sheets of the finance companies taken year by year reflect the skilled use which they have made of this existing financial mechanism. At the same time, variations among the balance sheets of the different types of companies—national, regional and local—reflect the different ways in which these various types have adapted their individual financial structures to the sources of funds that were open. An analysis of the principal sources of funds of selected sales finance companies for which data are available is presented in Table 7, for the period 1924-39. The figures are given as percentages of total assets rather than as dollar aggregates, which might be more illuminating, because data for sufficiently large groups of identical companies are not available for each of the years shown.

The first point of interest in the table is the size of the capital cushion, the proportion it has represented of total assets. For any given year alone this proportion is not necessarily typical of financial policies, since total assets are subject to wide fluctuations, but averages covering a series of years may be assumed to represent the operating policies of sales finance companies with respect to the employment of equity money as compared with borrowed funds. The

TABLE 7

PRINCIPAL SOURCES OF FUNDS OF SELECTED SALES FINANCE COMPANIES, 1924–39, IN PERCENT OF TOTAL ASSETS[a]

Year-End	National Companies[b]				Regional Companies[c]				Local Companies[d]			
	Short-Term Debt	Long-Term Debt	Equity Funds	Debt Ratio[e]	Short-Term Debt	Long-Term Debt	Equity Funds	Debt Ratio[e]	Short-Term Debt	Long-Term Debt	Equity Funds	Debt Ratio[e]
1924	68.1	..	22.9	3.0	52.8	..	36.9	1.4	52.7	...	33.0	1.6
1925	68.1	2.3	21.1	3.3	54.8	10.5	25.4	2.6	60.3	1.1	27.9	2.2
1926	61.5	11.5	18.6	3.9	45.3	18.3	26.5	2.4	59.0	.9	27.0	2.2
1927	49.0	22.0	20.5	3.5	43.6	15.0	31.9	1.8	56.6	..	32.2	1.8
1928	53.6	16.3	20.4	3.4	50.6[f]	8.7[f]	31.0[f]	1.9[f]	50.3	..	31.6	2.5
1929	50.5	13.3	25.8	2.5	42.4	9.1	38.8	1.3	57.8	1.0	31.6	1.9
1930	43.7	13.4	29.8	1.9	33.4[f]	3.7[f]	50.6[f]	.7[f]	52.1	1.2	37.2	1.4
1931	40.6	14.3	33.8	1.6	35.5	8.8	38.6	1.1	55.5	.9	30.7	1.7
1932	14.7	18.2	52.6	.7	20.3	9.7	55.9	.5	38.4	1.3	51.6	.8
1933	35.5	7.9	41.6	1.0	33.0	5.9	47.6	.8	50.9	.8	46.5	1.1
1934	46.1	4.7	33.6	1.5	41.1	3.6	40.0	1.1	51.9	.6	38.6	1.4
1935	51.1	5.0	27.8	2.0	55.0	1.9	30.6	1.9	61.3	.5	29.2	2.1
1936	45.3	17.7	20.4	3.1	51.7	8.0	28.5	2.1	60.5	2.6	27.9	2.3
1937	52.5	17.9	18.3	3.8	56.1	6.8	26.5	2.4	62.6	1.5	27.7	2.3
1938	33.8	23.9	27.8	2.1	39.3	9.8	40.3	1.2	52.4	1.7	38.6	2.0
1939	41.5	16.9	23.6	2.5	38.9	5.1	37.8	1.2	57.2	5.1	32.2	1.9

simple unweighted arithmetic averages of the annual percentages for equity funds over the whole sixteen years covered in the table are, for national companies, around 27 percent of total assets, for regional companies 37 percent, and for local companies 34 percent. These percentages are lower than would be typical of manufacturing, mining, communication and mercantile corporations, all of which require relatively heavy investment in fixed plant, equipment and inventories, but they are decidedly higher than the capital ratios that are typical of financial institutions, such as banks and mortgage companies, with which sales finance companies are more directly comparable. Since sales finance companies seldom own physical property in any large amount, such as real estate, equipment, inventories and the like, the greater proportion of these equity funds is used for financing receivables. They therefore constitute in a very direct sense a cushion for the absorption of bad-debt losses. Despite the fact that equity funds constitute a relatively large proportion of total funds employed, finance company earnings, expressed as a rate of profit on equity funds employed, have been relatively high, especially for well-managed enterprises. The high rate of profits accounts, of course, for the success of sales finance companies in attracting new capital into what was, during most of the period covered, a new and rapidly expanding business. It has also

[a] For 1924-33 based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market, and for 1934-39 based on data obtained directly from companies. The percentages do not add to 100; the difference represents corporate reserves.

[b] General Motors Acceptance Corporation, Commercial Investment Trust Corporation and Commercial Credit Company for all years, and Universal Credit Corporation from inception in 1928.

[c] Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California and Bankers Commercial Corporation for all years; Maytag Acceptance Corporation from inception in 1927.

[d] A sample of 13 for the years 1924-33, of 40 for the years 1934-38 and of 24 for 1939, selected according to availability of data.

[e] Ratio of total debt to equity funds.

[f] Based on data for 4 companies only.

facilitated the building up of equity funds out of retained earnings.

Variations in the policies of national, regional and local sales finance companies with respect to the proportion of equity funds employed are also revealed by Table 7. National companies throughout the period show a lower proportion of equity funds to total assets than do regional or local companies. In almost every year they show also a higher debt ratio, that is, a larger proportion of funds borrowed to funds owned. This undoubtedly reflects the preferred position attained by these companies in the national money markets. In fact, one of the allegations which its smaller competitors bring against General Motors Acceptance Corporation is that it can borrow five or more times its equity capital because it is owned and backed by General Motors Corporation.[5] Differences between regional and local companies with respect to the relative employment of equity funds are less distinct. It might be expected that as between these two types of companies the larger regional enterprises would show a lower proportion of equity funds to borrowed money, but this expectation is not borne out by the data assembled in Table 7. In most of the years shown, the regional companies maintained a proportion of equity funds to total assets that was slightly larger than that maintained by local companies, and also, in most years, a smaller debt ratio.

It is more difficult to draw from these data inferences concerning changes during the period in the policies that have motivated the different types of companies, the difficulty arising largely because increases in the proportion of equity funds to total assets have usually reflected a falling off in business volume rather than a policy decision to strengthen the equity position. The fact, however, that equity funds

[5] "The Automobile Finance Business," a mimeographed monograph of the American Finance Conference, Chicago (July 15, 1937) pp. 19-20.

tended to rise in proportion to total assets during the period 1926-29, when business volume was expanding rapidly, would seem to indicate that at that time all types of companies were making active efforts to strengthen their equity positions. There may also be some significance in the fact that during the peak year 1937 the proportion of equity funds to total assets was lower than in 1929 and back to the levels prevailing in 1926. This may indicate that as the business has matured, its credit standing has improved and its borrowing capacity increased.

The factor of size as an index of ability to tap the central money markets is indicated also by the extent to which the various types of sales finance companies have incurred long-term debt, and the amount, source and character of their short-term indebtedness. Table 7 clearly indicates that national sales finance companies have made fairly extensive use of long-term money markets to secure funds to finance their operations, and that the regional companies have used this source of funds to a moderate extent. Local companies, on the other hand, have been forced to rely upon the short-term money markets for practically all of their borrowed funds.

In spite of the heavy proportion of equity funds used in the sales finance business, and the supplementary drafts made on the long-term money markets by national and regional companies, short-term debt has constituted on the whole a more important source of funds for the purchase of sales finance receivables than equity funds and long-term borrowings combined. A simple average of the annual percentages presented in Table 7 indicates that for the period as a whole short-term debt represented, for national companies, around 47 percent of total assets, for regional companies 43 percent, and for local companies 55 percent. During part of the period, particularly the years after 1934, this heavy reliance on short-term borrowing was affected by the fact that interest rates in the short-term markets were favorable. Primarily, however, it reflects the needs of sales finance companies for a source of funds that can be expanded or contracted rapidly in accordance with rapidly changing conditions. As was indicated in Table 6, the volume of business conducted by sales finance companies is subject to wide fluctuations from prosperity to depression, so wide that if business were financed wholly or even largely on the basis of long-term funds it would mean incurring heavy costs for idle money in periods of contraction. Therefore the basic needs of the business necessitate major reliance on short-term debt, even when interest rates are not particularly favorable.

From the beginning, access to these sources of funds has been fairly easy. In the early days it took the form mainly of direct loans which banks were able and willing to make. Although the business was new at that time, and did not enjoy its present high credit standing, it did possess definite attributes that served to open the channels of bank credit. Its capital cushion of equity funds was large, large enough to absorb heavy losses before there was any danger to the safety of funds advanced; its assets consisted of instalment receivables that lent themselves readily to hypothecation; when hypothecated, the paper bore the name of, and was secured by the net worth of, not only the borrowing company but also a retail dealer and a consumer buyer of the commodity financed; the paper itself was comparable to self-liquidating commercial paper in that it was repaid currently out of income and the current position of the company financed could be followed readily from its record of monthly receipts on outstanding instalment contracts; finally, the business was highly profitable, and therefore able to pay remunerative rates for ample accommodation.

As the business matured, finance companies came to be regarded as excellent risks. During recent years, when bank failures were numerous, there were few failures among sales finance companies. For the period 1925-33 the National Association of Sales Finance Companies has records of only 39 failures. In 19 of these there was no loss to creditors. As this quality of financial stability became recognized, new sources of short-term funds were opened to the larger well-managed companies, with the result that sales finance companies now make extended use of the open market through the commercial paper houses and maintain extensive borrowing relations with hundreds of banks throughout the country.

The varied nature of this short-term borrowing under present conditions is indicated in Table 8, which presents for 1937—the latest year of large operations—a more detailed analysis of sales finance companies' sources of funds. The table shows that in that year borrowing through the open market was equivalent to 18 percent of the total assets of national companies as compared with 10 percent and 15 percent respectively for regional and local companies. Direct bank debt, on the other hand, amounted to 31 percent of total assets for the national companies, as compared with 46 and 44 percent respectively for the regionals and locals. These variations reflect, of course, the greater accessibility of the larger corporations to the open markets. By 1937 all of the bank debt of the national companies, and practically all that of regional companies, was incurred on an unsecured basis. Among the local companies, however, 80 percent of the bank debt was still secured by pledge of collateral.

In the early 1920's these collateral trust notes were quite generally used as the basis of bank borrowing, and for 72 larger companies constituted about two-thirds of total notes payable.[6] Since then first the national companies, subse-

[6] According to National Credit Office, Inc., Bank Service Department, "A Study of Specialized Finance Companies" (1927).

TABLE 8

PRINCIPAL SOURCES OF FUNDS OF SELECTED SALES FINANCE COMPANIES, 1937, IN PERCENT OF TOTAL ASSETS[a]

Capital Item	*National Companies*[b]	*Regional Companies*[c]	*Local Companies*[d]
Borrowed funds	*68.9*	*63.6*	*64.8*
Bank debt			
Secured	..	1.4	34.9
Unsecured	31.1	44.2	9.3
Open-market debt	17.9	9.9	15.0
Other short-term debt	2.4	1.2	4.2
Long-term debt	17.5	6.9	1.4
Equity funds	*17.9*	*26.8*	*28.0*
TOTAL[e]	86.8	90.4	92.8
Receivables	88.9	85.9	84.4
Total assets	$1,470,500,000	$201,200,000	$166,043,000

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market, and on data obtained directly from companies.
[b] General Motors Acceptance Corporation, Commercial Investment Trust Corporation (including Universal Credit Corporation) and Commercial Credit Company.
[c] Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California, Bankers Commercial Corporation and Maytag Acceptance Corporation.
[d] A sample of 40, selected according to availability of data.
[e] The differences between these percentages and 100 represent corporate reserves.

quently the regionals and more recently the larger locals have increasingly employed the unsecured note,[7] until in recent years collateral trust borrowing has become a relatively unimportant method of financing. In the case of local companies, where it still exists, the assembly of receivables for collateral security is a relatively simple matter. Some banks, deploring the trend, have undertaken to restrict un-

[7] Practice, however, is sometimes deceptive. One large local, for example, although it borrows on straight notes, has all notes, contracts and accounts receivable held by a trustee for the benefit of holders of the companies' notes.

secured lending to companies with at least $5,000,000 capital,[8] but this standard is not generally adhered to.

Direct borrowings are from depository banks, which in the case of national companies may number from 250 to 400. Credit lines are usually arranged in advance of borrowing in accordance with maximum expected needs, and are subject to revision, seasonally and cyclically, as business expectations change. In order to take care of any possible expansion, total credit lines arranged usually exceed actual borrowings by a wide margin.

The terms under which sales finance companies borrow from banks have probably undergone considerable change, but no data are available on their trend over any extended period. Reports from about 150 large banks in various parts of the country indicate that at the end of 1938 maturity requirements ranged from a demand basis to 24 months or longer, but the maturity most frequently reported was 6 months. Interest rates varied from 1 to 12 percent, with 1½ percent the rate most frequently required. National sales finance companies borrow on the most favorable interest terms, the spread between the rates they pay and those paid by other companies varying from under 1 percent at some banks to more than 3 percent at others.[9]

Since the early 1920's sales finance companies have availed themselves of the open market as a means of financing their needs for short-term funds. Only 6 companies used the open market in 1922, and by 1926 the number had risen to 76,[10] but at the middle of 1938 it was reduced to 63, a few of these being subsidiaries of the others and a few doing no

[8] For example, some of the large Chicago banks. See A. W. Newton, "Finance Companies," address before the Association of Reserve City Bankers at White Sulphur Springs, April 27, 1937.

[9] For fuller detail on the terms of bank borrowing by sales finance companies see National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit,* by John M. Chapman and Associates (1940) Chapter 8.

[10] National Credit Office, Inc., *op. cit.*

retail instalment business. For companies using the open market this type of borrowing is conducted on terms as favorable as, and usually more favorable than, those regulating direct bank borrowing. It is handled by the usual commercial paper dealers, by several investment dealers or, directly, by the finance company's own organization. Maturities range up to 6 months, but interest rates, except for the largest companies, appear to run somewhat higher than rates prevailing on commercial paper regarded by the market as "prime."[11]

The proportion of total funds that sales finance companies should obtain through borrowing is a matter on which no two finance men or bankers agree. In the middle 1920's it was said that companies with the highest credit rating could then borrow five dollars for every equity dollar in their business, but that less highly regarded companies were more limited,[12] a conventional maximum standard of four dollars of debt to one equity dollar being generally accepted.[13] In 1935 the National Credit Office, Inc., reported a maximum debt standard of three times net worth to be in vogue. At the end of 1938 reports from leading banks engaged in lending to sales finance companies indicated that a standard of two and a half to three times equity funds was typical, a few banks approving a more liberal standard (4 to 1) and others a more conservative one (2 to 1 or lower).[14] Factory ownership is said to affect the attitude of bank lenders, since in such cases reliance is placed upon the financial strength of the parent company.

Because their assets consist predominantly of financial paper, the liquidity and ultimate solvency of sales finance

[11] John M. Chapman and Associates, *op. cit.*
[12] E. R. A. Seligman, *The Economics of Instalment Selling* (1927) vol. 1, p. 85.
[13] M. V. Ayres, *Installment Selling and its Financing,* report to American Bankers Association at Pinehurst, North Carolina, May 4, 1926. A. W. Grimes (*Financing Automobile Sales,* 1926, p. 66) sets the figure at one and one-half times for companies with a capital of $500,000 or less, and three to five times for those of larger size.
[14] John M. Chapman and Associates, *op. cit.*

TABLE 9

CASH AND RECEIVABLES OF 24 LEADING SALES FINANCE COMPANIES, 1935–39, IN PERCENT OF DEBT[a]

Date	*Cash and Receivables*[b] Maturing in 6 Months or Less	Maturing in 12 Months or Less
December 31, 1935	108.8	143.8
June 30, 1936	96.3	130.3
December 31, 1936	103.5	140.2
June 30, 1937	95.9	134.8
December 31, 1937	103.1	141.3
June 30, 1938	119.9	157.5
December 31, 1938	130.4	169.9
June 30, 1939	110.3	148.0

[a] Based on special surveys by the First National Bank of Chicago, covering 2 national companies, 3 regionals and 19 locals; of these, 14 companies reported for all dates, 10 only for some dates.
[b] Wholesale, retail and other.

companies can be judged only in terms of the quality of that paper, and of the policies followed in its acquisition. A rule of thumb standard commonly applied by bankers as a test of a sales finance company's general liquidity is its theoretical ability to liquidate all debts within the span of 6 months, merely by letting its existing instalment receivables mature.[15] Table 9, which shows, for 6-month intervals in the period 1935-39, the total cash and receivables

[15] A. W. Newton, *Installment Finance Paper,* address to Federal Reserve Member Bank Conference, Minneapolis, March 12, 1938, p. 28. A well-known finance company executive, D. Cates, expresses the same thought slightly differently by stating that bank credit should not exceed cash and instalment receivables maturing within 9 months, minus operating expense and a margin shown by past experience to be enough to cover the lag in collections. M. V. Ayres, "Long Term Requirements," in National Association of Sales Finance Companies, *Time-Sales Financing* (November 1936) p. 14, observes that a finance company with a stabilized business in 12-month paper could borrow, under the criterion of 6-month liquidation, 2.71 times its own capital.

of twenty-four larger sales finance companies, in percent of debt, indicates adherence to such a standard, and also shows a substantial excess margin available for liquidating debt on a 12-month maturity limit. It should be observed, however, that there is not complete agreement among bankers as to the wisdom of adhering to a 6-month liquidity standard. Reports from leading banks in various sections of the country as of the end of 1938 indicated a preponderance of bank opinion in favor of a 5- to 7-month liquidity standard, but a large proportion of the reporting banks (more than one-third) favored a more liberal standard, the extreme being 14 to 16 months.[16]

Commercial banks that are important creditors of sales finance companies necessarily take an active interest in the quality of the retail receivables that such companies hold.[17] The banker, of course, has no way of appraising the reliability of the company's hundreds or thousands of customers, but he can ascertain the typical down payment on the merchandise financed, and the average duration of customer notes, and on the basis of past experience estimate the relative risk of the company's account. In general, banks that lend regularly to automobile sales finance companies consider as standard a down payment of one-third of cash selling price on both new and used cars, and a contract duration of 18 months on new cars and 12 months on used cars, but these standards are by no means universally held. Leading creditor banks obtain regular reports on typical down payments and instalment contract lengths, and on at least two occasions, 1924 and 1937, such banks took an active part in persuading sales finance companies to check a competitive liberalization of sales financing terms.

[16] John M. Chapman and Associates, *op. cit.*

[17] For a fuller discussion of the interest of the commercial bank creditor in the quality of instalment receivables held by sales finance companies, see John M. Chapman and Associates, *op. cit.*