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Income, Expenses, Profits

SINCE its beginning, in about 1915, the business of instalment financing has been a highly profitable one, with a very low rate of failure among the companies engaged in it. After a decade of operation, which included the downswing of the business cycle in 1920-21, it was said by a competent observer that the few failures which had occurred had been due principally to mismanagement or to legal defects in the sales agreements.[1] During the storm of business contraction from 1929 to 1933 no bank lost money from a finance company failure, although many finance companies lost money from bank failures. In fact, from the beginning there have been scarcely any finance company failures that resulted in serious loss to bank creditors, even though banks lend to these organizations much larger sums than they would to almost any other kind of business enterprise with the same net worth.[2]

Data available for a study of the income and expenses of sales finance companies are less complete than for certain other consumer credit agencies; therefore on this subject it is necessary to rely on information covering a relatively small number of companies. It is possible, however, to examine income and expense data of national, regional and local companies, and in addition to compare the profit rates of factory-controlled, factory-preferred and independent companies, figured on the basis of total capital employed in the business.

[1] G. W. Norris, address before the fourteenth annual meeting of the Chamber of Commerce of the United States, Washington, D. C., May 12, 1926.

[2] Milan V. Ayres, "The Economic Function of the Sales Finance Company" in *Time-Sales Financing*, vol. 3, no. 1 (January 1938) p. 4.

GROSS INCOME

The gross earnings of sales finance companies come from retail and wholesale financing, insurance placement, small loans, factoring (the discounting of various types of accounts receivable) and rediscounting the paper of other finance companies. It is not possible to generalize precisely regarding the relative importance of these various sources, but there is no doubt that retail financing, which constitutes from two-thirds to three-fourths of receivables outstanding, furnishes the bulk of gross earnings.

Wholesale financing, which constitutes 10 to 20 percent of receivables outstanding and a much higher proportion of volume (because of more rapid turnover than in retail business), accounts for scarcely more than 5 to 10 percent of gross income. Table 60 shows that for ten local sales finance companies, selected according to availability of data, income from wholesale financing averaged 5.5 percent of gross income in 1937, ranging from 3.2 to 11.7 percent; wholesale credit averaged 42 percent, however, of all credit extended. Wholesale financing is commonly transacted at the prevailing commercial interest rate, or even less, because the sales finance companies habitually accommodate dealers in this regard in order to share in the dealers' retail instalment paper.

Income from handling the insurance entailed in the retail financing of automobiles typically ranks after retail financing as a source of finance company earnings. It is considered in the trade as so important a source of income that one executive stated to an examiner for the Federal Trade Commission that the profit, in automobile financing, is in the insurance. Many finance companies own their own insurance companies and thus receive insurance profits directly; others have special arrangements with particular insurance companies. When the two types of business are independent the finance company receives a commission on the insurance busi-

TABLE 60

INCOME FROM WHOLESALE FINANCING OF 10 LOCAL SALES FINANCE COMPANIES IN PERCENT OF TOTAL GROSS INCOME, AND WHOLESALE CREDIT IN PERCENT OF TOTAL CREDIT EXTENDED, 1937[a]

Company[b]	*Wholesale Income in % of Total Gross Income*	*Wholesale Credit in % of Total Credit Extended*
A	5.0	48.2
B	3.9	26.7
C	6.9	40.9
D	4.4	49.0
E	11.7	51.3
F	6.1	40.0
G	3.2	36.7
H	7.8	52.9
I	3.2	25.3
J	5.1	35.9
AVERAGE	5.5	41.9

[a] Based on data obtained from the National Credit Office, Inc.; companies selected according to availability of data. Total gross income of the 10 companies in 1937 was $6,109,000, and total credit extended by them was $105,470,000. For the few companies whose fiscal year did not end on December 31, 1937, the nearest fiscal year-end figures were used.
[b] Companies ranked according to volume of wholesale credit extended, with company of greatest volume designated as A.

ness it places, and according to the Federal Trade Commission this income has amounted to 30 to 50 percent of the retail insurance premium, sometimes more, depending on the loss record on business already placed by the finance company.[3] Available data covering ten local sales finance companies, presented in Table 61, show that in 1937 the insurance commissions of all ten companies averaged 7.3 percent of gross income; for the companies which had the highest percentages, however, commissions averaged almost twice this

[3] Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 926.

TABLE 61

INSURANCE COMMISSIONS RECEIVED BY 10 LOCAL SALES FINANCE COMPANIES, 1937, IN PERCENT OF TOTAL GROSS INCOME[a]

Company[b]	*Percent of Total Gross Income*
A	1.2
B	8.6
C	4.1
D	.1
E	18.4
F	10.9
G	21.3
H	2.2
I	15.7
J	10.7
AVERAGE	
10 companies	7.3
6 highest companies	13.6

[a] Based on data obtained from the National Credit Office, Inc.; companies selected according to availability of data. For one company the fiscal year ending June 30, 1937, was used.

[b] Companies ranked according to volume of retail automobile credit extended, with company of greatest volume designated as A; total volume of such credit extended by the 10 companies in 1937 was $54,444,000.

figure—13.6 percent. Wide variation is shown, the lowest percentage being 0.1 and the highest 21.3.

Gross income shows considerable variation according to the scope of a company's operations. Table 62 indicates that in the period 1928-39 gross income, in percent of year-end total assets, was lowest for nationals, and was lower for regionals than for locals. For the entire period it averaged about 11 percent for nationals, 13 for regionals and 15 for locals.

It does not necessarily follow from this comparison that the largest companies charged lower rates for financing, or that their *net* income was lower. It is a fact, however, that on the whole their charges were lower than those of companies

TABLE 62

GROSS INCOME OF SELECTED SALES FINANCE COMPANIES, 1928–39, IN PERCENT OF TOTAL ASSETS[a]

Year-End	*National Companies*	*Regional Companies*	*Local Companies*
1928	12.3	11.9	14.6
1929	12.4	13.4	17.0
1930	11.6	15.5	15.6
1931	11.2	11.8	17.1
1932	12.8	14.4	16.7
1933	11.5	12.1	14.1
1934	12.2	13.7	14.7
1935	11.1	13.1	13.9
1936	10.0	12.3	13.5
1937	10.4	12.0	12.9
1938	11.1	13.1	13.1
1939	9.5	10.4	12.0

[a] Based on data assembled by the Bureau of Business Research of the University of Illinois in connection with its study of *The Financial Policies and Practices of Automobile Companies* by H. W. Huegy and A. H. Winakor (Bulletin no. 56, 1938), and on data obtained from the National Credit Office, Inc. The number of companies included for each year was determined by the availability of data, and varied for nationals from 2 companies in 1928-29 to 3 in subsequent years, for regionals from 3 in 1928-30 and 4 in 1931-34 to 5 in subsequent years, and for locals from 7 in 1928 to 39 in 1937.

operating over less territory. Their smaller percentage of gross income is due mainly to the fact that they handle a larger proportion of low-profit types of paper. The national companies hold a larger proportion of new-car paper and a smaller proportion of used-car paper than do the locals (new-car contracts properly bear a lower finance charge than used-car contracts, which entail a greater risk). Also, whereas the regional and local companies have a relatively larger volume of retail automobile and small loan paper, the national companies handle more wholesale automobile paper and more factoring paper, which are low-rate, low-risk business.

EXPENSES

The three major categories of sales finance company expenses are operating expense, cost of borrowing and provision for taxes. Table 63 shows these categories for forty-seven sales finance companies in 1937, expressed in percent of year-end total assets and of gross income. It is evident that in relation to total assets the nationals had not only the lowest percentage of gross income but also the lowest percentage of total expense, 6.2 as against 8.1 for the regionals and 9.2 for the locals, although the regionals required less to meet the cost of borrowing, and the locals required less for taxes, than did the

TABLE 63

INCOME, EXPENSES AND PROFITS OF 47 SALES FINANCE COMPANIES, 1937, IN PERCENT OF TOTAL ASSETS AND OF GROSS INCOME[a]

Item	*National Companies*		*Regional Companies*		*Local Companies*	
	% of Total Assets	% of Gross Income	% of Total Assets	% of Gross Income	% of Total Assets	% of Gross Income
Gross income	10.4	100.0	12.0	100.0	12.9	100.0
Operating expense	3.6	34.4	5.8	45.4	6.4	48.9
Cost of borrowing	1.6	10.0	1.1	9.0	1.9	15.0
Provision for taxes	1.0	15.7	1.2	10.9	.9	7.3
Net profit	4.2	39.9	3.9	34.7	3.7	28.8
Total assets (year-end)	$1,470,484,000		$201,155,000		$164,255,000	
Gross income	$153,590,000		$24,227,000		$21,136,000	

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market, and on Moody's *Manual of Investments*. National companies comprise General Motors Acceptance Corporation, Commercial Investment Trust Corporation and Commercial Credit Company; regionals comprise Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California, Bankers Commercial Corporation and Maytag Acceptance Corporation; local companies are a sample of 39 selected according to availability of data. For the few companies whose fiscal year did not end on December 31, 1937, the nearest fiscal year-end figures were used.

nationals. For regionals and locals over two-thirds of expenses were for operating outlays, for nationals a little less. Cost of borrowing absorbed about one-fourth of total expenses for the nationals, somewhat less for the locals and still less for the regionals, these differences arising partly from differing ratios of borrowed funds to equity funds. After meeting expenses the national companies had a larger proportion of gross income remaining for net profits than had either the regionals or locals, the percentages being 40, 35 and 29 respectively.

The trend of sales finance company expenses for the period 1928-39, expressed in percent of gross income, is indicated in Table 64. For all companies the proportion of gross income required for operating expenses and taxes increased considerably in 1930-32, thereafter declining irregularly; the later levels are substantially higher, however, than those obtaining in 1928-29, chiefly because of increased provision for taxes. During the difficult depression years the cost of borrowing, in relation to gross income, declined sharply for the national and regional companies, less conspicuously for the locals. This decline was due partly to the circumstance that the very low volume of business handled in those years decreased money costs in general. The fact that borrowing costs in relation to gross earnings were maintained at their lower level during the expansion years that followed reflects mainly the low interest charges on finance company borrowing.

The relatively high level at which all companies maintained their net profit in relation to income during the entire twelve-year period resulted in part from the fact that changes in operating expenses and taxes were compensated by changes in the cost of borrowing. It indicates too that the proportion of sales finance company expense which is in the form of overhead is comparatively small, while the corresponding proportion which is variable is relatively large. As a result of this distribution of costs, sales finance companies are able to

TABLE 64

EXPENSES AND PROFITS OF SELECTED SALES FINANCE COMPANIES, 1928–39, IN PERCENT OF GROSS INCOME[a]

Year	*Operating Expense and Provision for Taxes*			*Cost of Borrowing*			*Net Profit*		
	National Companies	Regional Companies	Local Companies	National Companies	Regional Companies	Local Companies	National Companies	Regional Companies	Local Companies
1928	47.8	49.5	51.2	29.5	21.5	21.8	22.7	29.0	27.0
1929	44.5	42.9	50.5	32.8	24.0	25.4	22.7	33.1	24.1
1930	47.2	46.5	54.9	25.2	20.5	25.7	27.6	33.0	19.4
1931	54.7	54.9	60.1	19.3	13.7	25.1	26.0	31.4	15.9
1932	58.6	67.9	61.7	19.8	16.7	23.7	21.6	15.4	14.6
1933	55.6	62.1	58.0	9.8	13.1	20.7	34.6	24.8	21.3
1934	51.2	57.9	56.8	8.8	9.8	19.5	40.0	32.3	23.7
1935	49.5	53.8	57.3	8.0	7.0	16.5	42.5	39.2	26.2
1936	51.0	56.0	56.7	9.0	7.0	14.8	40.0	37.0	28.4
1937	50.1	56.3	56.2	10.0	9.0	15.0	39.9	34.7	28.8
1938	54.5	56.8	59.9	10.4	6.2	11.4	35.1	37.0	28.7
1939	52.3	58.2	56.2	17.2	7.1	21.2	30.5	34.7	22.6

[a] Based on data assembled by the Bureau of Business Research of the University of Illinois in connection with its study of *The Financial Policies and Practices of Automobile Companies* by H. W. Huegy and A. H. Winakor (Bulletin no. 56, 1938), and on data obtained from the National Credit Office, Inc. The number of companies included for each year was determined by the availability of data, and varied for nationals from 2 companies in 1928-29 to 3 in subsequent years, for regionals from 2 in 1928-30 to 7 in 1936, and for locals from 8 in 1928 to 43 in 1936. Net profit is regarded as profit remaining after deduction for all expenses.

cut expenses promptly when business volume contracts, quite in contrast to businesses that are burdened with large overhead costs.

NET PROFITS

Table 63 showed that in 1937 net profit, in relation to total assets, was 4.2 percent for the national companies, 3.9 percent for the regionals and 3.7 for the locals. The comparative position of the three types of companies is much the same if net profit is regarded in relation to net worth (owners' invested capital), which is a more significant relationship in a consideration of a company's investment profitability. These percentages in 1937—for the same companies covered in Table 63—were 18.9 for the nationals, 14.6 for the regionals and 14.1 for the locals. This ranking reflects, of course, differences in the capital structures of the three types of companies—differences which were discussed in Chapter 2.

The relationship of net profit to net worth is shown in Table 65 for the period 1928-39, and these figures may be compared with those in Table 64 on the relationship of net profit to gross income during the same period. Both sets of figures are based on small and varying samples but they serve to corroborate other evidence: it can be seen from Table 65 that finance companies in general realize a high rate of return on invested capital, and that for the national companies the rate of return is generally higher than for the others; and Table 64 indicates that net profits represent a relatively high proportion of gross income, again usually higher—at least in recent years—for national than for regional or local companies. For all companies net profit in relation to net worth was lowest in the depression years 1932-33, and, especially for the nationals and regionals, has been highest since that period. Roughly the same trend is apparent in the relationship of net profit to gross income.

TABLE 65

NET PROFIT OF SELECTED SALES FINANCE COMPANIES, 1928–39, IN PERCENT OF NET WORTH[a]

Year	*National Companies*	*Regional Companies*	*Local Companies*
1928	14.6	12.3	12.5
1929	11.8	9.8	13.4
1930	11.9	8.4	9.8
1931	9.7	8.8	7.3
1932	6.1	3.8	4.2
1933	9.6	6.9	6.8
1934	14.6	11.6	9.5
1935	17.2	16.9	12.3
1936	19.5	16.0	13.7
1937	18.9	14.6	14.1
1938	14.2	16.2	7.9
1939	12.3	12.9	11.2

[a] Based on data assembled by the Bureau of Business Research of the University of Illinois in connection with its study of *The Financial Policies and Practices of Automobile Companies* by H. W. Huegy and A. H. Winakor (Bulletin no. 56, 1938), and on data obtained from the National Credit Office, Inc. The number of companies included for each year was determined by the availability of data, and varied for nationals from 2 companies in 1928-29 to 3 in subsequent years, for regionals from 2 in 1928 to 7 in 1936, and for locals from 11 in 1928 to 48 in 1936. Net profit is regarded as profit remaining after deduction for all expenses.

In view of the statement mentioned above that the profit in automobile financing is in the insurance, it would be interesting to examine the comparative significance of this item for many companies. There are but few companies, however, for which data are available. Among the ten local companies whose records were drawn upon in Table 61, income from insurance commissions in 1937 accounted for widely varying proportions of net profits, ranging from a low of 2 percent to a high of 89 percent; for all ten companies it averaged 23 percent, and for the six highest companies 54 percent.

It should be remembered, however, that in some cases insurance profits appear not on the books of the finance company itself but on the books of an affiliated insurance company.

In a consideration of the profitability of an entire business a profit rate computed, as above, in percent of net worth, or owners' invested capital, is a less significant figure than one computed in percent of total capital employed, including borrowed funds. The Federal Trade Commission has used the latter basis in its investigation of the motor vehicle industry, and its figures for five selected years in the period 1927-37 provide still further confirmation of the evidence already presented that sales finance company profits are relatively high and stable. The Commission's data, which have the special advantage of showing the comparative profit positions of independent, factory-preferred and factory-controlled companies, are presented in Table 66.

It is evident from this table that even in 1932, when the depression was at its worst, the average net profit on total capital employed was 6.5 percent for the independent companies, 5 for those that were factory-preferred and 5.9 for the company under factory control. In each year except 1927 the independents showed higher rates than either of the other types of companies; in recent years the factory-controlled company has shown the lowest rate, on this basis, although it was higher than either of the others in 1927 and was still a close second in 1932. It is interesting to observe that relatively few of the independent companies classified in this table had profit rates of less than 3 percent of total capital employed; in each year reported on, the greatest concentration of companies was in either the 6-9 or the 9-12 percent level.

Various factors help to account for the relatively high and relatively stable profit rates that have persisted among sales finance companies. Certainly one reason for the profit record

TABLE 66

CLASSIFICATION OF INDEPENDENT SALES FINANCE COMPANIES BY NET PROFIT IN PERCENT OF TOTAL CAPITAL EMPLOYED, AND AVERAGE NET PROFIT IN PERCENT OF TOTAL CAPITAL EMPLOYED FOR INDEPENDENT, FACTORY-PREFERRED AND FACTORY-CONTROLLED SALES FINANCE COMPANIES, SELECTED YEARS, 1927–37[a]

	1927	1932	1935	1936	1937
Net Profit		*Distribution of Independent Companies*			
Under 3%	3	3	..	1	1
3– 6	..	5	5	4	6
6– 9	2	7	9	12	15
9–12	6	3	10	7	4
Over 12	1	..	..	1	..
Total number of companies[b]	12	18	24	25	26
Type of Company		*Average Net Profit*			
Independent[c]	7.0%	6.5%	9.2%	9.4%	7.9%
Factory-preferred[d]	6.8	5.0	8.9	7.9	6.5
Factory-controlled[e]	7.7	5.9	7.0	5.7	5.6

[a] Based on Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 947.
[b] For some companies data were not available, or company was not in business, in years earlier than 1937.
[c] Same companies as those tabulated above.
[d] Includes Commercial Credit Company and Commercial Investment Trust Corporation (exclusive of Universal Credit Corporation) in all years, and Universal Credit Corporation in 1935, 1936 and 1937.
[e] General Motors Acceptance Corporation.

of this business is the fact that there has been for two decades an expanding market for sales financing services. Also, the nature of the business is such that in periods of cyclical decline in volume, operating expenses can be correspondingly adjusted, to a greater extent than is possible in many other fields. And the imperfectly competitive conditions that have characterized the business, in conjunction with the relative inelasticity of demand in periods of business recession, make it possible for companies to raise their charges in the face of declining volume. Over the past few years low interest rates on borrowed funds have worked in favor of sales finance company earnings, and have helped to offset increased costs and increased business taxes and somewhat decreased finance charges.

Such explanations, however, are not in themselves sufficient. They do not touch upon certain important questions that are prompted by the profit record of the business. Why is it that such profits are not reduced by rate competition and by the entry of new capital into the field? Why is it that the business itself—standing so profitably between the ultimate source of funds and the retailer who finds the use for them—is not pressed into smaller and smaller scope by bankers and dealers, and even by those who offer alternative credit facilities to the consumer? These questions demand consideration of the peculiar competitive conditions that characterize the sales finance business.