

# Comparative Operating Experience of Consumer Instalment Financing Agencies and Commercial Banks, 1929-41

BY ERNST A. DAUER

**Financial Research Program**

**Studies in Consumer Instalment Financing 10**

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***Comparative Operating Experience  
of Consumer Instalment Financing  
Agencies and Commercial Banks,  
1929-41***

This study is being published at a time when restrictions of a wartime economy are profoundly affecting the credit operations both of consumer instalment financing agencies and commercial banks. Based on a period, 1929-41, when such operations reached their peak, the study is especially valuable now, by virtue of the implications it carries for consumer financing in the postwar era.

The comparative data cover all phases and conditions of consumer credit—the operation of agencies and banks in rural areas and metropolitan centers, sources and uses of funds, rates of interest and payment of dividends, costs of operation and rates of profit. Over the period covered perhaps the most significant development has been the tendency for certain of the consumer instalment financing agencies to assume some of the characteristics of commercial banks, and for an increasing number of commercial banks—traditionally opposed to extending credit for “non-productive” purposes—to enter the consumer financing field.

Preparation of this study was made possible through a cooperative arrangement with the Federal Deposit Insurance Corporation, Division of Research and Statistics, which made available the part-time services of Dr. Dauer, senior economist on its staff, and otherwise contributed research facilities and valuable tabulations on insured industrial and commercial banks.

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*Studies in Consumer Instalment Financing:*  
Number Ten

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BY ERNST A. DAUER

Financial Research Program  
*Studies in Consumer Instalment Financing*

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## Preface

THIS survey of the financial structure and operating characteristics of consumer instalment credit agencies and commercial banks is the tenth of the Studies in Consumer Instalment Financing, prepared under the National Bureau's Financial Research Program. It constitutes a logical supplement to descriptive studies of the principal agencies of consumer instalment financing already published, and was undertaken with three objectives in mind: first, to bring together in a single comparative analysis our materials on the financial characteristics of consumer credit agencies; second, to contrast the operating characteristics of such agencies with those of commercial banks; third, to observe their operating experience during recent periods of business contraction and expansion.

The materials on which this study is based are much more extensive than were available for our earlier studies, and cover a longer period. Five sets of data were used. The first comprises tabulations of the principal financial statement items of 229 sales finance companies, 179 personal finance companies and 204 industrial banking companies for the years 1929, 1933 and 1936, prepared from federal income tax returns by the Treasury-WPA Income Tax Study of Philadelphia, at the request of the National Bureau. The second set of data was compiled by our staff from the files of the National Credit Office, Inc., and includes tabulations covering the principal financial statement items, 1929-41, of a varying number of sales finance and personal finance companies that finance themselves through the open market. The third set covers insured industrial banks, 1934-41, and was provided by the Division of Research and Statistics of the Federal Deposit Insurance Corporation. The fourth covers federal credit unions reporting to the Farm Credit Administration, 1934-41. A fifth set of data, also provided by the Division of Research and Statistics of the Federal Deposit Insurance Corporation from official banking records, covers the financial characteristics of insured commercial banks.

The National Bureau of Economic Research wishes to express its indebtedness to the agencies that have cooperated in furnishing materials for this study. Without their cordial assistance the underlying data would have been far less comprehensive. In particular, we are obligated to the Income Tax Study of the Treasury Department and the WPA for the preparation of the income tax tabulations mentioned above, covering selected samples of sales finance, personal finance and industrial banking companies. The plans for these tabulations were prepared by the financial research staff of the National Bureau, but the task of executing them was entirely borne by the staff of the Income Tax Study. The National Bureau was required to furnish to the Income Tax Study comprehensive lists of names of consumer credit companies, and in the preparation of these lists we obtained the helpful cooperation of the Consumer Credit Division of the Russell Sage Foundation and the Consumer Credit Institute of America. The many technical problems that arose in making the tabulations were resolved by consultation between the author and the staff of the Income Tax Study.

Copies of all tabulations prepared by the Income Tax Study on these agencies are on file at the Division of Tax Research, United States Treasury Department, and at the Hillside offices of the National Bureau of Economic Research.

In connection with our special studies of personal finance and sales finance companies the National Credit Office, Inc. gave us access to its files of financial reports of companies selling commercial paper in the open market. The National Credit Office allowed us to bring the tabulations prepared from its files up to date for the present study, and we take pleasure in acknowledging their further cooperation in our work.

The preparation of the study was made possible through a cooperative arrangement with the Division of Research and Statistics of the Federal Deposit Insurance Corporation. The Division made available to us the part-time services of Dr. Ernst A. Dauer, senior economist on its staff, and otherwise contributed statistical assistance and research facilities. Dr. Dauer has had full responsibility for the conduct of the research and the analysis, and he has executed this responsibility with diligence and resourcefulness. The conclusions that he has reached are necessarily his own, and in no way represent the official views of the Federal Deposit Insurance Corporation.

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The National Bureau is especially indebted to the Federal Deposit Insurance Corporation. That organization has not only cooperated cordially and generously in the preparation of the present study, but has taken an active interest in the work of the Financial Research Program since its inception.

RALPH A. YOUNG

*Director, Financial Research Program*

April 1, 1944

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## Author's Acknowledgments

MANY individuals and a number of organizations have cooperated generously in making data available, or in providing valuable assistance in the organization and development of this study.

I wish to express my indebtedness in particular to the Chairman and the Directors of the Federal Deposit Insurance Corporation, for allowing me to engage in this study and for granting permission to use data on insured banks from the files of the Corporation.

The staff of the Income Tax Study, Earl D. Krickbaum, Director, was very cooperative. John Benz was most patient in locating and rectifying or explaining apparent irregularities in the tabulations. The contribution of Laurence Brokate in the selection of the income tax sample was material.

I am very grateful to members of the staff of the National Bureau's Financial Research Program: to Ralph A. Young and Winfield W. Riefler for encouragement and assistance in planning the study and for their penetrating criticism; to Raymond J. Saulnier, David Durand and Janet Vaughn Koch for suggestions and advice; to Mildred Courtney and Lucy Rozanski for secretarial work; to Sophie Polah and Muriel Ratigan for statistical assistance; to Elizabeth Todd for materially improving the style and clarity of the manuscript through her painstaking and critical editing and to Isabel Lundberg for seeing the manuscript through the press.

A number of persons with particular competence in the field of banking or consumer credit have furnished material, made specific suggestions, or read portions of this manuscript in preliminary form and aided me with constructive criticism; of these, I wish to acknowledge the assistance of Benjamin H. Beckhart, Burr Blackburn, John M. Chapman, Lewis N. Dembitz, Harry Anson Finney, M. R. Neifeld, Rolf Nugent, and Arthur R. Tebbutt.

Not so much for specific assistance in this study as for the stimulus that arises from a daily exchange and clash of ideas, and imperceptibly colors one's thoughts, I am indebted to former associates

of the faculty of Northwestern University—particularly James W. Bell, Herbert F. Gane, Harry G. Guthmann, and the late Horace Secrist—and to associates in the Division of Research and Statistics of the Federal Deposit Insurance Corporation. To the following associates in the Division I am most deeply indebted for specific assistance: to Donald S. Thompson, Chief, for continuous encouragement, invaluable criticism and wholehearted cooperation; to Sally S. Ronk for assistance in all stages of the work; to Florence Helm and Tynan Smith for criticism and suggestions; to Vivian W. Osias and Mary J. Crowell for preparing most of the statistical material and carefully checking all of it; to Ethel Bastedo for bibliographical assistance; and to Katherine Miles and Estelle Kaufman, secretaries, for generous diligence.

ERNST A. DAUER

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## Summary Survey

IN A little more than twenty years the financing of consumers on an instalment basis grew from what was probably an unimportant amount into a 6 billion dollar business in 1941. The major share of this business was handled by specialized types of agencies, rather than by commercial banks. These specialized agencies may be classified into two groups, according to the character of activity in which they predominantly engage. The first includes sales finance companies, which typically engage in the financing of consumers' purchases of goods through the acquisition of instalment contracts from retail dealers; the second group includes personal finance companies, industrial banking companies, and credit unions, which typically engage in the direct extension of personal cash loans to borrowers.

The original development of the specialized agencies, and their subsequent garnering of the major share of the consumer instalment business, was at least partly due to lack of competition from commercial banks for this type of paper. There were a number of reasons why commercial banks, as a whole, had not entered this field.

First, the average commercial bank had profitably employed its facilities in financing agriculture and business enterprises; second, commercial bankers were traditionally reluctant to grant credit for "non-productive purposes"—a category in which the financing of consumption was generally included; and third, the extension of consumer credit was regarded by banks as unprofitable and uneconomic because loans for small amounts entail high operating costs, generally in excess of the rates of charge permitted banks under the usury laws.

The specialized agencies found the business profitable, however, for they were enabled to exceed the legal usury rates, either by receiving specific legislative authorization to charge higher rates, or by avoidance of the limitations in the usury statutes through the benefit of favorable judicial decisions or the use of technical devices.

In 1929 consumer instalment paper, held almost exclusively by retailers and the specialized agencies, amounted to 3 billion dollars.

With bank earnings during the 1930's at lower levels than in earlier years, commercial banks entered the field in considerable numbers, and acquired a substantial share of the business. At the end of 1941 the total amount of consumer instalment outstandings was distributed as follows:

Sales finance companies	33 percent
Commercial banks	26 percent
Retail dealers	19 percent
Personal finance companies	10 percent
Industrial banking companies	6 percent
Credit unions	4 percent
Others	2 percent

In spite of commercial banks' rapid acquisition of a considerable share of the consumer instalment credit business, this type of financing, except in relatively few banks, still represented only a small portion of their activity. Their loan operations remained typically those of an agency engaged primarily in the financing of business enterprises.

In this study the operations of the specialized agencies, engaged almost entirely in financing consumers, are contrasted with the operations of commercial banks. Specific data on banks' consumer instalment lending activities are either not available or inadequate. In this field their cost of operations and rate of operating profit probably do not differ materially from those of insured industrial banks, but because of lack of information no attempt has been made to compare the operating results of their consumer financing with those of the specialized agencies.

In the analysis of operating characteristics in this study, reliance was based chiefly upon summary balance sheet and profit and loss statements. For the most part, assets of individual companies were classified into the four major categories: loans, securities, cash, and miscellaneous assets; liabilities were classified as borrowings or miscellaneous liabilities, while all capital accounts were classified as net worth. Profit and loss accounts of individual companies were classified into the following broad categories: income; cost of operations, including taxes, losses and all expenses except interest;

interest payments or the cost of borrowed funds; and net profit, including dividends and interest paid on equity capital.

The term, operating profit, designates the difference between total income and the cost of operations, and the term net profit designates the difference between operating profit and interest payments or the cost of borrowed funds. The rates used in the analysis are expressed as percent per annum. The rate of income on loans (income received during the year in percent of loans) represents the gross return from the funds lent; the rate of operating profit (operating profit during the year in percent of total assets) reflects the degree of success of the business in utilizing the total funds at its disposal; while the rate of net profit (net profit during the year in percent of net worth) represents the degree of success of the business in utilizing the owners' investment.

The results of this study may be summarized in five main points. *First*, there is a sharp contrast between the character of assets, operating methods and activities and sources of funds of the specialized agencies, on the one hand, and of commercial banks on the other. *Second*, with respect to each of these operating characteristics, however, differences exist among the various types of specialized agencies; among individual companies within each type of agency; and among individual commercial banks. *Third*, significant differences in rates—of total income, costs of operations, and operating profit—among types of agencies and among individual companies and banks, are traceable to differences in character and typical size of loan; they do not appear to be traceable to size of enterprise, as such. *Fourth*, significant differences in cost of borrowed funds—among agencies and individual units—result from variations in sources of funds, and from variations in activities and in character of assets which accompany variations in size of enterprise. *Fifth*, important changes in total income, costs, profits and dividend records over the period 1929-41 reflected severe business recession, subsequent recovery, and the growth to maturity of the specialized agencies.

#### CONTRASTS IN OPERATING CHARACTERISTICS: CONSUMER AGENCIES AND COMMERCIAL BANKS

An outstanding characteristic of the consumer instalment financing agencies, as a group, was their ability throughout the period under

review to maintain from 80 to 90 percent of their assets in the form of loans, predominantly in small amounts to consumers. Enterprises of this type have normally needed to keep only a low proportion of their total assets in the form of cash, for the regularity of the flow of repayments gives them a high turnover of funds, and their cash needs are limited to uses incident to current and new business operations. Ordinarily, too, they do not invest in securities, except as an alternative to holding cash when they cannot readily adjust sources of funds to changes in volume of activity. Miscellaneous assets, including real estate, furniture and fixtures, and repossessions, have also been a negligible percentage of total assets.

In sharp contrast to the typical specialized agency, commercial banks as a group have in recent years held less than 30 percent of their total assets in loans, with securities exceeding loans at nearly 40 percent of total assets, and cash equaling loans. This asset distribution is partly the result of the peculiar position of commercial banks in our monetary structure, for banks have rarely been in a position to hold loans in excess of 65 percent of total assets. Their function of providing a circulating medium through the demand deposit, and their use as a means of effecting the transfer of funds, make it necessary that they maintain reserves in cash, and in balances with a central bank and with correspondents—reserves that are not required of the consumer agencies.

The figures for commercial banks as a whole are dominated, however, by those of the largest banks in the large centers, which have experienced the most marked increase in deposits in recent years. One out of every four banks still holds half its total assets in the form of loans. In general, banks in the western and southern states, regions dominated by agricultural and extractive industries, hold larger proportions of loans than banks in states that are dominated by manufacture and trade.

Many commercial banks—about 1,500, or one-eighth—still hold no consumer instalment loans, and the extent to which others have entered the field varies widely. It might be expected that banks in the largest centers, where the growth in deposits has been greatest, would have had the strongest incentive to enter the consumer instalment financing field. Actually, however, there is much diversity in this respect. The largest banks in these centers, accustomed to dealing with the largest business borrowers, have developed the

consumer instalment business the least, but other banks in the same centers have extended a larger proportion of consumer loans than have those in the small centers.

Banks in the smallest centers have not developed a significant volume of instalment loans to consumers, because the regular repayment basis is not suited to the needs of the dominant type of borrower in such communities; but in significant proportion their loans—extended to farmers, workers, tradesmen and small manufacturers—are otherwise similar to the typical consumer instalment loan. The small amount of the note, the use of chattels as security, the low net worth of the borrower, are all characteristic also of instalment lending to consumers.

Although all the specialized agencies have been engaged predominantly in the extension of consumer credit in small amounts, repayable on an instalment basis, they have differed widely in the sources from which they have derived their funds. This variation arises from differences in the creditworthiness attributed to retail instalment paper and cash loans; differences in the degree of seasonal and cyclical fluctuations to which these two types of paper are subject; differences in the size of individual enterprise—and also from certain peculiarities of borrowing practices, particularly those of industrial banks. The latter, alone, have derived a significant proportion of funds from depositors, as a result of which they are, in fact, an intermediate type, between the other specialized agencies and commercial banks.

In all the specialized agencies except industrial banks, the proportion of funds represented by net worth has been materially higher than in commercial banks. In the latter, the net worth proportion has decreased materially and is now at its lowest level since the formation of the national banking system, amounting to less than 9 percent of total funds. This continued reduction has been largely due to forces beyond the control of the individual banks, chiefly to the large increases in United States government securities and in demand deposits occasioned by the financing of the recovery and war programs.

A consumer instalment financing agency derives its income mainly from loans, in the form of interest or discount or special types of fees, or charges arising from the extension or collection of loans. The proportionate amount of income from other sources depends



upon the diversification of the activities of the individual company.

In commercial banks, on the contrary, income from loans accounts for somewhat less than half of total income. Interest and dividends on securities account for somewhat more than one-quarter, and the remainder is derived mainly from commissions and fees for services performed, from service charges on deposit accounts, trust department income and rent from real estate and safe deposit vaults.

The effective rate of income on loans differs significantly for each type of agency, and also for different companies within each type. These variations may be attributed in large measure to the difference in charges against different types of loans (particularly as regards security and size) rather than to the difference in rates charged on loans of a comparable nature and size.

In all the specialized agencies the effective rate of income on total loans has been materially higher than that received by the typical commercial bank on its total loans. Here again, the difference reflects a difference in type of loan. On the average, the loan income of banks has amounted to less than 4½ percent of average outstandings, and income on securities about 2 percent. Thus income on earning assets has amounted in recent years to a little over 3 percent in commercial banks, as compared with from 9 to over 30 percent in the specialized agencies.

There is no evidence to indicate that the internal distribution of operating costs (that is, all expenses except interest on borrowed funds) varies materially among the different agencies: except in credit unions, operating costs absorb about the same proportion of total income in all the specialized agencies and in commercial banks. Although rates of operating costs have been considerably higher among consumer instalment financing agencies than among commercial banks, the indicated rate of loss in some of the specialized agencies has been less than, and in others has not greatly exceeded, the average loss ratio of commercial banks on all their loans. In both consumer agencies and commercial banks charge-offs on loans have characteristically absorbed only a small proportion of total income.

In regard to rate of operating profit, therefore, the agencies as *types* may be ranked, on the average, in the same order as for rate of total income. That commercial banks' rate of operating profit has

been consistently below that of the specialized agencies may be attributed not only to their lower rate of income on loans, but also to the inherent inability of banks to invest as high a proportion of total funds in earning assets.

The burden of interest payments is primarily dependent upon the proportion of borrowed funds and on those factors determining creditworthiness which are now characteristic of individual enterprises rather than types of agencies. The rate of interest on such funds has been less than the rate of operating profit, so that the average net profit has consistently represented a high rate of return on capital funds in each type of specialized agency. The same has been true of commercial banks because of the large volume of funds represented by demand deposits upon which no interest is paid.

The rate of return on the capital funds of commercial banks, however, is considerably lower than that of any of the specialized agencies except credit unions. All types of specialized agencies and commercial banks show higher rates of net profits on capital funds than does corporate enterprise in general.

Income tax returns indicate that a larger proportion of commercial banks than active corporations in general has shown profitable operations except in years of deepest depression. In addition, the average rate of net profit on net worth of all commercial banks filing returns has been higher than that shown by all other types of corporations combined.

Cash dividends paid by the specialized agencies have represented relatively high percentages of net worth, particularly in the sales finance and personal finance companies. However, as a result of their relatively higher rates of net profit on net worth, dividends paid have rarely exceeded net profit, averaging about 80 percent. All these specialized agencies, and also commercial banks, appear to average higher dividend rates (on net worth) than all corporations in general.

The rate of dividends paid by commercial banks, on the other hand, though lower than the specialized agencies' rate (with the exception of credit unions) tends to be more regular. Whereas commercial bank dividends far exceeded net profit in the early thirties, since 1935 they have typically been about 60 percent of net profit. This dividend record has been more conservative than that of sales

finance and personal finance companies, and much more conservative than the average for all corporations filing income tax returns during the same period.

#### DIFFERENCES AMONG THE SPECIALIZED AGENCIES

##### *Sales Finance Companies*

The increased industrialization of the country accompanying and subsequent to the First World War, and the increased level of national income in the 1920's, gave impetus to the growth of the sales finance company, which provided means for a wider distribution of durable consumer goods. This type of agency is free from the jurisdiction of the usury statutes, for the courts have held that income arising from the purchase of instalment contracts—the business typical of sales finance companies—is a part of the cost of the merchandise purchased and does not constitute "interest" in the statutory sense.

Sales financing is not only subject to seasonal fluctuations, reflecting changes in the volume of retail instalment sales, but it has also shown extreme cyclical fluctuations, paralleling business cycle changes in the production of durable consumer goods. The maintenance by sales finance companies of a high percentage of total assets in the form of loans has been made possible only by their very flexible sources of funds, consisting chiefly of short-term borrowings, either from banks or in the commercial paper market.

Such funds have been made readily available to sales finance companies because of the high quality of the instalment receivables that serve as security. Repayment is, in effect, doubly or triply assured—by the borrowing sales finance company, by the retail dealer from whom the paper has been acquired (if acquired on a recourse basis), and by his customer, the purchaser of the article sold—in addition to the possibility of securing physical possession of the article itself.

In common with other specialized agencies, the sales finance company can, if necessary, effect a rapid liquidation of its short-term debt, since its credits are repaid out of the current income of the ultimate consumers. With this heavy dependence upon short-term funds, net worth has amounted to a moderate proportion, generally about one-third, of total funds (that is, of total assets). Through most

of the period 1929-41 long-term debt was found in only a few of the larger sales finance companies.

Although the credits extended are ultimately secured by the article financed, the companies have tended to refinance delinquent contracts. When repossession is resorted to they make every effort to dispose of the article, through recourse to the dealer or through sale. As a result, miscellaneous assets, including repossessions, have constituted a low proportion of total assets.

In the typical sales finance company, whose principal asset is automobile paper, the chief source of income has been the discount on such paper, and insurance commissions have been next in importance. But in some companies, particularly the larger ones, income from wholesale financing, interest on small loans, and income from factoring (the discounting of accounts receivable) have been significant sources of total income.

The average rate of income received by sales finance companies, generally in excess of 12 percent of outstanding loans, has been as high as that of any type of specialized agency except the personal finance company. Operating costs (excluding interest payments on borrowed funds, but including charge-offs) have absorbed slightly over 60 percent of total income, leaving an operating profit amounting to over 4 percent of total assets. This rate of return is materially above that shown by industrial and commercial banks, and below that shown by personal finance companies.

The rate of interest paid on borrowings has been lower, however, than the rate of operating profit, and therefore the residual net profit has represented a return of at least 10 percent on equity funds. Among the specialized agencies this rate of return has been exceeded only by the personal finance companies.

### *Personal Finance Companies*

The personal finance company is generally engaged in but one type of activity—the extension of loans to individuals, usually not exceeding \$300 in amount. Since these loans have constituted about 85 percent of total funds, the proportion representing cash, securities and miscellaneous assets (business quarters and equipment) is characteristically low.

To combat the evils of loan sharks and unregulated lenders, small loan laws have been adopted in all but a few states, granting per-

sonal finance companies specific exemption from the usury statutes and authorizing them to charge rates within stipulated legal limits. The legal maximum varies from state to state, ranging mainly from  $1\frac{1}{2}$  to  $3\frac{1}{2}$  percent a month on the unpaid balance of the loan. Actually the companies' interest income tends to be lower than the maximum would indicate, averaging about 30 percent of year-end loans. This rate of income represents, nevertheless, twice as high an average as that of the other agencies covered in this study.

Not only the rate of income on loans but also the rate of operating costs—averaging over 20 percent of outstandings—has been highest among the personal finance companies; this total includes charge-offs, or bad-debt expense, which have not been significantly higher than in the other types of agencies. Although total operating costs have represented a slightly higher proportion of total income, operating profit in relation to total income has been about the same as in industrial banks and only slightly less than in sales finance companies, so that in relation to total assets it has been higher than in any other of these agencies—over 10 percent.

Since their volume of cash loans has been subject to relatively smaller seasonal or cyclical fluctuation, personal finance companies have not found it undesirable to derive their funds from relatively permanent sources. The fact remains, however, that at the beginning of the period 1929-41, funds from banks and other short-term sources were not readily accessible to these companies, partly because of bankers' prejudice against small consumer loans and partly because the stigma that earlier attached to the loan shark carried over in some degree to the personal finance company. Characteristically, the bulk of funds, usually 60 percent or more, has been provided by stockholders. Long-term funds from outsiders have taken the form of preferred stock and, in some instances, the participating debenture bond. Except in the very largest companies short-term borrowings have rarely amounted to more than a quarter of total funds.

For their borrowings personal finance companies have in recent years paid only slightly higher rates than the other types of agencies. As a result of the small proportion of borrowed funds, however, net profit, averaging over 12 percent of net worth, has not been much above the rate of operating profit on total funds. Even so, the net profit rate has exceeded that of any other type of specialized agency.

*Non-Investment Type Industrial Banking Companies*

The non-investment type industrial banking companies may be characterized as a cross between industrial banks and personal finance companies. In their balance sheet characteristics they approximate the latter. A large percentage of their total funds—considerably over half—has been owners' equity, some from preferred stockholders; and the proportion of short-term funds has been small. In the character of their loans, however, and in their rates of income and expense, they approach the industrial banks, although some of them are not distinguishable from personal finance companies specializing in low-rate paper. As a rule they operate under industrial banking laws, which stipulate a maximum rate of charge below that specified in the small loan laws.

In some jurisdictions, where no statutory authorization exists, these companies are permitted by judicial interpretations to charge interest, at the rate prescribed in the state usury law, on the original amount of the loan for its entire term, regardless of the instalment form of repayment. In most cases their interest income is supplemented by service fees, commissions and other charges. On the average their rates of income have been slightly lower than those of sales finance companies, but higher than those of industrial banks.

In the years for which figures are available their charge-offs and total operating costs were lower than those of personal finance companies, and exceeded those of industrial banks. Though they borrowed little, their interest payments absorbed a significant proportion of income, since the rate of interest they paid on borrowings was about the highest of any of the agencies. This may have been due to the relatively small size of the typical company, and thus to difficulty in gaining access to money markets; borrowings, like those of the small personal finance company, may have been from stockholder or management interests.

With the rate of interest on borrowings only slightly lower than the rate of operating profit, and with a high proportion of total funds represented by net worth, the rate of net profit on net worth—slightly over 5 percent—was lower than that of any other type of agency except the credit union.

*Industrial Banks*

Industrial banks, or investment type industrial banking companies, are characterized by the use of a hypothecation device to accumulate repayments on loans, instead of applying repayments directly to reduce the unpaid balance. This device, linking a loan and a deposit or investment transaction, makes it possible to charge interest on the original amount of the loan at the legal rate for the entire period covered by the transaction. If repayments were applied directly to reduce the loan, the interest collected on the average outstanding balance would represent a rate approximately double the specified rate.

These enterprises, first developed under the name "Morris Plan," after Arthur J. Morris, the founder, were originally intended to grant cash loans to "industrial" workers. In the beginning they issued investment certificates, but with changes in state laws most of them now derive about 80 percent of their funds from depositors. Their net worth proportion, averaging between 15 and 20 percent of total funds, has been the lowest among the specialized agencies, and has approached the low level characteristic of commercial banks. The proportion of deposits was highest—and the net worth ratio lowest—in large institutions in the financial centers, where they experienced the same marked growth that has characterized deposits of commercial banks in recent years.

While most industrial banking companies are now accorded the status of "banks," including the protection of deposit insurance, the extent to which they have assumed other functions of commercial banks varies considerably; in general, this tendency has been greater among the larger banks in the larger centers. Another indication that they are veering away from the typical business of a consumer instalment financing agency is the fact that they hold slightly larger proportions of cash—particularly those that are subject to member bank reserve requirements—and of securities. Nevertheless, security holdings have remained small in comparison with those of commercial banks, and, as in the other specialized agencies, instalment loans have constituted a high proportion of total assets.

Interest and discount, service charges, investigation fees and fines on loans, at an effective rate averaging about 11 percent a

year, have constituted the main income of industrial banks. Other sources of income, which vary from one institution to another, depending on the degree of diversification of activities, include most of the sources from which commercial banks typically derive income—interest and dividends on securities, rents from real estate and from safe deposit vaults, insurance commissions, service charges on checking accounts and interest on bank deposits.

Total operating costs, other than interest payments, have averaged somewhat in excess of 8 percent of average loans outstanding. Most of this cost is attributable to expenses other than charge-offs, for the latter have characteristically been lower than in any type of agency except credit unions—averaging (net) less than 0.5 of 1 percent a year. Since operating costs have absorbed a relatively high proportion of total income, the rate of operating profit on total assets has been lower than that of any of the specialized agencies, though higher than that of commercial banks.

The rate of interest paid on deposits by industrial banks has been subject to the same influences as the rate paid by commercial banks, though in centers of comparable size it has been somewhat higher. In industrial banks, however, the net worth proportion has become so low that these institutions have been able to earn a rate of net profit on net worth averaging more than 10 percent a year. This return is smaller than that earned by personal finance companies but higher than that of either non-investment type industrial banking companies, commercial banks or credit unions.

### *Credit Unions*

The credit union is a cooperative association, usually of individuals who have some tie, industrial, cultural or religious. Since credit unions are mutual institutions, practically all of their funds are provided by members' purchases of shares, and only an insignificant proportion by borrowings, chiefly from other credit unions. The charter under which all credit unions operate contains restrictions on investment and lending activities. As a result their assets, other than loans to members, are generally limited to high-grade securities and cash.

Although these organizations have been in existence for about thirty years the only comprehensive figures on their income and expenses are those covering federal credit unions, first organized



in 1934. The present analysis is therefore limited to these data. In the first few years after the establishment of federal credit unions, entrance fees of 25 cents per member represented a significant proportion of total income; in subsequent years, however, more than 90 percent of total funds has been derived from interest and fines on loans.

Federal credit unions have received an average income on loans amounting to about 10 percent of average outstandings—as compared with a legal maximum of 12 percent, or 1 percent a month on the unpaid balance. This rate is much lower than that charged by personal finance companies on loans of comparable size. Credit unions' operating costs, too, have been particularly low, partly because of their cooperative form and partly because of the lower investigation and collection costs entailed on loans made exclusively to members.

Charge-offs of federal credit unions have been negligible, amounting to less than 0.07 of 1 percent of the loans made since the organization of the system. With such very low operating costs the average rate of operating profit—about 5 percent of total assets—has been higher than that of any type of agency except the personal finance company. Since there has been essentially no trading on equity the rate of net profit has only fractionally exceeded the rate of operating profit. At about 5 percent of net worth it has been lower than that of any of the other institutions, including commercial banks.

#### INFLUENCE OF CHARACTER OF PAPER ON INCOME, COSTS AND PROFITS

In each type of agency there was a great deal of variation in the rate of income on loans, and there was substantial overlapping among the types. As between commercial banks the variation was greater than within any single type of specialized agency, an indication of the high degree of diversification in their activities; among the specialized agencies it was considerable in personal finance and sales finance companies, and it was least in industrial banks.

In commercial banks the variation, ranging from less than 2 to more than 20 percent, reflected chiefly the influence of differences

in the character and size of loans made by different banks—though it was due in some degree to geographic differences in interest rates, and to differences in competitive conditions. The lowest rates are received on the largest loans, made primarily to the largest firms, and involving a minimum of risk and a minimum of service. On smaller loans, to smaller firms, involving a greater proportionate amount of service, and perhaps a greater risk, the charge is higher.

The highest rates—in the form either of interest alone, or of interest in combination with service charges and fees—are obtained on retail instalment loans, on personal instalment cash loans or on cash loans that are practically the same as consumer instalment credit except for regular instalment repayment. These loans are small in amount; most of them are for less than \$100, and many are for less than \$50. Many of the very smallest are made to factory employees and other workers, and provide for complete repayment within periods as short as 15 or 30 days, at minimum charges of 50 cents or more; others, made to farmers and local businessmen, are frequently secured by chattels, and call for repayment in unequal instalments at the convenience of the borrower.

Among sales finance companies there was wider variation in rates of income than in any other type of specialized agency. Companies that received higher-than-average rates probably concentrated on the financing of used rather than new durable goods; those that received lower-than-average rates may have charged less on comparable paper, to meet competitive conditions, but they probably also held a high proportion of wholesale or other low-rate paper.

Among personal finance companies those that received the lower rates probably extended relatively more of the larger loans, rates of charge being generally graduated inversely according to size of loan. Also, they may have specialized in certain types of lower-rate transactions—in endorsed as contrasted with unsecured loans, or in loans to selected types of customers, such as teachers.

These differences in the character of the predominant type of paper and in the size of the average loan held—expressed in the varying rates of income among types of agencies and among individual enterprises within each type—account for differences in

operating cost and profits. The data on commercial banks indicate that differences in the proportion of total assets represented by loans have also had an important influence on costs and profits.

In all the types of institutions a pronounced relationship was found between rate of total income and rate of total operating costs, indicating that rates charged customers and the rate of operating cost are dependent on the character and quality of the loans extended. Paper bearing a higher-than-average rate of income was also in general paper which involved higher-than-average costs for acquisition, servicing and collection as well as other operating costs, and also showed a somewhat higher, but not proportionately higher rate of charge-offs.

Higher rate loans were not higher risk loans in that they resulted in a materially higher rate of loss. The losses sustained on these loans, while higher than on the lower rate loans, nevertheless absorbed a smaller proportion of total income. Thus the higher costs and charge-offs did not eliminate the advantage accruing to the companies from the higher rate of income, for they showed higher-than-average rates of operating profit. The charges made on high-rate paper therefore appear to have been higher than required to cover the higher losses and other operating costs on such paper.

The character of typical loans appears to have been the most significant factor also in the rate of interest paid on borrowed funds. The higher the rate of income received on loans, the higher the rate of interest paid on borrowed funds. This may be partly attributed to the fact that an enterprise experiencing an active demand for loans at high rates of interest is willing to pay high rates for funds; this appears to have been true, particularly, with respect to individual commercial banks. It may have been due, too, especially in the smaller agencies, to a practice of borrowing from sources close to the management or the dominant stockholder interest. Finally, in certain of the agencies, it may have resulted from a carryover in the minds of bankers of the early prejudice against those engaged in high-rate lending.

Although the high-income-rate companies and banks paid a higher-than-average rate of interest on borrowings (and deposits) they did not use a higher proportion of total income for this purpose, since the differential between rates received and paid

operated in their favor. In addition, they tended to have a relatively small proportion of borrowed funds. It follows that institutions with loans of higher-than-average rates showed higher-than-average rates of net profit on total assets. Whether or not they showed higher rates of net profit on net worth depended largely on the net worth proportion. The latter was larger in high-rate than in low-rate institutions, but not so much larger as to offset the advantage of higher rates of operating profit. Therefore, in general, the high-rate companies showed higher-than-average rates of net profit available for owners.

#### INFLUENCE OF SIZE OF ENTERPRISE ON OPERATIONS

In all types of institutions, including banks, differences in size of enterprise were associated with significant differences in the proportion of funds derived from various sources, in rates of interest paid on borrowed funds and in the payment of dividends. On the other hand, there was little evidence of a relationship between size of enterprise and operating efficiency, or rate of operating profit.

Among the specialized agencies differences in sources of funds among companies of the same type are attributable almost entirely to differences in size. Increase in size, particularly when accompanied by the greater stability in operations that results from a wider geographic scope, has provided more ready access to money markets and has resulted, in general, in a larger proportion of borrowed, and a smaller proportion of equity, funds. The high net worth proportion in the smallest companies may be attributed, in part, to the existence of minimum capital requirements; among industrial and commercial banks this was of particular significance. Among the largest banks the very rapid growth of deposits has led to a decline in the net worth ratio.

The decline in the rate of interest paid for borrowed funds over the period covered by this study was felt first by the larger companies within each of the types of specialized agencies, and reflected the fact that open-market rates react more quickly to changing conditions than do customers' rates. The larger companies, having access to a greater variety of sources for borrowed funds, were able to take advantage of the decline in open-market

rates and were, thereby, probably able to exert some influence upon customers' rates.

Although most of the differential between the rate of interest paid on borrowings by large and small institutions had disappeared by the end of the period, some was still evident. Since they borrowed a larger proportion of their funds, the burden of interest cost tended to be heavier on the larger companies, though exceptions occurred in certain years, during the transition to lower interest rates.

In all types of institutions it was found that the smaller the enterprise the greater the likelihood that it retained all of its net profit and did not pay dividends. This may be laid, in part, to the greater difficulty among smaller companies in obtaining borrowed funds; moreover, in a small company, whose stock is usually closely held, the management is more willing to withhold dividend payments than in a large company, where that action might adversely influence the market value of widely held stock.

Although the payment or nonpayment of dividends appears to have been strongly influenced by size of company, except among the largest institutions, the rate paid bore little relationship to size of company. Among banks the rate of dividends paid bore more relationship to the rate of net earnings and the rate of net profits available for dividends, than to size of bank.

Among the specialized agencies there appeared to be no important differences in the distribution of assets when the companies were grouped by size. Much of the variation in rates of income with size of institution may be attributed to differences in the average size and character of the loans. This was particularly evident among the very largest sales finance companies, which held a higher proportion of wholesale and other low-rate paper.

Among commercial banks there was a strong inverse relationship between size of bank (in so far as this can be isolated from the influence of geographic location and size of center) and the ratio of loans to total assets. There was also a strong relationship between size of bank and rate of loan income, arising from differences in the average size and character of loans.

Available data show some decrease, among the specialized agencies, in the rate of operating costs—and some increase in the rate of operating profit—with increase in the size of company; but

this variation was relatively slight compared to the variation with increase in rate of income. There is no evidence that a larger volume of loan operations, beyond a certain practicable minimum, brought any marked decrease in operating costs. There is reason to believe, therefore, that the apparent size variation was, except among the very smallest companies, due to differences in the character and average size of loans—which could not be isolated in the available data—rather than to greater efficiency of the larger companies. There were no important differences in rates of operating profit among commercial banks of different size, which showed substantially equivalent rates of income from loans and percentages of loans to total assets.

#### CHANGES OVER THE PERIOD 1929-41

During the years 1929-41 the consumer instalment financing agencies and commercial banks showed wide changes in operating results as the economy moved from prosperity to depression and to subsequent revival. Significant changes due to other causes have taken place in the operations of commercial banks, and the specialized agencies have shown changes which evidence the growing maturity and public acceptance of the consumer instalment financing business.

#### *Changes in Sources and Uses of Funds*

Over the last decade there has been a gradual lowering of the proportion of equity funds in each type of specialized agency. The greater ability to borrow in the last few years, and the lower rates at which funds have been borrowed, are indicative of the fact that these companies have become much more widely accepted, by banks and in the money market generally, as their sound credit character has become evident. The industrial banks in this period underwent, in addition, a change from companies dependent upon the sale of investment certificates to institutions having the status of banks.

During the depression, the decline in capital ratios was temporarily reversed, as a result of the contraction in volume of business. This affected the sales finance companies to the greatest extent, since they were better able to contract their funds, making

use of the flexibility provided by the relatively short maturity of bank borrowings and open-market paper.

In commercial banks a similar lowering of the net worth proportion had occurred over the past half century. From the formation of the national banking system until about 1895, the net worth of all national banks averaged between 30 and 40 percent of total funds. During the McKinley boom, the First World War and the recent periods 1932-36 and after 1938, the net worth ratio dropped sharply; in the intervening periods it fluctuated about the previously established level.

Each period of rapid decline in this ratio was one in which business activity and the volume of total deposits were increasing rapidly. The growth of deposits in the recipient bank could be prevented only by its refusal to accept such funds, and the decline of its net worth ratio could only be stemmed in this way or by increasing the amount of stockholder investment.

Throughout the last decade, characterized by widely varying business conditions, the specialized agencies have had sufficiently flexible sources of funds available to enable them to expand the volume of borrowings and other liabilities when desirable, and likewise to reduce them to avoid the accumulation of idle funds. The volume of operations of sales finance companies was subject to the greatest cyclical and seasonal fluctuations, but their funds were obtained from sources that permitted a ready adjustment to changing business conditions.

In contrast to most of the specialized agencies, some personal finance companies which sustained a serious decrease in loan volume between 1929 and 1933, could not, because their funds were provided principally by equity capital, reduce their volume correspondingly, and acquired securities and other more liquid forms of investment. Loans extended by industrial banking companies declined to a greater extent than those of other specialized agencies during the depression, probably as a result of lack of qualified loans coupled with a desire to be liquid in order to be prepared to meet demands for withdrawal of deposits or investment certificates.

In the early 1930's both the total dollar amount of loans held by commercial banks, and the ratio of this amount to total assets, declined sharply to about half their previous levels, and failed to

show any material increase with the subsequent recovery, up to the time of the expansion in business stimulated by the war program. The degree of decline in the loan proportion varied sharply, however, in different communities and different banks; it was greater in the financial centers than in the agricultural areas, and greatest in the largest banks in those centers, which had experienced the greatest growth in deposits.

The expansion in deposits was associated, in large part, with the purchase of gold imports by the United States Treasury and with an increase in bank holdings of federal government securities incident to the recovery and war programs, and only to a lesser degree was it associated with bank financing of expanding production, inventory accumulation and consumption, and an increase in interbank correspondent balances.

#### *Changes in Total Income, Costs and Operating Profit*

In the specialized agencies the rate of total income on loans fell with the decline in business activity after 1929, reflecting difficulties in the collection of interest, and turned upward again after 1933. Although it reattained its 1929 level in some companies, this level was not maintained, and for the period as a whole the rate showed a slightly declining trend. This decline was probably the result of voluntary rate reductions due in part to increased competition in the consumer credit field and in part to the favorable loss experience of the depression.

Among sales finance companies, in which the downward trend was most marked, the decline in rate of total income on loans may be attributed primarily to the more active competition from industrial and commercial banks for retail instalment paper, which was accompanied by an increase in the proportion of wholesale, factoring and other low-rate paper held by sales finance companies.

Conversely, the rate of operating profit did not regain its 1929 level in the post-depression years. This discrepancy was most noticeable among sales finance companies, least noticeable among personal finance companies. Reflecting the significant drop in the rate of total income on loans, the rate of operating profit of sales finance companies was less than half the 1929 figure by the end of the period.

Commercial banks' average rate of income on loans fell from



about 6 percent in 1929 to about  $4\frac{3}{4}$  percent in 1933, and remained relatively stable thereafter; the average rate of income on securities declined throughout the period, from  $4\frac{1}{2}$  percent in 1929 to less than half that rate in 1941. These declines are indicative not of an equivalent decrease in rates on all loans and securities, but rather of the sharp decrease in rates on very large loans, and the increased concentration in federal government securities characteristic of the largest banks.

In commercial banks operating costs, other than net charge-offs, represented an almost constant proportion of total loans and investments, varying only from 2.3 to 2.5 percent of earning assets throughout the period. Fluctuations in the amount of charge-offs and recoveries on loans, securities and other assets were so extreme, however, that total operating costs showed very erratic movements from 1929 to 1941. Consequently the operating profit of commercial banks was negative or negligible in the depression years, in contrast to the maintenance of a positive operating profit by most of the specialized agencies.

#### *Changes in Interest Payments, Net Profit and Dividends*

At the beginning of the period those agencies whose borrowed funds were derived from credit agencies, through the sale of bonds, in the open market or from banks—sales finance, personal finance and non-investment type industrial banking companies—paid a rate of interest of 6 to 8 percent, or approximately twice the rate paid by those agencies whose funds were derived chiefly from depositors and the sale of investment certificates—investment type industrial banking companies and commercial banks. This sharp divergence was eliminated by the decline in interest rates after 1929, which benefited all types of institutions. By 1941 differences in the rates paid by the different types of institutions were much less significant.

Because of the decline in interest rates on borrowed funds the share of total income absorbed by interest expense tended to decrease considerably during the period, in all groups, despite the increase in the proportion of borrowed funds. Nowhere was this more apparent than in the commercial banks: a decade ago over one-third of their total income was required for interest payments on deposits, but less than one-eighth in 1940.

The rate of interest *received* on loans and the rate of interest *paid* on borrowings by these institutions both represent a cost of borrowed funds but the costs are borne by different segments of the economy. Although both rates were affected by the relative availability of money, the differential in favor of these institutions increased sharply over the period.

The rate of net profit represented a high rate of return on capital funds in all the types of institutions during 1929-41. It declined sharply, however, during the depression, though in the specialized agencies it rarely reached a negative figure, as it did in commercial banks in three depression years. That all the institutions reattained a high level of net profit in the subsequent recovery, in spite of less satisfactory rates of operating profit, was due to the continued decline in the share of total funds supplied by owners and to the decline in the cost of borrowed funds.

The dividend record of the specialized agencies was that of a business growing into maturity. Of the companies that reported profitable operations a substantial proportion, in 1929, retained all of their net profit to retire borrowings or to provide additional funds for working capital, but in 1936 practically all of them paid dividends, and used a higher proportion of net profit to pay them at a higher rate than in 1929. In the interim the worthiness of these companies as potential borrowers had become more generally recognized, and the rates of interest required on borrowed funds had been reduced, with the result that the companies were no longer so dependent upon retained funds for expansion.

Commercial banks had attained a similar maturity much earlier, and the rate of dividends paid by all national banks became so stable that in twenty-three of the thirty years from 1900 to 1929 average dividends represented between 5 and 6 percent of net worth. Throughout this period the proportion of surplus and undivided profits grew substantially, and there was a concomitant increase in the rate of dividends on capital stock; it amounted to more than 10 percent of capital stock in each year from 1910 through 1931.

The continuance of dividend payments throughout the depression, though at a reduced level, combined with the heavy losses sustained on assets, resulted in a dissipation within five years of more than two-thirds of the net profit that had been retained by

the national banking system over the preceding forty-year period. In recent years dividends have been paid by from 75 to 85 percent of commercial banks, have absorbed less than 60 percent of total net profit, and have averaged less than 4 percent of net worth and about 9 percent of common stock.

### *War Restrictions*

With the present cessation in the production, and practical elimination of the sales, of durable consumer goods, and the imposition by the Board of Governors of the Federal Reserve System of Regulation W, tightening the terms of instalment credit extensions, the rapid expansion of the consumer instalment financing agencies under consideration has been halted—and reversed.

The amount of outstanding retail instalment paper has been decreasing much more rapidly than it did during the early 1930's. From 4.1 billion dollars at the end of August 1941 it had fallen to half that amount within a year, thus creating serious problems for sales finance companies. Some of the larger companies, already holding significant proportions of factoring paper, have been spurred to diversify their activities still further; simultaneously they have been contracting total funds by repaying short-term obligations in an effort to maintain their high loan proportions, but their rate of operating costs may be expected to rise, and their rate of net profit to fall sharply.

The smaller the sales finance company, the greater the likelihood that its sources of funds are less flexible and that its lending activities have been concentrated in the financing of retail durable goods. In the absence of resourceful management able to develop other lending activities, such a company may find its most reasonable alternative to be the investment of all permanent non-repayable funds in government or other securities, for the duration of the war.

Cash-lending agencies were relatively little affected during the closing months of 1941 by the imposition of Regulation W, but during 1942 they sustained a rapid curtailment of lending activity, totaling about one-third for the year. Since cash-lending agencies are less likely than sales finance companies to be able to adjust funds easily, they will probably be forced to invest to some extent in federal government securities in the event of continued curtailment.

Total loans of commercial banks increased sharply from the middle of 1940 through the first quarter of 1942, with the expansion in business activity. During the balance of 1942 they contracted with almost equal rapidity, as demands for the financing of civilian requirements decreased. How far loan curtailment will continue is dependent to a great extent upon the degree to which private or government agencies finance war production.

In a similar manner the degree of expansion of commercial bank security holdings is dependent upon the extent to which the war program is financed by taxes and the extent to which government securities are purchased by individuals and non-banking institutions. During 1942 bank holdings of United States government securities almost doubled, the increase amounting to nearly 20 billion dollars; and they may be expected to increase by as much if not more, during 1943 and 1944.

Total income of commercial banks may be expected to increase substantially on the basis of the established pattern of interest rates on federal government securities, a moderate decrease in outstanding loans, and an assumed service income from the handling of ration coupons commensurate with the costs incurred.

Operating costs are not likely to increase as rapidly as total income even with increased federal taxes. Thus, except in the event of substantial increases in federal surtaxes above the rates in the 1942 law, operating profit will be well sustained. Moreover, since interest paid on time deposits may show a further decline, the amount of net profit may be expected to increase substantially. If, as is likely, approximately one-half of net profit is paid out in dividends and the other half is added to net worth, the rate of additions to capital from profit for commercial banks as a whole will be maintained above recent levels.

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## Scope and Character of Analysis

FROM an unknown but probably negligible amount prior to 1920, the financing of consumers on an instalment basis had grown into a 6 billion dollar business by 1941. The bulk of this credit was extended by retailers and by specialized types of institutions; extensions of credit by the latter were either in the form of retail instalment credit, designed to finance the purchase of a specific commodity, or of instalment loans for which the borrower received cash. During the 1930's, when bank earnings were declining, commercial banks began to recognize the profitability of this type of credit, and increasingly participated in its extension, but at the end of 1941 there were still relatively few commercial banks in which consumer instalment credit accounted for a high proportion of loans. Bank lending as a whole continued to consist primarily of the traditional financing of business enterprises.

The present study was undertaken to examine the operating characteristics of the specialized *consumer* instalment financing agencies and to contrast them with the operating characteristics of commercial banks, the specialized *business* financing agencies. It proposes to answer a number of questions regarding operations, which may be summarized as follows: first, how the consumer instalment financing agencies—sales finance companies, personal finance companies, investment type industrial banks, non-investment type industrial banks, and credit unions—differ from one another with respect to sources and uses of funds, income, costs of operation, profits and dividends; second, how the operations of the specialized agencies contrast with those of commercial banks; third, how individual companies among the specialized agencies and individual commercial banks differ from one another; fourth, how differences in the character and size of the typical loan affect the operations of individual enterprises; fifth, how size, as such, affects the sources and uses of funds and the income, expenses,

profits and dividends of the individual enterprises; and sixth, how operations were affected by the severe business recession of 1929-33, and by the subsequent recovery.

#### NATURE OF THE CONSUMER INSTALMENT FINANCING BUSINESS

The term consumer instalment credit, as used in this study, refers to credit extended to consumers under a formal legal contract which requires repayment of principal and interest in regular scheduled instalments. The two principal types of consumer instalment credit arise from the financing of retail sales and from the extension of cash loans.

An individual who buys an article on the instalment plan is usually required to make a down payment,<sup>1</sup> which may be in cash or wholly or partly in the form of a trade-in, and to sign a credit instrument for the balance plus the finance charge and, in some cases, plus insurance. This balance is embodied in the contract, which provides for payment in instalments, usually equal in amount, at monthly or other equal intervals of time.

The dealer may sell the contract to a financing agency or a commercial bank, or he may hold it himself. The sales finance company specializes in the purchase of such paper. If the dealer sells the paper the subsequent collection of instalments is in the hands of the agency, although often the dealer signs the finance paper with recourse and is liable, in greater or lesser degree, for loss sustained by the agency through failure of the purchaser to pay the debt in full.

In the extension of cash loans, on the other hand, the borrower deals directly with the credit agency. He may use his loan proceeds as he pleases, and the security required of him varies widely. The institutions that specialize in cash instalment loans are personal finance companies, industrial banking companies and credit unions.

During the rise of the specialized types of consumer instalment financing institutions, commercial banks were making little pro-

<sup>1</sup> Minimum down payments are now required, as specified in Regulation W, issued by the Board of Governors of the Federal Reserve System, pursuant to the provisions of Executive Order No. 8843 of August 9, 1941, providing for "Regulation of Consumer Credit."

vision for the financing needs of low income groups. The cash loan needs of these groups were rapidly expanding, and their demand for retail instalment credit was stimulated by the development and intensive promotion of new types of durable consumer goods, notably automobiles.

But commercial banks traditionally considered cash loans to consumers unsound and outside their province, and looked with only slightly less suspicion upon the acquisition of retail instalment paper. Moreover, banks recognized that the extension of credits in small amounts, and collection on an instalment basis, constituted a high-cost business which was uneconomic at the rates permitted under most usury statutes. Thus the opportunity was provided for the development of specialized types of institutions. These, too, were confronted by the usury statutes, but they were able to skirt this obstacle either by receiving specific legislative authorization to charge higher rates or by avoidance of laws through the use of technical devices or through the benefit of favorable judicial interpretations.

The personal finance company, also known as the "small loan company" or the "licensed lender," operates under the sanction of special "small loan" legislation designed to combat the loan-shark evil.<sup>2</sup> By 1941 regulatory laws were in effect in 39 states, the District of Columbia and Hawaii. Under most of them the lenders are granted permission to make one over-all charge, including interest, at a rate not exceeding a specified percentage of the unpaid balance of the loan; the rate varies considerably but is never more than 3½ percent a month. As a rule the maximum loan allowed is \$300. The principal is repaid in equal instalments plus interest charges over a specified length of time, generally varying during the period under examination between 5 and 20 months.

The credit union is a cooperative association which, because of its nature, is able to operate at a nominal cost. Its rates are therefore

<sup>2</sup> Before the passage of small loan laws most credit facilities available to low income consumers were provided by illegal lenders at very high rates. For the activities of the illegal lender, including his rates of charge, see Russell Sage Foundation, *Regulation of the Small Loan Business*, by Louis N. Robinson and Rolf Nugent (New York 1935) Chapters 2 and 3. An extensive bibliography on illegal lending appears in *Consumer Credit Bibliography*, compiled by Ernestine Wilder (New York 1938) pp. 31-43.

generally lower than those of personal finance companies, amounting ordinarily to not more than 1 percent a month.<sup>3</sup>

Both the credit union and the personal finance company have been *exempted* from the usury statutes. The industrial banking company, first developed about 1910 under the name "Morris Plan," has made credit facilities available to "industrial" workers by utilizing a device for *avoiding* the usury statutes. This is done by linking a loan transaction, calling for lump payment at maturity, with a deposit or investment transaction in which the borrower agrees to deposit small sums, generally equal in amount, until a total equal to that of the loan has been accumulated. This total is then applied to the payment of the loan at its maturity.

Since the loan transaction calls for lump sum repayment, and is separate from the deposit or investment certificate agreement, interest can be charged at the maximum legal rate on the face amount of the loan for the entire period, whereas the same rate of charge would result in an effective rate of interest approximately double the specified rate, if payments were applied directly to reduce the loan.

This practice of accepting "hypothecated" deposits, or of selling "hypothecated" investment certificates for instalment repayment, is characteristic of the operations of industrial banking companies,<sup>4</sup> and those that follow it are called investment type companies throughout this study. There are some, however, that are not permitted to use the hypothecation device, and these are here called non-investment type companies. The latter operate, in some jurisdictions, through the imposition of service fees, commissions or other charges, in addition to the interest charge, and in others through licenses enabling them to make small instalment loans at stipulated rates of charge.<sup>5</sup>

<sup>3</sup> Federal credit unions are limited to a rate of 1 percent a month (*United States Code*, Title 12, Section 1757). For a summary of credit union laws in the 48 states and in the provinces of Canada see Roy F. Bergengren, *Credit Union North America* (Kingsport, Tenn., 1940) pp. 364-81.

<sup>4</sup> In some states commercial banks engaged in consumer instalment financing make use of the same device; where industrial banking companies are authorized to make charges in excess of the usual usury rates there is a tendency for them to discontinue the use of the hypothecation device.

<sup>5</sup> The first companies organized "to lend money to persons employed in industry" were chartered under general incorporation laws, but today over half the states provide for the organization of such companies under special legislation. A list of state statutes applying to industrial banking companies is given in National Bureau



In most states judicial interpretations permit avoidance of usury laws also by sales finance companies, since the finance charge added to the price of the goods sold is legally construed not as an "interest charge" but as a part of the retail price of the goods. The income of the sales finance company—represented by the difference between the amount paid the retail dealer and the amount collected from the purchaser—is also, technically, not an interest charge.

The finance charge is highly variable, on new merchandise ranging in general from 10 to 20 percent in terms of simple interest, depending upon the nature of the goods and the length of the transaction.<sup>6</sup> In automobile sales financing an added outlay is imposed on the consumer by the usual requirement of fire, theft and collision insurance (which would be optional with a cash purchaser).

In practice there is considerable overlapping in the business of the principal types of consumer credit agencies. Thus sales finance companies, while they engage characteristically in the financing of retail sales to consumers, may also, and usually do, finance the wholesale purchases of dealers. In addition, they sometimes finance the purchase of producer goods, such as taxicabs, trucks and tractors. Some also engage in other types of business financing, through the discounting of accounts receivable, or factoring. Enterprises regarded as sales finance companies are sometimes licensed to make small loans, either directly or through subsidiaries.<sup>7</sup>

<sup>6</sup> The Federal Trade Commission has published a study, *Report on Motor Vehicle Industry* (Washington 1939), which shows variations in automobile finance charges. For a summary in annual percentage rates see National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by Wilbur C. Plummer and Ralph A. Young (New York 1940) pp. 211-12, 214. For rates charged in diversified sales financing see the same volume, pp. 224-25.

<sup>7</sup> See Plummer and Young, *op. cit.*, pp. 36-40. There the distribution of outstanding receivables of 48 large sales finance companies is given as follows: automobile retail paper, 66 percent; other retail paper (including some industrial equipment), 13 percent; total wholesale paper, 15 percent; small loans, 0.5 percent; open accounts receivable and factoring, 4.6 percent; rediscounted paper and miscellaneous, 0.8 percent. A Census Bureau tabulation of the outstanding sales finance receivables of 302 sales finance companies, December 31, 1940, gave the following distribution: retail automobile paper, 65 percent; other retail paper, 17 percent; wholesale automobile

of Economic Research (Financial Research Program), *Industrial Banking Companies and Their Credit Practices*, by Raymond J. Saulnier (New York 1940) pp. 184-86, and Chapter 2 of that volume is devoted to a discussion of the companies' legal status. A short summary of the law of each state under which industrial banking companies carry on operations is presented in Consumer Credit Institute of America, *Industrial Banking*, by Margaret Grobden (New York 1940) Chapter 11.

In a great many cases the cash-lending agencies engage also in sales financing, both wholesale and retail. Moreover, enterprises regarded as industrial banking companies are frequently licensed to make small loans, their activities thus tending, particularly if they do not issue investment certificates or accept deposits, to merge into those of personal finance companies.

#### AMOUNT AND DISTRIBUTION OF INSTALMENT CREDIT OUTSTANDINGS<sup>5</sup>

The estimated amount of consumer instalment loans outstanding increased from about 3 billion dollars at the end of 1929 to about 6 billion at the end of 1941. Changes in total monthly outstandings closely followed changes in retail instalment outstandings, which represented a preponderant proportion of the total throughout the period, even though that proportion showed a conspicuous decline.

Fluctuations in retail instalment outstandings during the period were closely related to cyclical changes in retail sales of durable consumer goods customarily sold in this manner. The estimated amount of retail instalment paper outstanding declined from 2.5 billion dollars at the end of 1929 to 0.9 billion at the middle of 1933, or by more than 60 percent. The business revival from 1933 to the autumn of 1937 resulted in as great an increase, with the total exceeding the 1929 level during most of 1937; but the subsequent sharp recession was accompanied by a decline amounting to approximately 25 percent in one year, so that by December 1938, the total amount of retail instalment paper outstanding had fallen to 2.0 billion dollars. During 1939-41 the amount increased to 3.7 billion. Retail instalment outstandings showed some seasonal movement over the period, rising in the spring months and again in December.

Cash loan outstandings were less affected by the fluctuations in

<sup>5</sup> This analysis is based on National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38*, by Duncan McC. Hochhausen in collaboration with Malcolm L. Merriam and Rolf Nugent (New York 1940), and *The Business of Consumer Instalment Financing—A Summary Review*, by Ralph A. Young (ms. 1941) Chapter 2.

paper, 17 percent; other wholesale consumer goods paper, 0.3 percent; industrial, commercial and farm equipment, 0.8 percent. See United States Department of Commerce, Bureau of the Census, Current Statistical Service, *Sales Finance Companies* (March 24, 1942).

general business conditions, exhibited a greater growth over the decade, and gave practically no indication of a seasonal pattern. They stood at 0.7 billion dollars at the end of 1929, decreased to 0.5 billion in 1933, and then increased almost steadily to 2 billion at the end of 1941.

The distribution among the different agencies of retail instalment and cash loan outstandings for various years of this period is shown in Table 1.<sup>9</sup> Also included are outstandings on instalment credit advances insured by the Federal Housing Administration, which were first issued in 1934, and were soon handled by all the agencies except personal finance companies.

For most years of the period there are not sufficient data for determining the distribution of retail instalment paper among the various agencies. It is known, however, that the share held by commercial and industrial banks notably increased during 1929-41, and it is likely that the share held by sales finance companies declined. It seems reasonable to assume that sales finance companies' share of total consumer instalment outstandings declined to a degree perhaps greater than the decline in the proportion of retail instalment paper.

The bulk of cash loan outstandings in 1929 was held by personal finance companies and industrial banking companies; by 1941 they held less than half of the cash loans due to the increase in holdings of commercial banks and credit unions. The amount held by personal finance companies declined less from 1929 to 1933 than that held by the other cash-lending agencies, and consequently the proportion they held was almost doubled. With the very rapid expansion of total consumer instalment outstandings after 1933, the share held by personal finance companies declined as sharply as it had increased in preceding years. From 1936 to 1941 it increased gradually but fairly regularly, in dollar amount, though it declined considerably in relation to all cash loans.

The share of consumer financing handled by industrial banking companies showed a small increase from 1929 to 1933. Thereafter the proportion declined, notwithstanding a substantial growth in dollar volume.

Credit unions held only 1 percent of total consumer instalment

<sup>9</sup> The commercial bank estimates for 1936 and prior years include only those banks that had personal loan departments (see Holthausen, *et al.*, *op. cit.*, pp. 28, 122), but it is not likely that this limitation seriously affects the accuracy of the figures.

TABLE 1  
 PERCENTAGE DISTRIBUTION OF TOTAL ESTIMATED CONSUMER  
 INSTALMENT OUTSTANDINGS, YEAR-END 1929, 1933, 1936,  
 1941, BY AGENCY<sup>a</sup> (dollar figures in millions)

<i>Agency</i>	<i>1929</i>	<i>1933</i>	<i>1936</i>	<i>1941</i>
<i>Retail instalment credit</i>				
Sales finance companies	b	b	b	31.1%
Commercial banks	b	b	b	10.7
Insured industrial banks	b	b	b	.7
Other industrial banking companies	b	b	b	} 20.0 <sup>e</sup>
Retailers and others	b	b	b	
Total	78.3%	69.3%	69.4%	62.5
<i>FHA Title I loans<sup>d</sup></i>				
Sales finance companies	..	..	1.5	1.0
Commercial banks	..	..	4.7	3.5
Insured industrial banks	..	..	} .4	.3
Other industrial banking companies	..	..		
Credit unions and others	..	..	.1	} .1
Total	..	..	6.7	
<i>Cash instalment loans<sup>e</sup></i>				
Personal finance companies <sup>f</sup>	9.6	16.6	9.9	10.2
Commercial banks	1.3	1.8	3.7	12.3
Credit unions	1.0	1.7	1.9	3.4
Insured industrial banks	} 6.8	7.5	5.4	1.6
Other industrial banking companies				3.4
Other lenders	3.0	3.1	3.0	1.7
Total	21.7	30.7	23.9	32.6
TOTAL OUTSTANDINGS	100.0%	100.0%	100.0%	100.0%
	\$3,211.3	\$1,618.9	\$3,514.2	\$5,997.7

<sup>a</sup> Based on data in the *Survey of Current Business* (November 1942) pp. 9-25, which revised and brought up-to-date the National Bureau of Economic Research estimates published in *The Volume of Consumer Instalment Credit, 1929-38*, by Duncan McC. Holthausen in collaboration with Malcolm L. Merriam and Rolf Nugent (New York 1940). For 1941, based, in addition, on data from Federal Deposit Insurance Corporation and Federal Housing Administration.

<sup>b</sup> Breakdown not available.

<sup>c</sup> Holdings of other industrial banking companies are a negligible percentage.

<sup>d</sup> Notes under \$2,000 insured by the Federal Housing Administration. Breakdowns estimated from data obtained from the FHA for May 1 call dates.

<sup>e</sup> Includes direct instalment loans for financing retail purchases, repair and modernization loans not insured by the FHA and loans made by unregulated lenders.

<sup>f</sup> Inflated by "interest due and to become due" by the formula  $oi \frac{(d+2)}{3}$  with  $o$  representing outstandings,  $i$  the monthly interest rate, and  $d$  the duration of the loan. The duration was estimated at 15 months and the monthly interest rate in 1929 at 3.0 percent, in 1933 at 2.9 percent, in 1936 at 2.8 percent, and in 1941 at 2.5 percent.

loans outstanding at the end of 1929, the smallest share of any one of the principal types of agencies. The increase to more than 3 percent in 1941 may be attributed in large part to the rapid expansion in the number of federal credit unions after their authorization in 1934, and to the organization of additional state-chartered institutions.

In the last decade commercial banks, while they have invested a consistently decreasing proportion of their total assets in loans, have held a consistently increasing share of total consumer instalment outstandings. Through 1933 their cash instalment loans represented almost as small a share of the over-all total as did those of credit unions, but thereafter they increased very sharply.

It may be estimated that commercial banks' holdings of consumer instalment paper—retail and cash loans combined—rose from 2 or 3 percent of the total in 1929<sup>10</sup> to more than 10 percent in 1936 and to more than 26 percent at the end of 1941. In the latter year commercial banks held more than one-third of all instalment cash loan outstandings, more than one-half of outstanding FHA Title I loans, and about one-sixth of other instalment outstandings arising from retail sales.<sup>11</sup>

#### SOURCES OF DATA

The data used for this study may be summarized, as follows: WPA-Treasury income tax tabulations; information from the National Credit Office, Inc., tabulated by the National Bureau; Farm Credit Administration data on credit unions; figures on individual insured commercial and industrial banks, from the Federal Deposit Insurance Corporation; data on national banks from the reports of the Comptroller of the Currency; and miscellaneous data from other published sources.

<sup>10</sup> Indirectly the commercial banks had participated in the consumer instalment financing business to a much greater extent. The *Federal Reserve Bulletin* (January 1923) pp. 41, 44, pointed out that banks purchased (through commercial paper houses or directly) "almost all" the collateral trust notes issued by the larger sales finance companies to finance themselves, and that the smaller sales finance companies "frequently rely upon their lines of credit with their local banking institutions." The relatively high interest rates obtained in the 1920's by commercial banks on the paper of consumer instalment financing agencies undoubtedly contributed to their reluctance to participate in the business directly.

<sup>11</sup> It is generally agreed that many commercial banks first became interested in consumer instalment paper after the inception of the Federal Housing Administration, and that their interest was due to favorable experience with FHA Title I loans.

A large portion of the analysis is based on tabulations compiled from income tax returns for the years 1929, 1933 and 1936, of selected samples of each of four principal types of consumer instalment financing institutions—sales finance companies, personal finance companies, investment type industrial banking companies, and non-investment type industrial banking companies.<sup>12</sup>

These tabulations were prepared upon recommendation by the National Bureau of Economic Research to the Technical Advisory Committee of the Income Tax Study, an intensive analysis of income tax returns conducted under the joint supervision of the Work Projects Administration and the Division of Tax Research of the United States Treasury Department.<sup>13</sup> All tabulation work, including the handling of the income tax returns and the statistical abstracts of individual companies, was performed by employees of the Income Tax Study, and every precaution was taken to maintain the confidential character of the data.

The institutional studies already published under the Financial Research Program of the National Bureau of Economic Research analyze certain aspects of the operating experience of consumer financing agencies.<sup>14</sup> In general, the samples used in those studies, while they consisted of only a small number of companies, included the larger institutions in the respective fields.

Since the income tax samples do not include the largest companies, the two sets of data tend to complement each other. For

<sup>12</sup>Data on credit unions could not be included in these tabulations, since credit unions are exempt from federal income tax. Data on commercial banks were not included in the income tax tabulations, since ample data on the operations of commercial banks were readily available from other sources.

<sup>13</sup>The Technical Advisory Committee, representing governmental and non-governmental agencies interested in income tax statistics, invited various agencies to submit proposals for special tabulations, to be undertaken in addition to those prepared for the Division of Tax Research. The tabulations recommended by the National Bureau, referred to hereafter as the income tax data, were designated as Proposal 22 of the Income Tax Study.

<sup>14</sup>Sources and uses of funds, and income and expenses are discussed in: *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (1940) pp. 38 ff., 78 ff., 107 ff.; *Sales Finance Companies and Their Credit Practices*, by Wilbur C. Plummer and Ralph A. Young (1940) pp. 60 ff., 121 ff., 244 ff.; *Industrial Banking Companies and Their Credit Practices*, by Raymond J. Saulnier (1940) pp. 57 ff., 107 ff., 146 ff.; and *Commercial Banks and Consumer Instalment Credit*, by John M. Chapman and Associates (1940) pp. 101 ff., 140 ff., 163 ff. A description of the history and operations of credit unions appears in *The Business of Consumer Instalment Financing—A Summary Review*, by Ralph A. Young (ms. 1941).

this reason liberal supplementary use is made of samples available subsequent to the publication of the earlier studies, and covering essentially the same companies. The samples of sales finance and personal finance companies, which were obtained from the National Credit Office, Inc., consist of companies that financed themselves through the sale of commercial paper in the open market; although these samples are small the institutions they represent accounted for a substantial proportion of the outstanding loans in their fields.<sup>15</sup>

Figures for federal credit unions since their inception in 1934 provide a contrast between the operations of the privately owned agencies and of these cooperative institutions. Since, in the years after 1934, federal credit unions expanded very rapidly, both in number and assets, these data may not be entirely representative of the operations of credit unions as a whole. For the older state-chartered credit unions, however, data on earnings and expenses are either entirely lacking or are incomplete and of doubtful comparability.<sup>16</sup>

Data covering insured industrial banks, obtained from the Federal Deposit Insurance Corporation,<sup>17</sup> have been utilized in conjunction with the information accumulated for the National Bureau study of industrial banking companies to provide a further insight into their operations. The degree of detail in which these FDIC data have been available to the writer, and the increased manipulative possibilities resulting from the use of ratios for individual companies, have made this information particularly effective in appraising the influence of limitations in the form of the income tax data.

To contrast the operating experiences of the principal consumer instalment financing agencies with those of institutions traditionally

<sup>15</sup> The number and average total assets of the companies included in these samples, in each of the years 1929-41, are presented in Appendix Tables B-1 and B-2.

<sup>16</sup> The Bureau of Labor Statistics has published figures on the net earnings and dividends of a large sample of reporting federal and state credit unions for 1939-41, and on the amount of dividends for 1938. See *Monthly Labor Review*, August 1939, September 1940, August 1941, September 1942.

<sup>17</sup> In the tables in the present volume these data are designated as covering all insured industrial banks. In each year, however, the reports of a few banks had to be excluded because they did not cover a full year of operations, or because errors were discovered for which corrections could not be obtained. For these reasons, and also because of corrections that could be made, the figures in the present volume differ in some cases from those in Saulnier, *op. cit.*

engaged chiefly in the financing of business enterprises, this study has used data pertaining to commercial banks. Operating ratios of over 13,000 individual insured commercial banks were available for the years 1938-41, and for about 7,000 that submitted reports to the FDIC, ratios were available for the period 1936-41. These data have made it possible to isolate the effect of size and other factors on the expenses and profitability of commercial banks.

Comprehensive figures on the consumer instalment loans of these insured commercial banks became available for the first time at the end of 1940, through a special questionnaire addressed to insured banks by the federal bank supervisory agencies. These data made possible comparison of the operating experience of banks having a high proportion of consumer instalment paper with that of the consumer instalment financing agencies, and other insured commercial banks.<sup>18</sup>

For the historical analysis of the operations of commercial banks prior to the formation of the FDIC, reliance has been placed upon aggregate figures on national banks rather than upon figures covering the larger number of banks that are members of the Federal Reserve System. This choice was based on the fact that the former, despite shifts to and from state systems as a result of charter changes, may be presumed to be the more representative of *all* commercial banks, both as to size and geographic location; figures for member banks are dominated by the banks in larger centers.

The coverage of the samples varies materially, but the combination of data from several sources has resulted in a significant total coverage and a satisfactory distribution with respect to size and geographic location. These aspects of the data are fully discussed in Appendix A, as are also various limitations and procedures regarding their use and specific considerations regarding terminology.

<sup>18</sup> Specific data on banks' consumer instalment lending activities are either not available or inadequate; in this field their costs of operations and rate of operating profit probably do not differ materially from those of the insured industrial banks. Because of the lack of information no attempt has been made to compare the operating results of their consumer financing with those of the specialized agencies.



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## Sources of Funds

IN ANY business enterprise the sources of funds depend on the relative ease with which funds of different types are obtainable, and this in turn is affected by the character of the company's assets, the seasonal and cyclical fluctuations in its volume of business, its rapidity of growth, its demonstrated or anticipated stability of profits and continuity of operations, its size, and any other aspect of its operations which affects its position as a potential borrower. These factors also determine its financial policy, causing the management to choose one source of financing rather than another.

Characteristic of the consumer instalment financing agencies was the high proportion, relative to other credit institutions, of funds obtained through use of equity capital. However, during the period 1929-1941 these agencies attained flexibility in the sources of their funds through the increased use of borrowed money, chiefly short-term borrowings.<sup>1</sup> They were, in general, able to adjust the volume of funds to the demand for accommodation, increasing borrowings when demand arose and paying them off when demand declined. In effect, these consumer instalment financing agencies secured funds at wholesale from other financial institutions, chiefly banks, and retailed the proceeds to consumers.

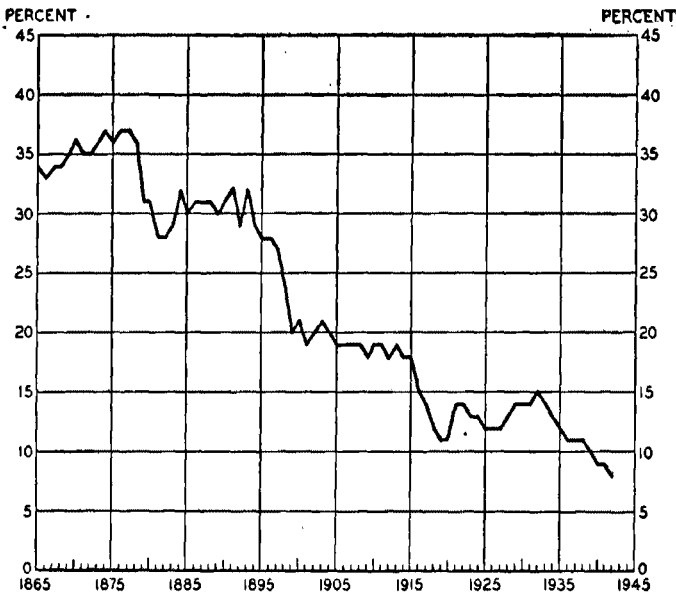
Over the period 1929-41, the sources of funds of the consumer instalment financing agencies give evidence of their progress toward maturity. The chief change was a gradual lowering of the proportion of equity funds in each type of institution. Also, as we shall see in Chapter 7, borrowed funds, both long- and short-term, were obtained at much lower rates in the last few years of the period than were available a decade earlier. This resulted from the

<sup>1</sup> Long-term debt was an unimportant source of funds in all types of consumer instalment financing agencies. Although some companies included in the income tax sample showed an increase in the proportion of long-term debt in 1933, this can be attributed to a concurrent contraction in their total assets except in those instances in which the increase occurred through an extension of maturing short-term obligations of institutions in difficulty.

much wider acceptance of these companies by banks, and in the money market generally, as their sound credit character became evident.

In contrast to the consumer agencies, commercial banks were characterized by low equity proportions throughout the period under review, although even for them these low net worth proportions have not always existed. From the inception of the national banking system until about 1895, the total net worth of all

CHART I  
NET WORTH RATIOS OF NATIONAL BANKS, 1865-1942\*



\* Represents net worth in percent of total assets at or about June 30 of each year. Based on Annual Reports of the Comptroller of the Currency.

national banks fluctuated between 30 and 40 percent of total assets, as can be seen from Chart I. In the rapid expansion of assets at the turn of the century the proportion dropped rapidly to about 20 percent, a level retained until the opening of the First World War. During the next few years assets again expanded rapidly, and by 1919 net worth amounted to only 11 percent of total assets. Over the next decade or so it fluctuated slightly, reaching about 15 percent in 1932. But with the very rapid expansion in the de-

posits of all national banks during the years 1932-36 and 1938-42 the net worth proportion declined to an all-time low of 8.2 percent.

It might be presumed that as a rule a reduction in a company's capital ratio could result only from the deliberate choice of its management. However, part of the rapid expansion in deposits experienced by commercial banks during the period 1933-41 occurred without either voluntary action on the part of bank management or a concomitant increase in suitable earning assets, but simply as the result of the purchase of monetary metal (chiefly imported gold) by the United States Treasury. Also, purchases of government securities by some banks resulted in increased deposits in others without purchases on their part.

None of the specialized agencies was faced with a comparable problem, for the nature of their business is not such as to produce an expansion of borrowed funds without their conscious action. As for the industrial banks, their deposits consist, either entirely or largely, of time and savings deposits; they have therefore had a somewhat greater measure of control over the volume of funds accepted, through variation in the rate of interest paid on such deposits.

#### COMPARISON OF THE AGENCIES

In general, a substantial proportion of the total funds of credit unions, personal finance companies, non-investment type industrial banking companies, and sales finance companies has consisted of owners' equity or net worth. Credit unions, being mutual institutions, receive practically all their funds from the sale of shares to members;<sup>2</sup> only an insignificant proportion is borrowed, chiefly from other credit unions.

The net worth proportion of the personal finance companies was the highest of all of the non-mutual agencies. As shown in Table 2,

<sup>2</sup> The "shares" of credit unions, like those of building and loan associations and the deposits of mutual savings banks, occupy a peculiar legal status. In the present discussion our interest lies in whether funds are obtained from ownership or from borrowing, and therefore emphasis is placed upon the fact that these shares have the characteristics of common stock equity, in that they bestow residual rights to assets and income, subject to statutory limitations. If our interest lay in the analysis of credit union solvency we should have to consider the shares as the equivalent of deposits, since it is general practice to permit their withdrawal upon demand; the cushion which protects the shareholders is limited to the amount of surplus, undivided profits and surplus reserves.

net worth averaged between two-thirds and four-fifths of total assets in each of the years for which the income tax data are available. The distribution of companies according to the proportion

TABLE 2

NET WORTH OF CONSUMER INSTALMENT FINANCING AGENCIES  
AND COMMERCIAL BANKS IN PERCENT OF TOTAL ASSETS,  
YEAR-END 1929, 1933, 1936\*

Agency	Total Net Worth	Preferred Stock	Common Equity
<i>229 sales finance companies</i>			
1929	39.2%	11.9%	27.3%
1933	53.9	16.4	37.5
1936	53.8	11.1	22.7
<i>179 personal finance companies</i>			
1929	67.7	17.8	49.9
1933	81.1	20.4	60.7
1936	66.0	15.7	50.3
<i>92 non-invest. type indust. blg. cos.</i>			
1929	57.3	13.4	43.9
1933	68.6	16.4	52.2
1936	56.2	12.1	44.1
<i>112 invest. type indust. banks</i>			
1929	16.1	.2	15.9
1933	20.9	.3	20.6
1936	16.4	1.2	15.2
<i>All national banks</i>			
1929 (7,408 banks)	13.3	.0	13.3
1933 (5,159 banks)	13.3	.7	12.6
1936 (5,351 banks)	10.2	1.1	9.1

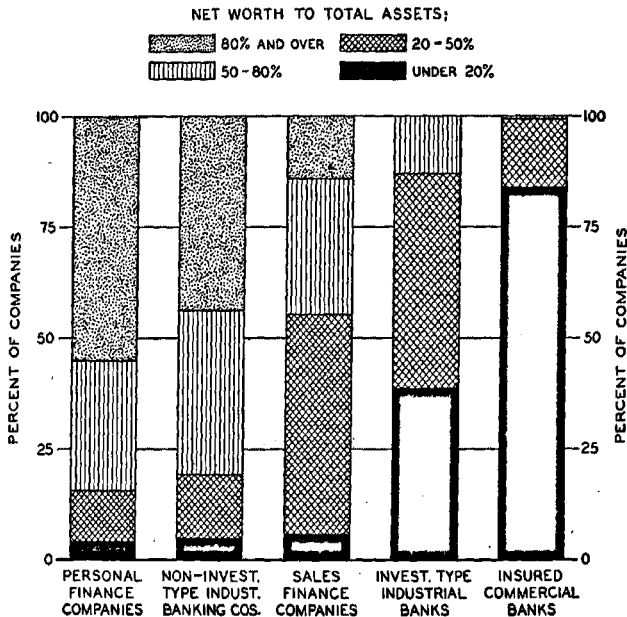
\* For instalment financing agencies, based on tabulations prepared by the Income Tax Study. For commercial banks, based on Annual Reports of the Comptroller of the Currency; the number of national banks is as of December 31.

of total funds represented by net worth (Chart II) shows that high net worth proportions were characteristic of personal finance companies. In materially more than half of the companies, net worth represented at least 80 percent of total funds in 1936; among the types of agencies, this was by far the largest percentage of companies showing such a high net worth proportion.<sup>3</sup> In addition, net worth was less than half of total funds in only a relatively small proportion of the personal finance companies.

Except in rare instances personal finance companies did not

<sup>3</sup> About 10 percent of the personal finance companies reported a capital structure consisting entirely of net worth. These companies that reported no liabilities were smaller institutions, practically all of them having assets of less than \$100,000.

## CHART II

NET WORTH RATIOS OF CONSUMER INSTALMENT FINANCING AGENCIES  
AND COMMERCIAL BANKS, 1936<sup>a</sup>

<sup>a</sup> Represents percentage distribution of companies, arranged according to ratios of net worth to total assets. For personal finance, sales finance and non-investment type industrial banking companies, and for investment type industrial banks, based on tabulations prepared by the Income Tax Study; in regard to these agencies net worth and total assets are year-end figures. For insured commercial banks, based on data from Federal Deposit Insurance Corporation, pertaining to the year 1938; in regard to banks that were members of the Federal Reserve System, net worth and total assets are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included.

obtain funds through long-term borrowings.<sup>4</sup> Their short-term borrowings were, among those of all the agencies, the least important, being the converse of their high net worth proportions. Figures

<sup>4</sup> In the income tax sample the definition of long-term borrowings—obligations with a maturity exceeding one year—was much more comprehensive than is prescribed by recent usage in the field of investment finance. In fact it includes all liabilities which the accountant does not regard as "current liabilities." Definitions of the terms used and of the content of the tabulated data are presented in Appendix A.

on borrowings are shown in Table 3. Among the companies included in the income tax sample, about one-quarter of total funds were obtained on a short-term basis—in the form of commercial paper, discounted notes receivable and notes payable—in the good

TABLE 3

LONG- AND SHORT-TERM DEBT OF CONSUMER INSTALMENT FINANCING AGENCIES IN PERCENT OF TOTAL ASSETS, YEAR-END 1929, 1933, 1936<sup>a</sup>

Agency	Long-Term Debt <sup>b</sup>	Short-Term Debt <sup>c</sup>		
		Notes & Accounts Payable	Deposits & Invest. Certifs.	Total
<i>229 sales finance companies</i>				
1929	3.0%	50.6%	1.1%	51.7%
1933	2.9	36.1	1.8	37.9
1936	2.0	55.9	1.3	57.2
<i>179 personal finance companies</i>				
1929	4.0	26.0	.5	26.5
1933	3.3	13.3	.3	13.6
1936	5.1	26.3	.2	26.5
<i>92 non-invest. type indust. bkg. cos.</i>				
1929	3.7	32.3	2.1	34.4
1933	6.9	18.8	1.5	20.3
1936	12.5	24.0	2.2	26.2
<i>112 invest. type indust. banks</i>				
1929	.3	6.2	73.3	79.5
1933	2.7	2.7	69.8	72.5
1936	.5	2.4	75.9	78.3

<sup>a</sup> Based on tabulations prepared by the Income Tax Study.

<sup>b</sup> All obligations maturing more than one year after the date of the balance sheet.

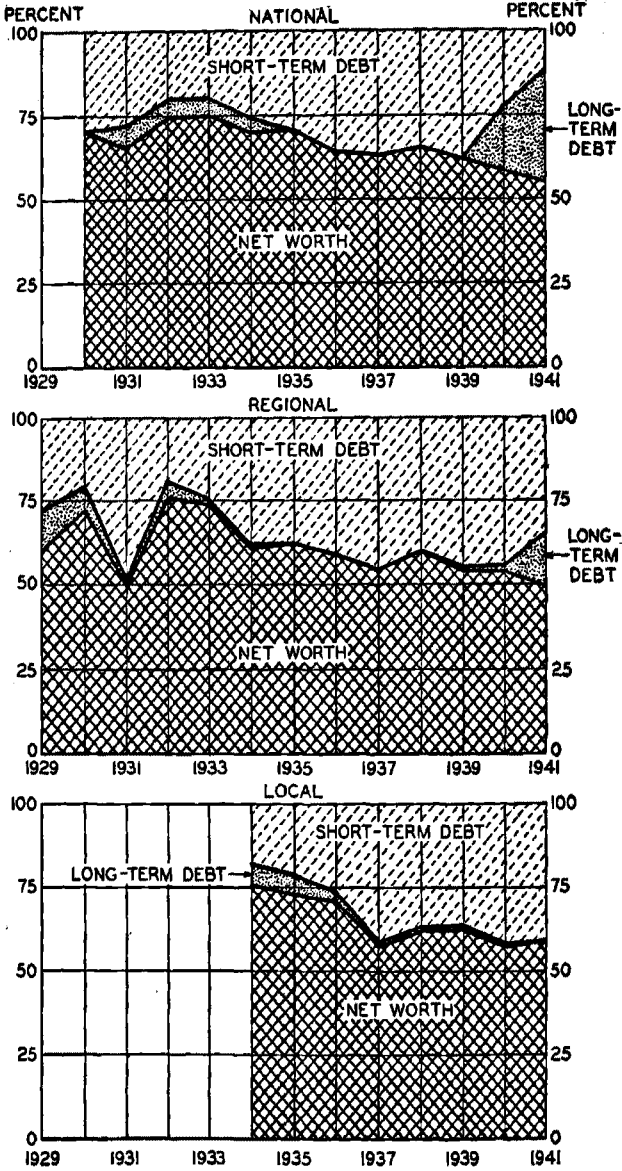
<sup>c</sup> Including bonded debt maturing less than one year after the date of the balance sheet.

years 1929 and 1936, while in the depression year, 1933, short-term borrowings averaged only about one-eighth of total funds. About one-quarter of these companies reported no short-term debt in 1936; somewhat more than one-quarter reported short-term debt of less than 10 percent of total assets, and very few reported such debt in excess of 50 percent of total assets.

The small proportion of short-term debt among personal finance companies reflects the difficulty encountered in securing access to the short-term money market and to commercial banks. The personal finance company faced the reluctance of the banker to recog-

CHART III

SOURCES OF FUNDS OF PERSONAL FINANCE COMPANIES, 1929-41\*



\* Footnote on opposite page.

nize the soundness or the ethical justification of its chief asset, which he construed as loans for consumption purposes, largely to improvident borrowers.<sup>5</sup>

Personal finance companies, because they were considered the least creditworthy, made the most use of preferred stock (in relation to total assets) as an alternative source of funds from outsiders (Table 2).

Among the national, regional and local personal finance companies included in the National Credit Office sample, the proportion of net worth declined over the period as a whole from about three-quarters of total funds in 1929 to about one-half in 1941 (Chart III), reflecting a gradually wider acceptance of these institutions in the money markets. There was some year-to-year fluctuation in the proportion of short-term debt due to fluctuations in the volume of business.<sup>6</sup>

In sales finance companies net worth represented a materially lower proportion of total funds than in personal finance companies. Among the companies included in the National Credit Office sample, this proportion fluctuated sharply between 1929 and 1941, increasing and decreasing as the volume of business contracted and expanded (Chart IV). Fluctuations in the net worth proportions were due to the practice within these agencies of relying on larger proportions of borrowed money for their funds. Borrowed funds increased as business expanded and were paid off as business de-

<sup>5</sup>A description of sources of funds in the small loan business prior to the period covered here appears in M. R. Neifeld, *Personal Finance Comes of Age* (New York 1939) pp. 98-99.

<sup>6</sup>For national and regional personal finance companies the chart reveals that during 1933-36 the short-term debt increased sharply; during the same period, however, the short-term debt of the companies in the income tax sample increased only to the level shown in 1929 (see Table 3, above). The differences between the two sets of data for 1936 appear to result from the larger companies' greater ability to borrow, since the proportions shown in the chart approximate those of the larger companies in the income tax group. For figures on the sources of funds of 274 personal loan licensees in Indiana, classified according to corporate affiliation and legal form of organization, see National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (New York 1940) p. 42.

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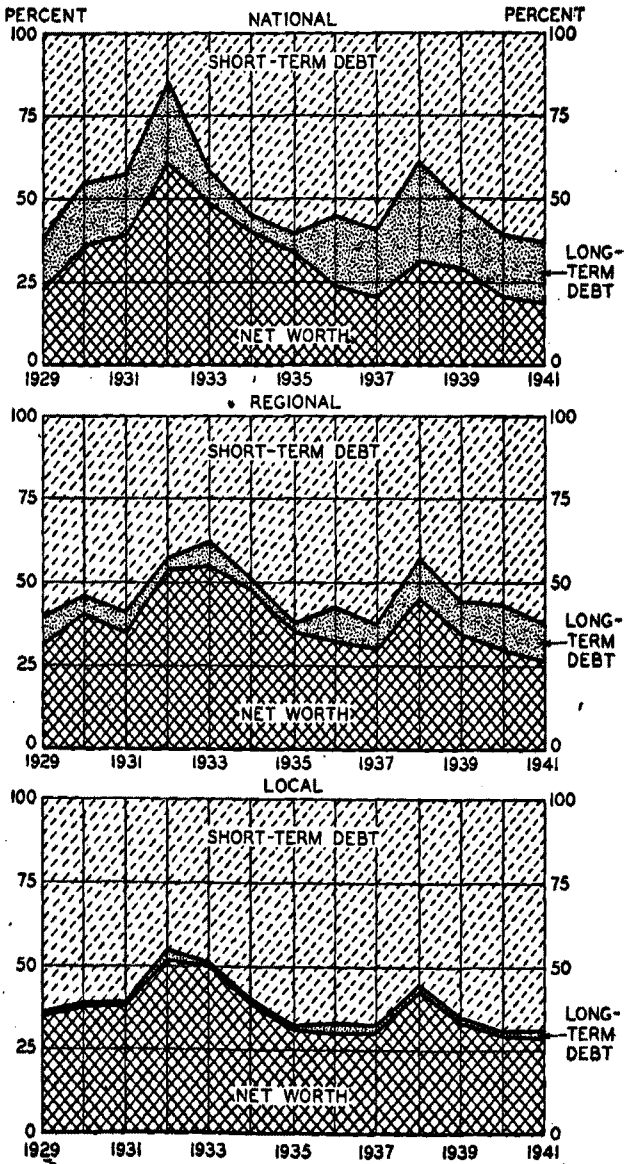
FOOTNOTE TO CHART III

\* Represents distribution of net worth and liabilities in percent of total assets. Based on data from the National Credit Office, Inc. The number of companies for each year and the amount of year-end total assets may be found in Appendix Tables B-1 and B-2. Miscellaneous liabilities have been omitted from total liabilities in computing the distributions for this chart.



CHART IV

SOURCES OF FUNDS OF SALES FINANCE COMPANIES, 1929-41\*



\* Footnote on opposite page.

creased, while net worth or equity changed little. Their borrowings were chiefly short-term commercial paper, discounted notes receivable and notes payable; deposits were either non-existent or insignificant in amount.<sup>7</sup>

Not only did sales finance companies in the aggregate derive a materially higher proportion of funds from these sources than did the other types of institutions (Table 3) but they also showed the greatest frequency of use of these sources. In 1936 more than four-tenths of the companies included in the income tax sample had short-term funds amounting to more than 50 percent of total assets, and seven-tenths had such funds in amounts exceeding 30 percent of total assets.

The high proportion of short-term debt in the capital structure of sales finance companies is evidence of the high credit standing accorded this type of enterprise, and implies a recognition of the high quality of their principal asset—the instalment receivable. A loan made against it was usually secured by the net worth not only of the borrowing sales finance company and consumer-purchaser of the goods, but sometimes of the retail dealer as well; in addition, there was usually the ultimate security of a disposable asset of reasonably ascertainable value. The paper was liquidated currently out of the income of the consumer-purchaser.

Bankers, in fact, did not require sales finance companies to maintain the traditional current ratio of two times current liabilities, or better, as is evidenced by the high proportion of these companies with short-term debt exceeding 50 percent of total assets. Instead they made a "liquidity" requirement: a borrowing sales finance company should be able to liquidate its current liabilities out of its collections within a specified period, usually about six months.<sup>8</sup>

<sup>7</sup> These represent dealers' deposits or "hold-backs," and actually they constitute either a reserve for bad debts (set up by the customer himself against notes discounted with recourse) or a current liability, to the extent that they are not needed to cover losses, and will be returned to the dealer.

<sup>8</sup> See National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit*, by John M. Chapman and Associates (New York 1940) p. 210; also *Sales Finance Companies and Their Credit Practices*, by Wilbur C. Plummer and Ralph A. Young (New York 1940) pp. 70-72.

FOOTNOTE TO CHART IV

\* Represents distribution of net worth and liabilities in percent of total assets. Based on data from the National Credit Office, Inc. The number of companies for each year and the amount of year-end total assets may be found in Appendix Tables B-1 and B-2. Miscellaneous liabilities have been omitted from total liabilities in computing the distributions for this chart.

Common equity owners usually regard the sale of preferred stock as the most expensive type of "borrowing." But to the corporate management of consumer instalment financing agencies the use of preferred stock generally seems a less expensive means than the sale of common stock. The explanation lies in the high dividend yield and the high "earnings yield" required by investors in the common stock of these agencies, a condition readily apparent in quotations on the major stock exchanges.

This situation probably explains why sales finance companies resorted to preferred stock financing as frequently as did personal finance companies. In comparison with either personal finance or non-investment type industrial banking companies they obtained not only a larger proportion of total funds through borrowing, but also a larger proportion of equity funds from preferred stockholders. The largest companies tended to rely most frequently on preferred capital and by being able to borrow a large proportion of total funds from short-term sources, attained a degree of flexibility in their long-term financing which permitted them to utilize whichever segment of the capital market became the most favorable.

The non-investment type industrial banking companies had almost as high net worth proportions as the personal finance companies (Table 2). In almost half of the companies included in the income tax sample net worth in 1936 represented more than 80 percent of total funds and in only a small proportion was it less than 50 percent (Chart II),<sup>9</sup>

Like personal finance companies, non-investment type industrial banking companies had relatively high proportions of preferred stock (in relation to total funds) and obtained a relatively small proportion of total funds—averaging from one-fifth to one-third in the years for which income tax data are available—from outsiders in the form of short-term debt (Table 3). Long-term debt, of relatively little importance in 1929, increased in 1933 and 1936, the increase reflecting changes in a relatively few large companies which dominated the sample.

Investment type industrial banking companies showed by far the lowest net worth proportion among the consumer instalment

<sup>9</sup> A few smaller companies—with total assets of less than \$100,000—reported no liabilities.

financing agencies included in the income tax sample. Averaging about 16 percent of total funds in both 1929 and 1936 and only 21 percent in 1933, their net worth proportions were only slightly higher than those of commercial banks (Table 2). At least part of their low capital ratio reflects the practice of these industrial banks in showing loans in gross amounts and in accumulating payments in the form of hypothecated deposits on the liability side of the balance sheet.

Correction for this "overstatement" would increase the percentage of net worth of these banks in 1936 from 16.4 percent to a figure between 20 and 25 percent of total assets.<sup>10</sup> Even with this "correction," however, the net worth proportion for industrial banks is intermediate between the other consumer instalment financing agencies and commercial banks. Moreover, nearly nine-tenths of these companies had net worth of less than 50 percent of total funds in 1936 (Chart II).

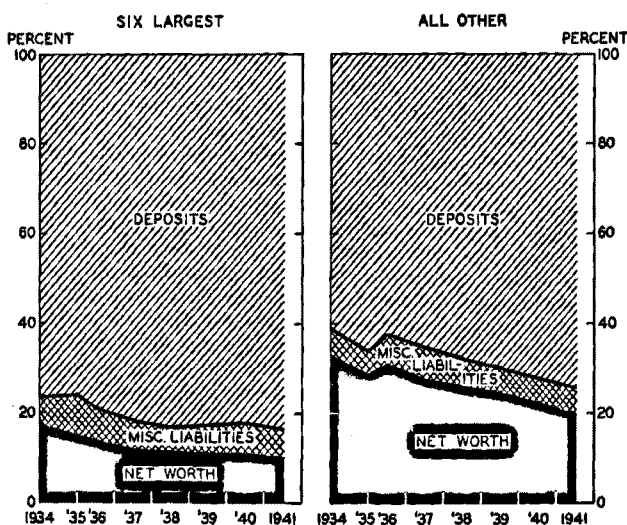
In the early 1920's equity funds probably constituted more than two-fifths of the total funds of investment type industrial banking companies, with investment certificates providing about one-third and borrowings another fifth.<sup>11</sup> Over the succeeding decade, with the fourfold expansion in total assets, equity funds dropped to almost one-fifth in the early thirties and borrowings decreased to less than one-tenth, while the sale of investment certificates—and deposits in a relatively few institutions—accounted for almost three-fourths of total funds.

<sup>10</sup> For several reasons the amount of "overstatement" cannot be determined exactly, the most important reason being that some of these companies reported loans and deposits on a "net" basis. In National Bureau of Economic Research (Financial Research Program), *Industrial Banking Companies and Their Credit Practices*, by Raymond J. Saulnier (New York 1940) p. 60, aggregate figures for 60 to 71 insured industrial banks show hypothecated deposits varying from 17.2 to 18.4 percent of total assets for year-end dates, 1934-38; in each of these years some of the banks reported their loans and deposits on a net basis, a method specified in the instructions issued by the Commissioner of Banks for the State of New York. In an individual institution hypothecated deposits may easily amount to from 40 to 50 percent of total loans. The exact proportion of hypothecated deposits depends upon the average maturity of the loans, and upon the constancy or variation of loan volume from month to month. The above correction of the "overstatement" is based on the assumption that the hypothecated deposits of all these companies, combined, represents from 18 to 35 percent of total assets.

<sup>11</sup> Since the only data available on the earlier years pertain to Morris Plan companies—*ibid.*, p. 58—it is probable that a large proportion of the borrowings represented advances from the parent corporation or its affiliates; other companies would probably have shown a smaller proportion of borrowings. It is also likely that deposits were non-existent or proportionately insignificant.

With the establishment of the Federal Deposit Insurance Corporation and the subsequent extension of insurance to the bulk of industrial banking companies in those states in which they acquired the status of "banks," borrowings practically disappeared and deposits continued to grow while the net worth proportion diminished. In recent years industrial banks, like commercial banks, have been able as a group to attract a sufficient volume of deposits to free them from the necessity of borrowing from other sources. This is evident from Chart V, which covers all insured industrial banks for the years 1934-41.

CHART V  
SOURCES OF FUNDS OF INSURED INDUSTRIAL BANKS, 1934-41\*



\* Represents distribution of net worth and liabilities in percent of total assets. Based on data from Federal Deposit Insurance Corporation, representing averages of figures for beginning, middle and end of year, except in 1934 and 1935, when year-end figures are used. For most of these years the amount of borrowed funds cannot readily be determined, and therefore this item has here been incorporated with miscellaneous liabilities.

With the development of personal loan departments by competing commercial banks there was a complementary development of "commercial bank" activities by the industrial banks and a consequent increase in the proportion of demand deposits. This develop-

ment was accelerated in the last three years of the period under review but the proportion of demand deposits was still small in 1941.

For these industrial banks, as for commercial banks, the use of preferred stock was a post-crisis phenomenon, such stock consisting almost entirely of preferred capital furnished by the Reconstruction Finance Corporation as a part of the bank rehabilitation program of 1933 and subsequent years.<sup>12</sup>

Between 70 and 80 percent of the funds of investment type industrial banks included in the income tax sample were short-term, consisting almost entirely of deposits and investment certificates. Even after allowance is made for hypothecated accounts the proportion of funds obtained by investment type industrial banking companies from deposits and investment certificates remains considerably in excess of the short-term debt of the other types of agencies. This proportion differed sharply as between the various companies, partly because those that had acquired the status of banks were able to obtain a higher proportion of funds in the form of deposits than those that obtained their funds through the sale of investment certificates.

Moreover, industrial banks showed a relatively high concentration in the larger urban centers, where capital requirements for the organization of a bank are around 100,000 or 200,000 dollars. A bank in such a center thus showed a high proportion of equity capital until it had acquired a substantial amount of deposits. Differences in the degree of acceptability accorded this type of institution in different parts of the country probably also played a large part in determining the extent to which an individual company could trade upon equity.

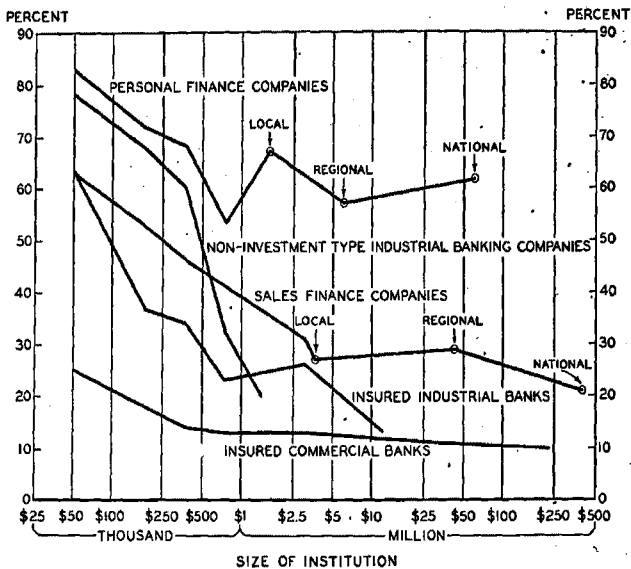
#### INFLUENCE OF SIZE

Within each type of agency the differences in the net worth ratios between companies may be attributed to a considerable degree to differences in size. Chart VI reveals that in 1936, for each type of agency, the net worth ratio decreased as company size increased. Consumer instalment financing agencies with total

<sup>12</sup> Capital notes and debentures—issued in states which did not permit the issuance of preferred stock without double liability—sold to the RFC by insured banks, have been considered a part of preferred stock in this study, in accordance with the general practice of the federal bank supervisory agencies.

CHART VI

RELATIONSHIP OF SIZE AND NET WORTH RATIOS OF CONSUMER INSTALMENT FINANCING AGENCIES AND COMMERCIAL BANKS, 1936\*



\* Represents averages of net worth in percent of total assets for companies in arbitrary size groups, as measured by total assets (or deposits, in the case of banks). Points for net worth ratios were located midway between the size groups, except for the highest size group and for the national, regional and local sales finance and personal finance companies, where points were located at the averages of total assets (or deposits) for the companies included.

For the smaller sales finance and personal finance companies, and for non-investment type industrial banking companies, based on tabulations prepared by the Income Tax Study; for the national, regional and local sales finance and personal finance companies (some of which are included in the income tax samples), based on data from the National Credit Office, Inc.; in regard to these agencies, net worth and total assets are year-end figures and size is based on total assets.

For insured industrial and commercial banks, based on data from Federal Deposit Insurance Corporation, pertaining to the year 1939 for commercial banks; in regard to banks that were members of the Federal Reserve System, net worth, total assets and deposits are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of year; size is based on deposits. Total assets and deposits of insured industrial banks are net, after deduction of hypothecated deposits. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included with insured commercial banks.

assets of less than \$100,000 had an average net worth ratio of more than 60 percent, regardless of type. The degree of decrease accompanying the increase in size varied from one type of institution to another: the decline was least among the personal finance companies and greatest among insured industrial banks.<sup>13</sup> The decline was greatest, too, among the companies with assets of less than 5 million dollars; beyond that point the decrease continued, but less markedly.

The relatively high net worth shown by the smallest companies may be explained, in part at least, as follows: a company that starts with a net worth of \$25,000 has a very high proportion of net worth as long as it remains small; the ratio decreases as the amount of borrowed funds increases. In general, the lower net worth ratios shown by the larger companies are indicative of their more ready access to borrowed funds and of the stronger credit position which accompanies wider diversification of the risk.<sup>14</sup> Moreover, there is a rather deep-seated prejudice—not ignored by lenders—which confuses size with strength and contributes to the creation of a larger proportion of borrowed funds in larger companies. The very low net worth ratio shown by the largest industrial banks, approaching that of commercial banks of the same size, may be attributed to the great growth in deposits among the large institutions, a growth characteristic also of large commercial banks during this period.

Among insured commercial banks, also, the smaller the bank, the higher the proportion of net worth to total assets, although the degree of variation is not so great as among consumer instalment financing agencies. The net worth ratios of insured commercial banks located in centers of approximately the same size are consistently lower as we pass from the smaller to the larger banks;

<sup>13</sup> Data for all insured industrial banks are presented in the chart, instead of the income tax data on investment type industrial banking companies, because the former are corrected for hypothecated deposits and are therefore comparable to the figures for the other agencies. The ratios shown by the two sets of data on industrial banks do not differ materially. The figures covering the largest sales finance and personal finance companies merge in an almost continuous line with those from the income tax data.

<sup>14</sup> In all these agencies the proportion of total funds represented by short-term borrowings varied directly with size of company, the largest companies showing the highest percentages. This is the counterpart of the relationship between size of company and the proportion of total funds derived from equity, and particularly from common equity, sources.



on the other hand, there is no relationship between the size of the center and the net worth ratio among banks of approximately the same size. This is contrary to the commonly held view that the large growth in commercial bank deposits in recent years, and consequent decline in net worth ratios, has been typical more often of larger than of smaller centers, irrespective of size of bank.

The variation in the net worth ratios of commercial banks is probably related to unevenness in the growth of deposits from 1933 to 1941, a development particularly conspicuous in certain urban centers. It probably occurred in a number of agricultural communities as well, but in such communities commercial banks have usually had a relatively high net worth ratio; in certain parts of the country this may well have been the result of supervisory insistence, or of a conservative tendency, derived from custom, in view of the catastrophe hazard in banks whose lending and deposit risks are not diversified.

These differences between one type of agency and another, in net worth ratios, were shown in Chart VI to hold for all size groups.<sup>15</sup> Taken size for size, personal finance companies had the highest net worth ratios of any of the consumer financing agencies. The non-investment type industrial banking companies had the next highest ratios,<sup>16</sup> while the sales finance companies showed sharply lower ratios in almost all size groups, and investment type industrial banking companies showed the lowest ratios of any type of agency.

<sup>15</sup> It should be borne in mind that the various types of institutions differ materially in their size composition. The very small enterprise is predominant among personal finance and non-investment type industrial banking companies, while investment type industrial banking companies are predominantly large; sales finance companies are more evenly distributed according to size. See Appendix Table B-3.

<sup>16</sup> Definitional differences between these two types of agencies are not clear-cut, and overlapping may account in part for the very high net worth proportion shown by the non-investment type industrial banking companies; the very low ratios of the largest companies in the latter group may be ignored, since they pertain to only 4 companies.

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## Uses of Funds

THE ability of the consumer instalment financing agencies to vary the supply of funds in accordance with their needs during 1929-41 enabled them to keep a high proportion of their funds actively employed in loans throughout years both of prosperity and depression.<sup>1</sup> Commercial banks, on the other hand, particularly those that experienced a large increase in deposits, found it increasingly difficult to maintain a large proportion of total assets in the form of loans.

In the aggregate, loans have never constituted as large a proportion of total assets for the commercial banking system as for the specialized lending agencies because banks operate under legal requirements to maintain specified reserves, generally in the form of cash or deposits with other banks. Moreover, at any one time a commercial bank's balance sheet reflects a certain amount of "float"—cash items in process of collection—which serves to inflate the figures of total assets and thus reduce the loan proportion. Nevertheless, throughout most of the period 1929-41, commercial banks' loans were notably lower in dollar amount, as well as in percentage of total assets, than they had been in the previous decade. Most banks therefore entered the consumer instalment financing business, but it still constituted only a small proportion of their lending activity by the end of the period.

Cash holdings of consumer instalment financing agencies, other than credit unions, constituted a small—almost negligible—proportion of assets. In commercial banks they were relatively large at the beginning of the period, and a sizable proportion of the

<sup>1</sup> In this discussion the term "loans" refers to credit receivables, regardless of whether they consist of direct loans or of discounted sales finance paper. The term will always refer to the net amount of outstanding receivables after the deduction of any reserves for bad debts or valuation allowances. Except where specifically stated, however, no deduction is made by offsetting hypothecated deposits against the loans. The amount of loans includes the finance charge or the discounted interest, except in regard to personal finance companies and credit unions; in regard to banks discounted interest may or may not be included.

subsequent increase in their total assets represented cash assets—vault cash, reserves with other banks including required reserves, and cash items in process of collection.

The low proportion of cash held by consumer instalment financing agencies can be attributed to two factors: first, they needed cash only for current and new business operations, in contrast to commercial banks, which were subject to substantial withdrawals of funds upon demand; and second, they had an extremely high turnover of funds, since every month a typical company was repaid from one-tenth to one-fifteenth of its outstanding loans. The regularity of this flow of repayments permitted the company to operate on a very small reserve of cash in excess of its actual till-money needs.

Among the specialized agencies the proportion of funds invested in securities fluctuated considerably during the period under review but in general remained relatively unimportant, whereas among commercial banks in the aggregate securities became a more important component of total assets than loans. This increase in securities consisted almost entirely of holdings of United States Government obligations which represent bank financing of the federal deficit incurred in promoting the recovery program and, since 1939, the defense and war programs.

Only a negligible proportion of the total assets of consumer instalment financing agencies and commercial banks was in a form other than loans, cash or securities. The proportion was, in general, highest for commercial banks, reflecting their tendency to acquire the buildings in which they do business. Besides real estate, whether used as a place of business or otherwise, these other assets included furniture and fixtures, repossessions of automobiles or other chattels, prepaid and unamortized expenses, and intangible items such as goodwill.

In their asset distribution there is little evidence that size of company made any material difference among the specialized agencies. The reverse was true among commercial banks.

#### PERSONAL FINANCE COMPANIES

Because the dollar volume of loans of personal finance companies showed little or no decline during the depression, these companies, possessing the least flexible sources of funds, were able to main-

TABLE 4

PERCENTAGE DISTRIBUTION OF TOTAL ASSETS OF SELECTED SAMPLES OF PERSONAL FINANCE COMPANIES,  
YEAR-END 1929-41, BY ASSET ITEMS<sup>a</sup>

Sample	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>2 national<sup>b</sup></i>													
Loans	..	87.5%	85.7%	83.1%	85.8%	88.4%	88.3%	89.0%	87.9%	86.1%	87.8%	91.2%	90.8%
Cash	..	8.2	9.6	10.1	8.5	9.2	10.0	9.6	10.8	12.7	11.1	7.6	7.8
Securities	..	.6	.4	3.0	2.1	.0	.0	.0	.0	.0	.0	.1	.0
Other assets	..	3.7	4.3	3.8	3.6	2.4	1.7	1.4	1.3	1.2	1.1	1.1	1.4
<i>2 to 5 regional<sup>b</sup></i>													
Loans	85.1%	85.4	91.0	87.0	84.5	84.4	83.9	84.3	84.6	83.7	85.3	85.1	84.1
Cash	7.8	9.3	4.7	8.3	10.7	11.9	11.8	11.5	11.5	12.5	11.5	11.8	11.7
Securities	.0	.0	.0	.0	.0	.0	1.8	1.6	1.9	1.7	1.3	1.2	1.1
Other assets	7.1	5.3	4.3	4.7	4.8	3.7	2.5	2.6	2.0	2.1	1.9	1.9	3.1
<i>5 to 7 local<sup>b</sup></i>													
Loans	..	..	..	..	..	87.5	84.9	89.5	91.3	86.4	88.4	84.9	86.7
Cash	..	..	..	..	..	4.7	7.5	6.9	5.4	10.2	8.5	7.6	9.1
Securities	..	..	..	..	..	.0	.1	.1	.0	.2	.4	.3	.2
Other assets	..	..	..	..	..	7.8	7.5	3.5	3.3	3.2	2.7	7.2	4.0
<i>179 local<sup>c</sup></i>													
Loans	89.2	..	..	..	82.1	..	..	84.0	..	..	..	..	..
Cash	3.7	..	..	..	5.8	..	..	5.5	..	..	..	..	..
Securities	2.3	..	..	..	8.4	..	..	5.3	..	..	..	..	..
Other assets	4.8	..	..	..	3.7	..	..	5.2	..	..	..	..	..

<sup>a</sup> The number of companies for each year will be found in Appendix Table B-1.

<sup>b</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 179 local companies of the income tax sample.

<sup>c</sup> Based on tabulations prepared by the Income Tax Study.

tain high loan proportions of 80 to 90 percent of total assets throughout the period. After the depression their loan volume expanded rapidly; for companies included in the income tax sample, loans in 1936 were 40 percent higher in dollar amount than they had been in 1929.

For the two national companies, and for local companies included in the income tax sample, the proportion of total assets invested in securities trebled from 1929 to 1933. It is probable that some of these companies could have decreased their short-term borrowings—and thus avoided investing in securities—but preferred to continue the use of specific borrowed funds, once acquired, in view of the difficulty in securing access to satisfactory credit facilities.

A number of personal finance companies included in the income tax sample acquired, between 1929 and 1933, significant proportions of taxable securities which they continued to hold in 1936. Examination of their income tax returns reveals two interesting developments: growing companies had organized subsidiaries to engage in the same or similar types of business, and held their securities; or, companies that were faced with a decline in demand for loans had acquired a variety of common stocks, thus becoming, to a limited extent at least, investment trusts.<sup>2</sup>

Cash proportions were materially higher for national and regional personal finance companies than for local companies in most years for which data are available. Even so, cash was rarely more than 10 percent of total funds and other assets were negligible. Percentage distributions of total assets of the selected samples of personal finance companies, 1929-41, are shown in Table 4.<sup>3</sup>

<sup>2</sup> These tendencies made it necessary to exclude these companies from the analysis of income and expenses. See Appendix A.

<sup>3</sup> M. R. Neifeld's estimate of the asset distribution of all personal finance companies in the United States on December 31, 1936 reveals a sharply higher proportion of miscellaneous assets and a slightly lower loan proportion than that shown in the income tax or in the National Credit Office data (Neifeld, *Personal Finance Comes of Age*, New York 1939, p. 209). This discrepancy is due entirely to Neifeld's inclusion in total assets of going-concern value, represented by cost of development and cost of financing, amounting to 5.6 percent of total assets.

The Neifeld estimate was prepared from available data in reports of state supervisory officials and, like its source material, is subject to two limitations: first, the figures represent assets and liabilities reported for individual offices within each state, rather than assets and liabilities of corporate entities; and second, since the state regulatory agencies have as their objective the determination of rates of profitability and "fair" rates of charge, their emphasis is placed on asset values allowed in the preparation of a rate base rather than on book values. This accounts for the inclusion

## SALES FINANCE COMPANIES

During the depression the decline in the volume of loans of sales finance companies was so drastic that despite their greater ability to contract the use of short-term borrowed funds their loan proportions fell off to a slightly greater extent than those of personal finance companies. For the companies included in the National Credit Office sample, the low point in loan percentage was reached in 1932. By 1936, however, both the dollar volume of loans and the percentage of loans to total assets had increased to a greater extent for sales finance than for personal finance companies. Table 5 gives percentage distributions of total assets of selected samples of sales finance companies, 1929-41.

One would expect repossessions to be most frequent in the business of sales finance companies, and to show the greatest increase in periods when collections were difficult. It is the more surprising, therefore, to find that the sales finance companies' proportion of miscellaneous assets was so low, and that the dollar amount decreased from 1929 to 1933.<sup>4</sup>

<sup>4</sup>For companies included in the income tax sample this decrease amounted to 10 percent. It is necessary to point out that the income tax figures represent data for identical companies which filed reports in all of the three years under consideration. Therefore the figures for miscellaneous assets, particularly those representing repossessions, are not entirely representative of the operations of all such institutions, since those companies which encountered serious difficulties in the early 1930's and failed, or which sold their assets to other companies and liquidated, or which reorganized and continued business under a different name, are not included in these data. Companies not represented may be presumed to have shown less favorable results, particularly with respect to the acquisition of repossessions, than those companies that continued operations throughout the period.

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of going-concern value, as a separate item, in the Neifeld estimate.

For comparable reasons there are also differences between the distribution of assets of the personal finance companies in the income tax sample and the hypothetical distribution of assets prepared by the Russell Sage Foundation. This distribution sets the amount of "necessary and useful" assets at 115 percent of loans, and assumes that for the proper conduct of the personal finance business total assets would be distributed as follows: 87.0 percent loans; 4.4 percent cash, including securities; 1.7 percent furniture and fixtures; 1.7 percent other tangible assets; and 5.2 percent cost of development. The chief difference between the two distributions results from the fact that the companies included in the income tax sample did not capitalize cost of development and other intangibles to the extent that the formula assumes. When adjustment is made for this factor, cash and securities combined, and loans, are in line with the hypothetical percentages in 1929, but not in 1933 and 1936, when the income tax sample showed an increase in cash and securities. The discrepancy in those years illustrates the inflexibility of the hypothetical distribution, which, by its very nature, could not make allowance for the inability of personal finance companies to adjust their sources of funds to the change in volume of business.

TABLE 5

PERCENTAGE DISTRIBUTION OF TOTAL ASSETS OF SELECTED SAMPLES OF SALES FINANCE COMPANIES,  
YEAR-END 1929-41, BY ASSET ITEMS<sup>a</sup>

Sample	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>2 to 3 national<sup>b</sup></i>													
Loans	83.6%	84.1%	79.7%	75.2%	82.5%	83.1%	87.7%	89.2%	89.5%	86.9%	87.1%	89.1%	89.4%
Cash	13.2	12.1	14.6	18.8	13.2	13.7	11.3	9.6	9.5	11.6	11.4	9.3	9.1
Securities	1.7	1.9	1.4	3.2	2.7	2.3	.3	.6	.4	.8	.8	.9	.9
Other assets	1.5	1.9	4.3	2.8	1.6	.9	.7	.6	.6	.7	.7	.7	.6
<i>2 to 4 regional<sup>b</sup></i>													
Loans	85.4	84.1	82.0	78.2	79.5	83.0	86.4	85.9	85.7	82.0	84.9	86.3	88.2
Cash	11.1	11.9	14.3	17.0	14.5	11.6	11.2	12.3	12.7	16.0	13.3	11.9	10.5
Securities	1.8	2.3	2.4	3.7	4.4	3.1	1.3	1.0	.8	1.2	1.2	1.1	.8
Other assets	1.7	1.7	1.3	1.1	1.6	2.3	1.1	.8	.8	.8	.6	.7	.5
<i>9 to 32 local<sup>b</sup></i>													
Loans	80.7	79.3	84.9	81.6	82.5	83.3	85.8	84.5	84.9	80.8	84.2	85.2	84.9
Cash	9.6	11.7	11.2	12.7	12.3	12.8	10.8	12.0	11.8	15.0	12.3	11.7	11.7
Securities	5.1	3.5	.6	.6	.8	.6	.3	.4	.3	.7	.8	.6	1.2
Other assets	4.6	5.5	3.3	5.1	4.4	3.3	3.1	3.1	3.0	3.5	2.7	2.5	2.2
<i>229 local<sup>c</sup></i>													
Loans	84.6	..	..	..	78.8	..	..	85.1	..	..	..	..	..
Cash	7.8	..	..	..	9.4	..	..	8.7	..	..	..	..	..
Securities	3.8	..	..	..	7.0	..	..	3.1	..	..	..	..	..
Other assets	3.8	..	..	..	4.8	..	..	3.1	..	..	..	..	..

<sup>a</sup> The number of companies for each year will be found in Appendix Table B-1.

<sup>b</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 229 local companies of the income tax sample.

<sup>c</sup> Based on tabulations prepared by the Income Tax Study.

The low proportion of repossessions may be explained in several ways. On recourse paper, sales finance companies were able to transfer repossessions to the dealer, so that their own balance sheets and operating statements were not affected. Some companies, reluctant to show an increase in repossessions on their balance sheets, since it might adversely affect their borrowing power, charged the entire acquisition cost of the repossession to a reserve for losses, and showed recoveries when the asset was disposed of. Also, sales finance companies made strenuous efforts to dispose of repossessions, sometimes by sale at auctions, or by transfer to subsidiaries, which frequently disposed of the article in a community in which the parent company did not operate. The dollar decrease noted in total miscellaneous assets during 1929-33 probably resulted, in part, from a decrease in net fixed assets, brought about by an increase in the reserve for depreciation.

#### INDUSTRIAL BANKING COMPANIES

Although non-investment type industrial banking companies are, in general, similar to personal finance companies in their sources of funds and asset distributions, it is notable that their loan volume fell off considerably during the depression, and failed to regain its pre-depression level in 1936. Percentage distributions of total assets of selected samples of industrial banking companies are shown in Table 6.<sup>5</sup>

Loans of investment type industrial banks, whether calculated in percent of assets or in terms of 1929 outstandings, fell off almost as drastically as those of commercial banks during the depression and only regained their pre-depression level in 1936. The inability of industrial banks to maintain loan volume during the depression is due to the fact that depositors in industrial banks did not withdraw their funds to an extent comparable with the decline in demand for suitable loans. The initiative for varying the supply of funds did not rest with the institution, as in the case of the other specialized agencies. In part, also, industrial banks required a greater amount of liquidity than the other agencies because of the uncertain stability of deposits.

<sup>5</sup> The apparently lower loan proportion for insured industrial banks in 1936 than for those included in the income tax sample is due to deduction of hypothecated deposits from their loans.



TABLE 6  
PERCENTAGE DISTRIBUTION OF TOTAL ASSETS OF SELECTED SAMPLES OF INDUSTRIAL BANKING COMPANIES,  
YEAR-END 1929-41, BY ASSET ITEMS<sup>a</sup>

Sample	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>92 non-investment type<sup>b</sup></i>													
Loans	89.7%	..	..	..	82.5%	..	..	84.3%	..	..	..	..	..
Cash	2.3	..	..	..	4.3	..	..	3.3	..	..	..	..	..
Securities	4.3	..	..	..	7.3	..	..	6.7	..	..	..	..	..
Other assets	3.7	..	..	..	5.9	..	..	5.7	..	..	..	..	..
<i>112 investment type<sup>b</sup></i>													
Loans	83.5	..	..	..	73.4	..	..	82.3	..	..	..	..	..
Cash	4.9	..	..	..	7.3	..	..	6.1	..	..	..	..	..
Securities	10.1	..	..	..	16.0	..	..	9.4	..	..	..	..	..
Other assets	1.5	..	..	..	3.3	..	..	2.2	..	..	..	..	..
<i>6 largest insured<sup>c</sup></i>													
Loans	..	..	..	..	..	62.8%	77.8%	76.8	76.3%	73.4%	73.0%	75.9%	76.5%
Cash	..	..	..	..	..	8.6	6.6	7.6	9.2	12.2	13.1	14.0	14.4
Securities	..	..	..	..	..	25.1	12.8	12.2	11.8	12.2	11.8	8.4	7.7
Other assets	..	..	..	..	..	3.5	2.8	3.4	2.7	2.2	2.1	1.7	1.4
<i>All other insured<sup>c</sup></i>													
Loans	..	..	..	..	..	74.0	75.1	77.4	79.3	75.8	74.7	76.3	74.4
Cash	..	..	..	..	..	8.8	9.7	10.9	9.8	13.7	15.6	16.0	18.3
Securities	..	..	..	..	..	12.3	11.3	8.0	7.9	7.8	7.2	5.4	5.1
Other assets	..	..	..	..	..	4.9	3.9	3.7	3.0	2.7	2.5	2.3	2.2

<sup>a</sup> The number of companies for each year will be found in Appendix Table B-1.

<sup>b</sup> Based on tabulations prepared by the Income Tax Study. Some of these investment type industrial banks are insured.

<sup>c</sup> Based on data from Federal Deposit Insurance Corporation. Asset distributions are based on averages of figures for beginning, middle and end of year, except in 1934 and 1935; deposits accumulated for the repayment of loans have been deducted from total assets and from loans; and banks that operated less than the full year or whose operations were materially affected by mergers during the year are not included.

The tendency of investment type industrial banking companies to engage increasingly in a general deposit banking business led to a progressive shift in their cash requirements from those characteristic of consumer instalment financing to those more typical of banks of deposit. In 1929, practically all of the companies included in the income tax sample reported cash holdings of less than 5 percent of total assets, but by 1936 one-third reported cash in excess of 10 percent and another third reported cash between 5 and 10 percent of total assets. In 1936 insured industrial banks had cash averaging about 9 percent of total assets; by 1941 cash had increased to about 16 percent.

Industrial banks showed an average investment in securities somewhat higher than that of the other specialized agencies but sharply under that of commercial banks. A steadily increasing number of investment type industrial banking companies included in the income tax sample held tax-exempt securities over the period 1929 to 1933, though the amounts did not constitute a large proportion of total assets. The figures for insured industrial banks show higher securities proportions than those for noninsured companies. These differences, highlighted in 1936 by separate tabulations of these companies in the income tax sample, can be attributed to the greater degree to which the insured institutions were taking on the characteristics of commercial banks. From 1938 to 1941, however, while the volume of their assets expanded, the securities proportions of insured industrial banks declined.<sup>6</sup>

It was in investment type industrial banks that miscellaneous assets constituted the smallest proportion of the total, although in

<sup>6</sup>In the asset distributions prepared from data of the American Industrial Bankers Association, showing investment and non-investment type companies separately, cited in National Bureau of Economic Research (Financial Research Program), *Industrial Banking Companies and Their Credit Practices*, by Raymond J. Saulnier (New York 1940) p. 69, securities proportions were somewhat higher, with loan proportions correspondingly lower, than in the income tax tabulations, or in the tabulations of insured bank data prepared by the FDIC. It may be assumed that the AIBA data were based on consolidated reports for each company, whereas in the income tax data the figures are not consolidated; in other words, holdings in subsidiaries appear as securities. This difference in procedure could readily account for the small discrepancies shown.

A tabulation of 64 insured and noninsured Morris Plan companies—most of which are of the investment type—prepared from *Polk's Bankers Encyclopedia* for December 31, 1938, cited in Saulnier, *op. cit.*, p. 68 shows an asset distribution similar to that shown for insured industrial banks, when not adjusted for hypothecated deposits.

dollar amount they increased sharply from 1929 to 1933 in the companies included<sup>7</sup> in the income tax sample. This increase can probably be accounted for by the expansion in activities and, in some cases, by the acquisition of banking houses. The proportion dwindled in the insured institutions with the expansion in their assets after 1933.

#### FEDERAL CREDIT UNIONS

Federal credit unions, from 1934 to 1941, showed an ability to maintain almost as large a proportion of total assets in the form of loans as the other consumer credit agencies. This proportion, however, declined slightly but continuously during 1937-40, falling from 81.5 to 77.8 percent, and dropping further during 1941 to 65.6 percent.<sup>7</sup> The asset distribution of all reporting federal credit unions, 1934-41, is presented in Table 7.

TABLE 7

PERCENTAGE DISTRIBUTION OF TOTAL ASSETS OF FEDERAL CREDIT UNIONS, 1934-41, BY ASSET ITEMS<sup>a</sup>

Year	Loans	Cash	Securities	Other Assets
1934	66.2%	33.1%	b	.7%
1935	77.3	21.8	b	.9
1936	80.2	17.9	b	1.9
1937	81.5	16.1	b	2.4
1938	80.7	15.4	3.5%	.4
1939	79.5	14.0	6.2	.3
1940	77.8	13.5	8.2	.5
1941	65.6	17.8	15.8	.8

<sup>a</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts; figures pertain to all reporting federal credit unions; the number for each year will be found in Appendix Table B-1.

<sup>b</sup> Amounts not available; included with other assets.

During the early years of their existence, federal credit unions appear to have retained their surplus funds largely in the form of cash, in anticipation of demands for loans from members. In time, however, a good many credit unions seem to have decided

<sup>7</sup> Francis E. Wilcox, in *A Statistical Study of Credit Unions in New York* (Chicago 1940) pp. 80, 82, shows that at the end of 1937 state-chartered credit unions over ten years old had a lower ratio of loans to total assets than credit unions less than ten years old (68.4 compared with 78.5 percent).

that their members' demand for loans would develop no more rapidly than the influx of share capital from other members. As a result, since stringent regulations govern credit unions' investment of funds other than in loans to members, there was an increase in investments in United States government securities, and even more in insured shares of savings and loan associations.

By the end of 1940 the total investments of federal credit unions amounted to 8 percent of their total assets; by 1941 it had risen to 16 percent, probably as a result of a concerted demand that credit unions invest all available funds in government securities and keep their loans at a minimum. In assessing the advantages of this procedure from the viewpoint of the war effort, it should not be overlooked that such a development might eventually jeopardize the whole credit union system and make it necessary for members to turn to other, more expensive sources of loans.

#### COMMERCIAL BANKS

The drastic contraction which occurred after 1930 in the relative loan volume of commercial banks is pictured in Chart VII, which shows percentage distributions of assets of all commercial banks from 1919 to June 1942. From 1900 to 1930 the loans of all national banks fluctuated between 52 and 58 percent of total assets. After 1930 the decline was precipitous, to a low of 26 percent in 1936; since then the figure has fluctuated narrowly between 24 and 29 percent, as total assets continued to expand.

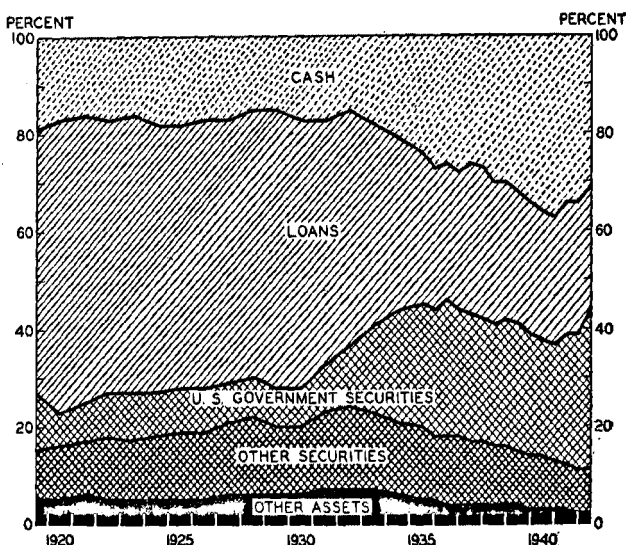
The loan proportions of commercial banks in the aggregate, however, are necessarily weighted by those of the larger banks. In general, the smaller banks had a relatively higher proportion of assets in the form of loans. Over half of the 10,600 banks with average deposits of less than 2 million dollars held loans in excess of 40 percent of total assets in 1940, whereas only six of the 132 banks with average deposits of more than 50 million dollars held loan proportions as high.<sup>8</sup> It is this tendency toward a much smaller

<sup>8</sup> See the *Annual Report* of the Federal Deposit Insurance Corporation for 1940, p. 201. In each year from 1936 to 1941 the percentage of insured commercial banks that had high loan proportions was larger than in the preceding year. Published figures on loan proportions for all insured commercial banks, 1938-41, and for insured commercial banks not members of the Federal Reserve System, 1936 and 1938, appear in the following *Annual Reports* of the FDIC: 1936, p. 189; 1938, p. 235; 1939, p. 187; 1940, p. 200; and 1941, pp. 168, 171. These published figures include banks designated in this study as insured industrial banks.

loan proportion among larger banks which results in a low figure for the country as a whole when the average is computed from dollar aggregates; the figure obtained is materially higher when the ratios of individual banks are averaged.<sup>9</sup>

Since size of banking center and size of bank are interrelated, it is not surprising that the percentage of banks in small towns having a high loan proportion was larger than that of banks in large

CHART VII  
USES OF FUNDS OF COMMERCIAL BANKS, 1919-42<sup>a</sup>



<sup>a</sup> Represents percentage distribution of total assets of all commercial banks. Based on Annual Reports of the Comptroller of the Currency. For 1919-34 and 1942 figures are as of June 30; for 1935-41 they are as of June 30 and December 31.

cities. However, size of bank bore a closer relation to loan proportions than did size of banking center. There was little apparent relationship between size of banking center and the loan proportion among banks of approximately the same size; on the other hand, in centers of the same size, the loan proportion showed a

<sup>9</sup> Averages computed from ratios of individual banks were used throughout this analysis because of the bias in favor of the relatively few large banks obtained from averages based on dollar aggregates (less than 10 percent of the insured commercial banks hold more than 80 percent of the assets).

consistent downward tendency with increases in size of bank. This would indicate that it was the largest banks in specific centers, rather than all banks in those centers, which had the greatest difficulty in finding outlets enough for suitable loans, or which deliberately acquired securities. These were probably also the banks that showed the greatest growth in deposits, particularly in interbank deposits; and doubt respecting the stability of such deposits may have prompted them to retain an even larger proportion of assets in liquid form than was held by other banks in the same centers.

Broad geographic differences in commercial banks' loan proportions are indicated by the fact that banks in agricultural areas generally tended to hold a high proportion of total assets in the form of loans. States in the midwest and south, generally considered to be dominated by agricultural and extractive industries, showed higher average loan proportions than states dominated by manufacture and trade.<sup>10</sup>

With respect to cash proportions, conflicting tendencies were shown during the years 1936-40, among banks of different sizes located in centers of different size. In centers of less than 10,000 population the smaller banks held a higher proportion of cash assets, and in centers of more than 10,000 the opposite was true.

Among banks of a given size, however, those in the smallest and largest centers held a higher cash proportion than those in the intermediate size centers. In the smaller centers, banks tend to keep a larger proportion of till-money because they are at a greater distance from facilities for replenishing cash; also, if they are not members of the Federal Reserve System, they tend to keep a large proportion of balances with correspondents. In the largest centers, higher legal reserves make for retention of a higher proportion of cash assets.

#### CONSUMER INSTALMENT LOANS OF COMMERCIAL BANKS

We have seen (Table 1) that the share of commercial banks in total holdings of consumer instalment loans increased greatly after 1929, rising to over one-fourth at the end of 1941. Nevertheless, consumer instalment loans continued to represent only a small

<sup>10</sup> Since a state is not a homogeneous unit in its economic development, state averages are not an entirely satisfactory measure of such differences, but more accurate measures are not readily available.

proportion of total loans, and a much smaller proportion of total assets, of insured commercial banks. At the end of 1941 their holdings of such paper amounted to about 1.7 billion dollars, or 8 percent of their total loans and discounts.<sup>11</sup> The proportion varied as markedly among individual banks as did the figure for total loans in percent of total assets.

It is shown in Table 8 that while one-eighth of the insured commercial banks reported no consumer instalment paper in 1941, more

TABLE 8

NUMBER AND PERCENTAGE DISTRIBUTION OF INSURED COMMERCIAL AND INDUSTRIAL BANKS, MID-YEAR 1941, BY PERCENT OF CONSUMER INSTALMENT LOANS<sup>a</sup>

<i>Consumer Instalment Loans in Percent of Total Loans<sup>b</sup></i>	<i>Commercial Banks</i>		<i>Industrial Banks</i>	
	Number	Percent	Number	Percent
No cons. inst. loans	1,665	12.6%	..	..
Under 2.5%	1,941	14.7	..	..
2.5-5	1,822	13.8	1	1.2%
5-10	2,989	22.6	..	..
10-15	1,758	13.3	..	..
15-20	1,147	8.7	..	..
20-30	1,155	8.7	..	..
30-40	412	3.1	1	1.2
40-50	191	1.4	4	5.0
50-60	76	.6	4	5.0
60-80	39	.3	15	18.8
80 or over	25	.2	55	68.8
ALL BANKS	13,220	100.0%	80	100.0%

<sup>a</sup> Based on data from Federal Deposit Insurance Corporation. Cash depositories and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included.

<sup>b</sup> Each level is inclusive of the lower limit and exclusive of the upper.

than one-eighth reported such paper in amounts of 20 percent or more of total loans. The proportion of total loans represented by consumer instalment paper was almost three times as large for

<sup>11</sup> While the proportion of consumer instalment loans to total loans showed a wide geographic range, varying from 3 percent in Rhode Island to more than 17 percent in Arizona and Oregon, no regular geographic pattern is evident. In general, the proportion is higher for the banks in the western and southern than for those in the eastern and northern states.

banks not members of the Federal Reserve System as for central reserve city member banks—12.2 percent as compared with 4.3 percent.<sup>12</sup>

In general, a commercial bank's strongest incentive in entering the field of consumer instalment financing has been the failure of business loans to increase with the volume of deposits. This might suggest that the larger banks in the larger centers, those that had experienced the greatest growth in deposits, would have had the strongest incentive to enter the consumer instalment field. However, although the growth in banks' consumer loans was greatest in the large centers, the large banks in those centers showed less of an increase than did the smaller banks.<sup>13</sup>

These tendencies with respect to holdings of consumer instalment loans by banks of different size in centers of different size are subject to wide variation, due probably to many factors, not all reducible to statistical analysis. It may be pointed out that interest rates on agricultural and commercial paper show a wide geographic variation, and in an area where high rates of return can ordinarily be obtained on such loans there is less inducement to seek consumer instalment paper than in an area where traditional business and agricultural loans bring very low rates of return.

Highly industrialized areas, on the other hand, provide a greater proportionate demand for retail instalment credit than agricultural areas, where fewer potential borrowers are in a position to make regular instalment repayments. A considerable proportion of the loans of small banks in rural areas had some of the characteristics of consumer instalment paper, but they cannot be regarded as such in any strict interpretation, because repayment was not provided for on a regular instalment basis.

On this latter point pertinent data are available for the years 1937-40, from a sample of 756 small banks, representing about 5

<sup>12</sup> See *Federal Reserve Bulletin* (May 1942) p. 440. Figures on the retail instalment outstandings of all insured commercial banks were first available as of December 31, 1939, when these banks submitted the figures on a supplementary schedule to the federal bank supervisory agencies; these figures are summarized, by states, in the *Federal Reserve Bulletin* (June 1940) p. 526. More comprehensive data on consumer instalment loans held by insured commercial banks have been available semi-annually since December 31, 1940; these figures are summarized, by states, in the *Federal Reserve Bulletins* and in Federal Deposit Insurance Corporation, *Assets and Liabilities of Operating Insured Banks*.

<sup>13</sup> See Appendix Table B-5.



percent of all insured commercial banks.<sup>14</sup> All of them earned materially higher rates of income on their loans than did other banks in the same state, and they attributed their higher-than-average income rates to the fact that a large fraction of their loans were small in amount. Of those banks that gave some indication of the dollar size of their loans all except a negligible proportion reported average loans of less than \$500.

Some of these loans were reported by the banks as consumer instalment paper; but whether or not they were so reported, they appeared to be very similar in character to the usual cash loan extended by consumer instalment financing agencies, in respect of size of loan, security, and character of the charges imposed. But though to some extent they were made to farmers and local businessmen for business purposes, they did not provide for equal instalment repayments at regular intervals. A large proportion of the banks made loans to factory employees and other workers, providing for complete repayment within short periods of time, sometimes as short as 15 or 30 days.

#### WAR DEVELOPMENTS

How well the consumer instalment financing agencies will be able to adjust themselves to drastic changes during the war period remains to be seen. Cessation of the production of automobiles and many other types of durable consumer goods has already created severe problems for the sales finance companies. In the past this type of agency had the most flexible sources of funds, and curtailment of operations was followed rapidly by curtailment of outstanding obligations. The decrease in the volume of retail instalment business has now become so severe that sales finance companies have taken additional steps to adjust their operations.

<sup>14</sup> Correspondence undertaken in order to verify amounts reported as loan income, 1937-40, by individual insured commercial banks not members of the Federal Reserve System resulted in a body of usable information with respect to the character of loans and of charges. This sample consists of banks whose rate of income on loans, after verification, remained higher than the average for their respective states. Most of the banks included in the sample held total loans of less than \$100,000, and were located in towns of less than 2,000 population, in the southern and western states. There were 26 of the banks, however, whose total loans amounted to \$500,000 or more (6 whose loans exceeded \$1,000,000), and 24 that were located in centers with a population of 50,000 or over. In this connection it is of interest that many country banks, responding to an inquiry from the National Bureau in connection with an earlier study, reported that all loans made by them were "personal" loans.

Some of the smaller companies have announced their intention of liquidating; others that had a substantial proportion of small loan business have shifted over completely to that type of activity. The larger companies, which had already developed other outlets for funds, have been spurred to expand into additional channels, such as the discounting of accounts receivable, making working capital loans to companies with war contracts or subcontracts, and even acquiring manufacturing or engineering subsidiaries engaged in the war effort, or insurance companies. One large regional company has sold its receivables to a national company, and another has been purchased by an affiliate of a large branch bank system, some of its automobile receivables and offices being acquired by the bank.

Figures for cash-lending agencies reveal that their loans also fell off during 1941, and more drastically during 1942, after Regulation W became effective. The decline was particularly acute among the industrial banking companies and credit unions. The decrease in loan volume among industrial banks has resulted in increased holdings of United States government securities in an effort to keep idle funds employed; and the same is true of credit unions.

On the other hand, a number of personal finance companies have succeeded in sufficiently curtailing the amount of funds, through the retirement of borrowings or of preferred capital, to avoid the retention of large supplies of vital funds. A number of personal finance companies have also been absorbed by other units, including one large local company in the National Credit Office sample.

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## Sources and Rates of Income

DURING the period 1929-41, consumer instalment financing agencies derived practically all of their income from loans, whereas commercial banks in the aggregate derived substantial amounts of income from other sources. Not only was the level of the effective rate of income received on loans markedly different for each type of specialized agency and for commercial banks, but effective rates differed even more significantly among individual institutions. These variations reflected primarily differences in the character of the predominant type of paper and in the size of the average loan held.

### SOURCES OF INCOME

The income of sales finance companies took many forms: discounts on retail instalment paper, income from wholesale financing, commissions on insurance, and sometimes interest on small loans, income from factoring (the discounting of accounts receivable) and from rediscounting the paper of other finance companies. Income from securities was negligible.

Despite wide variations between companies, discounted retail instalment paper normally furnished the bulk of gross earnings. Although wholesale financing—the financing of dealers' purchases—accounted in general for 10 to 20 percent of receivables outstanding at any one time, it accounted for a materially smaller proportion of gross income, because rates were set low as a competitive device intended to enable the company to share in the dealer's retail instalment paper.

Insurance income tended to be the second most important source of earnings in an automobile sales finance company. Although such income was sometimes derived directly from subsidiary insurance companies it more frequently took the form of commissions on insurance business placed with independent companies. A sample of 10 local sales finance companies reporting this item separately in 1937 revealed insurance commissions ranging from 0.1 to 21.3 per-

cent of total earnings: in 5 of the companies commissions exceeded 10 percent.<sup>1</sup>

If a sales finance company engaged in the extension of small loans at all, it constituted as a rule only a very small part of the business. Loan extension derived mainly from the refinancing of unfulfilled contracts, a procedure sometimes interpreted as making the contract subject to statutory interest provisions. Most sales finance companies engaging in this type of business solved the legal problem by setting up subsidiaries licensed as small loan offices, and charged the usual small loan rate on the unpaid balance (including the original finance charge). Such offices were able to extend small loans that were not connected with refinancing, but their business represented only a minor fraction of the sales finance company's activities. In a sample of 48 national, regional and local companies small loans constituted only 0.5 percent of outstandings at the end of 1937, though for the 40 local companies of this group the proportion ran as high as 6 percent.<sup>2</sup>

Factoring, the discounting of various types of accounts receivable, and the rediscounting of other finance company paper are specialized types of activity in which few sales finance companies engaged. Two large organizations of nationwide scope developed, however, a substantial amount of factoring, and a few companies rediscounted other finance company paper.

The income of personal finance companies consisted almost entirely of interest on loans, except in those jurisdictions where lenders were permitted to make a service charge. In this study both types of charge are regarded as income on loans, and no attempt is made to distinguish between them.

Some personal finance companies received income from interest on bank balances or on investments, but only an insignificant amount. Collections on accounts previously charged off are variously treated in published figures either as income or as a deduction from expenses; they represented about 1 to 3 percent of total income, varying from year to year and from company to company. When, to meet competition from other types of consumer instalment financing agencies, some personal finance companies undertook the

<sup>1</sup> See National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by Wilbur C. Plummer and Ralph A. Young (New York 1940) p. 247.

<sup>2</sup> *Ibid.*, p. 39.

financing of retail instalment sales, commissions on insurance placement constituted a further source of income.

Among industrial banks income from loans constituted, on the average, about 85 to 90 percent of the total, as can be seen from Table 9 (see also Table 12). The importance of other sources of income varied from one institution to another, depending on the degree of diversification of activities: other sources include factoring, interest and dividends on securities, rents from real estate and from safe deposit vaults, insurance commissions, service charges on checking accounts and interest on bank deposits.<sup>3</sup>

In the industrial banking company which limited its lending activities to cash instalment loans, income from loans—including interest, fees and fines—amounted to practically the whole of total earnings. But some industrial banks developed a substantial amount of sales financing, both retail and wholesale,<sup>4</sup> and their income from loans and discounts was likely to be supplemented by insurance commissions.

A good many industrial banks have attempted to diversify their activities, engaging to an increasing extent in a general banking business. Within the last few years, for example, several insured industrial banks have acquired membership in the Federal Reserve System, or have acquired a national bank charter, with a change in name. Whether this diversification of activities has been stimulated by growing competition from commercial banks in the field of consumer instalment loans cannot be determined.

<sup>3</sup> A discussion in considerable detail of the income of industrial banking companies appears in National Bureau of Economic Research (Financial Research Program), *Industrial Banking Companies and Their Credit Practices*, by Raymond J. Saulnier (New York 1940) Chapter 7.

The figures in the present table differ from those in Saulnier (pp. 148-49) for the following reasons: first, they include data on several insured industrial banks that became members of the Federal Reserve System in the later years; second, amounts reported as income from loans have been revised to include investigation and penalty fees, service charges and fines on loans, which had been improperly reported by the banks under other captions; third, recoveries on assets and profits on assets sold or exchanged have been excluded from total income and considered as offsets to gross charge-offs, in order that the figures for total income may be on a basis consistent with the income tax tabulations and with the concept of gross or total earnings from current operations, as reported by insured commercial banks.

<sup>4</sup> In recent years about 10 percent of total loans of industrial loan companies in Indiana have consisted of retail instalment sales contracts, and about 5 percent of real estate mortgage loans. In some insured industrial banks retail instalment paper amounted to as much as 60 percent of total loans on December 31, 1940.

TABLE 9  
 PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF ALL INSURED INDUSTRIAL BANKS,  
 1934-41, BY SOURCE OF INCOME<sup>a</sup>

<i>Source</i>	1934 <sup>b</sup>	1935 <sup>b</sup>	1936	1937	1938	1939	1940	1941
Interest, discount and fees on loans	84.0%	87.2%	89.1%	89.5%	89.7%	88.0%	90.0%	89.5%
Interest and dividends on securities	8.5	5.8	4.3	4.0	3.7	4.0	2.1	2.3
Commissions, fees, service charges	3.7	3.8	4.1	4.4	4.6	5.7	6.3	6.6
Other current operating earnings	3.8	3.2	2.5	2.1	2.0	2.3	1.6	1.6
<b>TOTAL</b>	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	\$7,880,000	\$9,252,000	\$11,484,000	\$13,776,000	\$15,070,000	\$16,515,000	\$18,407,000	\$20,226,000
Number of banks	60	62	63	66	70	73	75	80

<sup>a</sup> Based on data from Federal Deposit Insurance Corporation. Banks that submitted reports covering less than the full year's operations are not included.

<sup>b</sup> Partially estimated, on the basis of corrected figures submitted by the reporting banks for 1936-41.

Such competition has undoubtedly played a part, but it is also true that many business loans originate with successful clients who were formerly consumer-borrowers, or depositors. The expansion of service facilities represents an attempt to satisfy more completely the banking needs of customers. Income from such services—rent for safe deposit facilities, insurance commissions, service charges on checking accounts (chiefly of the no-minimum-balance types)—still accounted for a very small proportion of total earnings in the average industrial bank in 1941, though the proportion rose steadily after 1934. In some of the large urban, insured institutions service income assumed more importance, but even there it rarely exceeded 10 percent of total income.

Income from loans consisted chiefly of interest and discount, although in jurisdictions where statutes permitted, it included also a substantial amount from fees for investigation and other services as well as from penalty fees or fines for late payments. In banks for which data are available such fees represented from 15 to 40 percent of the interest on loans.<sup>5</sup>

In view of the earlier discussion it is not surprising that income from securities represented a small and decreasing proportion of industrial banks' total earnings for the period under review. In 1941 only one insured industrial bank received income from securities amounting to 10 percent or more of total earnings (see Table 12, below).

Among federal credit unions, as can be seen from Table 10, the second most important source of income, after interest on loans, was, in the early years, at least, the entrance fee. The Federal Credit Union Act of June 26, 1934, provides that each member shall "subscribe to at least one share of [the credit union's] stock and pay the initial installment thereon and the entrance fee. . . ." This fee amounts to 25 cents, or 5 percent of the \$5 par value of the first share subscribed, and the total of such fees represented a significant proportion of the total income of all credit unions in the years when expansion was rapid and many new organizations were being formed. But as the number of new credit unions has declined, the

<sup>5</sup> Fees and charges of reporting members of the American Industrial Bankers Association, 1936 and 1937, and of reporting members of the Morris Plan Bankers Association, 1937, aggregated in those years almost 20 percent of interest and discount on loans; see Saulnier, *op. cit.*, p. 151.

TABLE 10  
 PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF REPORTING FEDERAL CREDIT UNIONS,  
 1935-41, BY SOURCE OF INCOME<sup>a</sup>

<i>Source</i>	<i>1935</i>	<i>1936</i>	<i>1937</i>	<i>1938</i>	<i>1939</i>	<i>1940</i>	<i>1941</i>
Interest on loans	67.6%	85.8%	91.9%	93.6%	93.7%	93.1%	95.8%
Entrance fees and fines <sup>b</sup>	29.0	12.1	6.6	4.7	3.9	3.0	..
Income from investments	3.4	2.1	1.5	1.7	1.6	2.7	3.4
Other income							
<b>TOTAL</b>	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	\$112,000	\$555,000	\$1,399,000	\$2,261,000	\$3,570,000	\$5,422,000	\$7,293,000
Number of credit unions	762	1,701	2,276	2,753	3,172	3,715	4,144

<sup>a</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts.

<sup>b</sup> In 1938 and subsequent years this item—which is used to augment a reserve for bad loans—was not regarded in the source reports as a part of income. It is here so regarded, however, from 1935 to 1940; in 1941 the amount of this item was not published and it is therefore necessarily excluded; it probably did not exceed 2 percent of total income.



income from fees has also fallen off in relation to the aggregate total.<sup>6</sup>

The Federal Credit Union Act also specifies that a credit union may "fine members, in accordance with the by-laws, for failure to meet promptly their obligations to the Federal credit union." In accordance with the practice followed in this study with regard to industrial and commercial banks, such fines are considered as a portion of income from loans. Although in the published reports fines are not segregated from entrance fees their amount appears to have been nominal.

Investments permitted to federal credit unions are limited to those whose anticipated rate of return is materially lower than that on loans to members. Income from investments, while still only a small proportion of total income in 1941, increased considerably from 1938 to 1941, and may be expected to rise even more sharply as credit unions continue to invest all available funds in United States government securities.

With the rise in prices of government securities in recent years some federal credit unions may have received a significant proportion of total income from profits on securities sold; in the aggregate, however, this item has probably been unimportant. In Massachusetts, where credit unions operating under State charter have been permitted to invest in real estate mortgages, these investments have reached sizeable proportions in relation to total loans. The income they produce has not been segregated in reports of the State Superintendent of Banking from income on other loans.

In sources of income, as in distribution of assets, commercial banks differ markedly, in the aggregate, from the specialized agen-

<sup>6</sup>The entire amount of such entrance fees, as well as all fines and 20 percent of the net earnings of each year, must be segregated for the establishment of and addition to "a reserve fund against possible bad loans." This fund is directly analogous to the surplus frequently paid in at the organization of corporations, and to the surplus provided for in the organization of national banks. It is debatable, therefore, whether the entrance fees should be considered a portion of total income. Before 1938 they were so treated in reports published by the Farm Credit Administration; from 1938 through 1940 the amount of fees and fines transferred to the reserve for bad loans was reported as a memorandum to the operating statement, rather than as a part of total income; for 1941 the amount of fines and fees was not reported. For the purpose of this volume, both fees and fines have been treated as a part of total income, and the transfer to the "reserve" is regarded as an allocation of net profits, rather than as an expense.

TABLE 11  
 PERCENTAGE DISTRIBUTION OF TOTAL INCOME OF ALL INSURED COMMERCIAL BANKS,  
 1934-41, BY SOURCE OF INCOME\* (dollar figures in millions)

Source	1934	1935	1936	1937	1938	1939	1940	1941
Interest and discount on loans	45.5%	43.3%	42.3%	43.5%	44.5%	45.3%	47.1%	49.0%
Interest and dividends on securities	36.2	36.9	36.7	35.0	33.6	32.5	30.7	29.4
Commissions, fees, service charges	5.0	6.0	6.7	6.8	7.3	7.6	7.9	8.1
Other current operating earnings	13.3	13.8	14.3	14.7	14.6	14.6	14.3	13.5
TOTAL	100.0% \$1,518	100.0% \$1,486	100.0% \$1,567	100.0% \$1,634	100.0% \$1,584	100.0% \$1,606	100.0% \$1,631	100.0% \$1,730
Number of banks	14,137	14,123	13,969	13,795	13,657	13,534	13,438	13,427

\* Based on Federal Deposit Insurance Corporation, *Annual Report for 1941*, p. 158. Cash depositories and banks designated in this study as insured industrial banks are included.

cies.<sup>7</sup> Table 11 shows that income from loans, which had represented more than 60 percent of the total income of commercial banks in the late 1920's, dropped as low as 42 percent in the years after the depression, and in 1941 represented only 49 percent. Throughout most of the 1930's interest and dividends on securities constituted about 35 percent of total income, the proportion declining after 1938 as holdings of low-rate United States government securities increased.

Among other sources of commercial banks' income that gradually increased in importance during the period under review, service charges on deposit accounts have become the most significant, although a decade ago they probably represented less than 1 percent of total income. Trust department income, rent from real estate and from safe deposit facilities, collection charges, insurance commissions and fees account for practically all other forms of income from current operations.<sup>8</sup>

For commercial banks, however, aggregate ratios for the various sources of income are strongly influenced by the fact that in the large banks in large centers income from loans represents a particularly low proportion of total income. Actually, most banks have a higher figure for this item than is indicated in the table. If the average is taken from the ratios of individual banks, rather than from the aggregate amounts, thus eliminating the weight of the large banks, the figure for average income from loans in 1941 becomes 62 rather than 49 percent.<sup>9</sup>

In more than three-fourths of the insured commercial banks in the country (see Table 12) income from loans in 1941 represented 50 percent or more of total income, and in more than one-third of them such income amounted to 70 percent or more. Conversely, despite the fact that the average figure for income from interest and dividends on securities was about 30 percent, somewhat more than half of these banks derived less than 20 percent of total income in 1941 from these sources and three-fourths of them received less than the average.<sup>10</sup>

<sup>7</sup> The distribution of the sources of income of all national banks, 1917-37, in percent of gross current operating earnings, is presented in *Annual Report* for 1938 of the Comptroller of the Currency, pp. 100 ff.

<sup>8</sup> The proportion of total income derived from consumer instalment loans is not known.

<sup>9</sup> See also footnote 9, Chapter 3.

<sup>10</sup> About 70 banks, or 1 in 200, obtained more than 50 percent of their total income from sources other than loans and securities in 1940. These include banks with a

In the years for which data are available, small banks consistently received a higher percentage of their income in the form of interest on loans. This inverse relationship to size of bank was found to be characteristic, irrespective of the size of the banking center or the geographic location. The consistently higher proportions shown by smaller banks reflect their greater utilization of available funds

TABLE 12

PERCENTAGE DISTRIBUTION OF LOANS AND SECURITIES OF INSURED COMMERCIAL AND INDUSTRIAL BANKS, 1941, BY PERCENT OF TOTAL INCOME DERIVED FROM LOANS AND SECURITIES<sup>a</sup>

Income on Loans or Securities in Percent of Total Income <sup>b</sup>	Commercial Banks		Industrial Banks	
	Loans	Securities	Loans	Securities
Less than 10%	.1%	25.3%	..	98.8%
10-20	.9	29.7	..	1.2
20-30	3.0	20.6	..	..
30-40	7.1	12.4	..	..
40-50	12.7	6.8	..	..
50-60	18.5	3.2	1.2%	..
60-70	23.4	1.4	..	..
70-80	21.5	.5	3.7	..
80-90	10.7	.1	23.8	..
90-100	2.1	..	68.8	..
100	.0	..	2.5	..
ALL BANKS	100.0%	100.0%	100.0%	100.0%
Number of Banks	13,220		80	

<sup>a</sup> Based on data from Federal Deposit Insurance Corporation. Cash depositories and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included.

<sup>b</sup> Each level is inclusive of the lower limit and exclusive of the upper.

(discussed in the preceding chapter), and also their higher rate of income on loans.

Commercial banks' income from loans, in relation to total income, appears to have been much less closely related to size of center than to size of bank. True, banks in the smaller centers showed higher proportions, but for banks of the same size the proportion

large proportion of trust activities, a few institutions with substantial income from title departments, and others whose activities consist chiefly of the encashment of checks. The heterogeneity of the concept "commercial bank" appears from the definition of the term as used in banking statistics: see *Annual Report of the FDIC for 1941*, pp. 89-90.

varied little, showing no consistent decrease as the size of the center increased. To this there was one noteworthy exception: among banks with deposits of \$500,000 or less, those located in the very large centers showed a smaller loan income proportion than banks of the same size elsewhere. This may indicate that metropolitan banks have been better able to diversify their activities than banks of the same size in smaller centers.

The proportion of total income received from loans showed some geographic variation. In the south and west both the smaller and the larger banks showed higher proportions than did banks of the same size in the east and north.<sup>11</sup> Here, too, a contributory reason was a fuller utilization of lendable funds and, in particular, higher effective rates: among banks with the same percentages of loans those in the south and west showed higher average rates of income on them than did banks in other areas. Moreover, in the older, more stable eastern and northern sections more banks had developed supplementary activities, such as real estate, trust, insurance, foreign and title departments, which contribute to total income—activities less fully developed by banks of comparable size in the south and west, further removed from the money markets.

#### RATES OF INCOME ON LOANS

The best obtainable measure of the effective use of loan funds,<sup>12</sup> and of the average rate of charge borne by customers, is provided by computing income in percent of average or year-end outstanding loans. Such a measure must necessarily include, as a part of income, all fees or charges incident to the extension or collection of loans.

The rate of income from loans in percent of average or year-end outstanding loans has been used for commercial banks (average loans), insured industrial banks<sup>13</sup> (average loans) and federal credit unions (year-end loans), the only institutions for which it is readily available. The rate represented by total income in percent of aver-

<sup>11</sup> Among banks of intermediate size—those with deposits between \$500,000 and \$5,000,000—geographic location did not appear to make so great a difference.

<sup>12</sup> The best measure of an institution's use of all funds at its command is total income in percent of total assets. This measure would be most useful in comparing the various types of consumer instalment financing agencies with one another, but it would be unsatisfactory in comparing them with commercial banks, since the latter, as a result of their monetary function, are not able to invest so large a proportion of their resources in productive assets; compare Table 13 and Appendix Table B-6.

<sup>13</sup> For these institutions the amount of loans used as the base is net after deduction of deposits accumulated for loan repayments.

age or year-end outstanding loans has been used as the best available substitute for companies in the income tax sample (year-end loans) and for those in the National Credit Office samples (average loans).<sup>14</sup> Neither, however, provides a perfect measure of the rate of charge on loans, for both show the average rate *collected* rather than the average rate *charged*.<sup>15</sup> Moreover, they show the average rate collected on *all* paper acquired, weighted by the amount of paper at each rate, rather than the rate on any one class of loan. In the following pages no distinction will be made between these measures, and both will be referred to as loan-income rates.

### *Comparison of Averages*

Significant differences in the rates of income on loans are shown in Table 13, which presents averages for the various types of agencies and the various samples over the period 1929-41.<sup>16</sup> Although the averages shown by commercial banks were materially lower than those for consumer instalment financing agencies the rates of some of the individual banks approached those characteristic of the specialized institutions.

Among the specialized agencies sales finance companies showed the most marked decline in loan-income rate during the period. Local sales finance companies reported an average rate of 20 to 24 percent in 1929 and a rate of 16 percent in 1941; rates of the larger companies fell off relatively as much or more. The decline, after 1934, should probably be attributed in part to voluntary rate reductions following the favorable loss experience of the depression, but primarily to reductions following the increase in competition as in-

<sup>14</sup> It is not likely that this procedure results in any significant overstatement, since income from loans constitutes the overwhelming proportion of total income in the consumer instalment financing companies. In the National Credit Office samples, however, this rate may not be so accurate, for figures of some of the companies are based on published statements, which were probably not prepared in an entirely consistent manner from year to year.

<sup>15</sup> The average of charges collected to charges earned varies greatly from state to state and from year to year, with depression and prosperity. The average for all reporting personal finance licensees in selected states (from 2 to 19 in various years) ranged during 1929-36 from 81 to 98 percent. For individual companies the variation would be materially greater. See M. R. Neifeld, *Personal Finance Comes of Age* (New York 1939) p. 224.

<sup>16</sup> In the income tax tabulations—in contrast to the probable practice in the National Credit Office samples—bad-debt recoveries were deducted from bad-debt expense; whenever the former exceeded the latter the excess was treated as a negative expense item, not as a portion of total income.

TABLE 13  
 LOAN-INCOME RATES OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING  
 AGENCIES AND COMMERCIAL BANKS, 1929-41<sup>a</sup>

Sample	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>b</sup>	17.7%	15.3%	14.6%	14.6%	16.6%	17.6%	14.9%	13.3%	12.0%	10.7%	11.0%	9.9%	10.2%
2 to 4 regional <sup>b</sup>	17.3	17.1	17.2	16.7	18.4	20.5	19.5	17.7	15.6	12.8	14.4	12.7	11.6
9 to 32 local <sup>b</sup>	24.0	20.7	21.0	18.7	20.1	21.2	20.8	18.9	18.2	15.6	17.2	16.2	16.0
202 local <sup>c</sup>	19.6	..	..	..	18.7	..	..	16.4	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>d</sup>	..	32.6	32.8	33.4	35.0	34.7	34.0	33.2	33.8	31.8	32.0	31.1	30.5
2 to 5 regional <sup>d</sup>	37.2	35.5	29.1	35.6	33.2	35.5	36.7	36.5	35.5	33.4	32.1	32.5	33.2
5 to 7 local <sup>d</sup>	..	..	..	..	..	32.1	34.0	33.7	31.7	29.4	30.7	32.5	31.5
153 local <sup>e</sup>	25.5	..	..	..	26.0	..	..	26.7	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>g</sup>	15.5	..	..	..	13.7	..	..	15.2	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>e</sup>	10.4	..	..	..	10.4	..	..	10.3	..	..	..	..	..
6 largest insured <sup>o</sup>	..	..	..	..	..	11.5	9.4	10.4	10.7	11.1	10.5	10.0	9.4
All other insured <sup>e</sup>	..	..	..	..	..	12.5	12.0	13.0	12.8	12.5	12.3	11.8	11.3
37 insured <sup>d</sup>	10.0	..	..	..	10.1	..	..	9.3	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>f</sup>	..	..	..	..	..	..	4.1	6.5	8.2	8.9	8.8	9.0	10.1
<i>Commercial banks</i>													
All natl. banks (loans) <sup>g</sup>	6.1	5.6	5.2	5.3	4.8	4.7	4.6	4.5	4.4	4.4	4.5	4.4	4.2
All insured banks (loans) <sup>o</sup>	..	..	..	..	..	4.6	4.4	4.3	4.3	4.4	4.5	4.4	4.3
All natl. banks (securities) <sup>h</sup>	4.5	4.6	4.2	4.1	3.6	3.4	2.9	2.7	2.7	2.6	2.4	2.2	2.0
All insured banks (securities) <sup>i</sup>	..	..	..	..	..	3.2	2.9	2.7	2.7	2.6	2.4	2.2	2.0

(footnotes on opposite page)

dustrial and commercial banks expanded their activities in this field.<sup>17</sup>

In almost every year national and regional sales finance companies showed lower income rates than the locals, the nationals showing the lowest. These differences, reflecting differences in character of business, are indicative of the larger proportion of low-rate wholesale paper acquired by the larger companies.<sup>18</sup>

Highest in average loan-income rate was the personal finance group. The companies in the income tax tabulation, 1929, 1933 and

<sup>17</sup> A portion of the drop since 1938 may be attributed to a change in operating practices: at that time many sales finance companies lowered their discount rates and discontinued rebates to dealers subsequent to collections.

<sup>18</sup> The lower rates shown for the local sales finance companies in the income tax sample than for the local companies in the National Credit Office sample in 1929, 1933 and 1936 probably resulted from the use of year-end loans as the base in the income tax sample rather than average loans, as in the National Credit Office sample. In all three years year-end outstandings were higher than the average for the year.

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FOOTNOTES TO TABLE 13

<sup>a</sup> Except where otherwise indicated the figures represent total income (which is, except in commercial banks, composed predominantly of loan income) in percent of average or year-end loans outstanding. The number of companies for each year may be found in Appendix Table B-1.

<sup>b</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income. Here the denominator is the average of loans outstanding at beginning and end of year.

<sup>c</sup> Based on tabulations prepared by the Income Tax Study. The figures represent total income in percent of year-end loans outstanding.

<sup>d</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income. Here the denominator is the average of loans outstanding at beginning and end of year.

<sup>e</sup> Based on data from Federal Deposit Insurance Corporation. The figures represent income on loans only (not total income) in percent of average of loans outstanding at beginning, middle and end of year, except for industrial banks in 1934 and 1935, when year-end loans outstanding are used; deposits accumulated for the repayment of loans have been deducted from total loans of industrial banks. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

<sup>f</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts. The figures represent income on loans only (not total income) in percent of year-end loans outstanding.

<sup>g</sup> Based on data in Annual Reports of the Comptroller of the Currency. The figures represent income on loans only (not total income) in percent of average of loans outstanding on call dates during the year.

<sup>h</sup> Income on securities in percent of average of securities held on call dates during the year. For source see footnote g above.

<sup>i</sup> Income on securities in percent of average of securities held at beginning, middle and end of year. For source see footnote e above.



1936, reported an average rate of about 26 percent,<sup>19</sup> and the smaller group of national, regional and local companies in the National Credit Office sample indicated considerably higher rates. In part the latter are due to a definitional difference, for among the majority of companies in the smaller samples, "total income" probably included recoveries on assets previously charged off—an item which was significant after the depression and was treated as a deduction from expenses in the income tax data.

The difference thus produced between the two sets of data is much smaller, however, than the differences between one company and another in the income tax sample, and therefore the two sets of samples may be considered fully corroborative. While fluctuations appear in the rates shown for the samples of personal finance companies, only a minor downward tendency can be discerned from data covering the last decade.<sup>20</sup>

For non-investment type industrial banking companies included in the income tax sample average total income in percent of year-end loans outstanding was lower than for either personal finance or sales finance companies, but higher than that for the other industrial banking companies. Its fall from 1929 to 1933 was probably due to collection delinquencies, for its former level was regained in 1936.

Over the same period noninsured investment type industrial banking companies included in the income tax sample maintained a notably stable loan-income rate, but the insured companies experienced a slight drop. Data for 1934-41 on the six largest insured industrial banks, and on all other banks in this class, reveal a downward tendency after 1938, indicative of the expansion of lending activities to include more non-consumer loans as a result of competition from commercial banks.

Federal credit unions are permitted to charge interest on loans at an effective rate not exceeding 1 percent a month. Actually, the average effective rate reported rose from 8.2 percent in 1937 to 10.1

<sup>19</sup> The use of a higher-than-average year-end base of outstanding loans in 1929 and 1936 results in an understatement of the loan-income rates for the personal finance companies in the income tax sample. See Appendix Table A-2.

<sup>20</sup> Neifeld, *op. cit.*, p. 220, presents a table showing gross earnings of personal finance companies, in percent of total assets, by states, for 1929-36; these, too, show no consistent tendency, nor do figures supplied to me by Mr. Neifeld for the years 1937-40.

percent in 1941.<sup>21</sup> These rates are comparable to, or lower than, those received by commercial banks and insured industrial banks on consumer instalment paper. The low credit unions' rates may be attributed chiefly to low investigation and collection expenses, resulting from their cooperative character. Since the handling of small loans generally entails high costs per dollar it is significant that the average size of all federal credit union loans since their organization has been \$108<sup>22</sup>—an amount no larger than the average loan of personal finance companies and materially below the average consumer loan of industrial and commercial banks.

From 1929 through 1933 the loan-income rate received by commercial banks dropped rapidly, but after 1934 showed only minor fluctuations. On the other hand, income from securities (in relation to average securities holdings) continued to decline from year to year, until in 1941 it was less than half the loan-income rate as against three-quarters of it in 1929.

After 1934 the loan-income rate of all insured commercial banks was scarcely more than one-third the rate of all insured industrial banks, and approximately one-seventh the rate of personal finance companies. The lower average for commercial banks is due in large part to their high proportion of large commercial loans, commercial paper, bankers' acceptances and FHA Title II insured mortgage loans—on all of which the rate of charge is materially less than on consumer instalment paper.

### *Variation Among Individual Companies*

Average loan-income rates, while significant for general comparisons, give no indication of the wide variation from one company to another within each type of institution. To a slight degree this variation may result from differences in geographic location, but in gen-

<sup>21</sup> The materially lower rates shown in Table 13 for 1935 and 1936 result from the facts that year-end loans were used as the base in computing the average; that loan volume was expanding rapidly during this period as the number of credit unions grew; and that for a great many of the reporting institutions the amount of interest included probably represented income for only part of the year. These influences were probably also operative, to some extent, in later years.

Francis E. Wilcox, in *A Statistical Study of Credit Unions in New York* (Chicago 1940) Table 20, p. 54, shows that interest rates charged borrowing members of state-chartered credit unions in New York State, 1937, ranged from  $\frac{1}{4}$  percent to 1 percent per month. Although a discount rate of 6 percent per annum in advance (equivalent to 0.97 percent per month on an actuarial basis) was the most common rate charged, 67 of 148 credit unions reported lower rates.

<sup>22</sup> U. S. Farm Credit Administration, *Ninth Annual Report* (Washington 1942) p. 135.

eral it indicates that the companies in any one type of agency have, despite their similarity of function, engaged to a greater or lesser degree in other specialized activities which affected their rates of income.<sup>23</sup>

Chart VIII indicates for 1936 (1938 for commercial banks) the percentages of companies in various types of agencies which reported five different levels of loan-income rate.<sup>24</sup> Though the rates of individual companies showed marked shifts from 1929 to 1933 and also, though less notably, from 1929 to 1936, there was no discernible trend in the percentage reporting different rates. The movement was toward the middle, and away from both the high and low rates, except among the investment type industrial banking companies: between 45 and 70 percent of the companies reporting high rates in 1929 reported lower rates in 1933 and 1936; and conversely, a substantial percentage of those reporting low rates in 1929 reported higher rates in 1933 and 1936.

A majority of the personal finance companies—nearly two-thirds—reported rates of 16 to 32 percent in 1936. The distribution of companies was such that two-thirds also fell in the 20 to 40 percent rate group.<sup>25</sup> There was a tendency for the larger companies to show a higher rate than the smaller companies but it was not pronounced.

For a personal finance company the rate represented by total income in percent of year-end loans outstanding reflects closely the rate of charge on loans, since practically the entire income of a company engaged solely in the small loan business is derived from interest on loans. Moreover, since seasonal fluctuation in personal finance company outstandings is slight (in contrast to new credits and repayments), it may be presumed that the rate base used here—outstanding loans at a single date, December 31—achieves a reasonably satisfactory approximation of the rate that would be derived by using as base the average of loans outstanding throughout the year.<sup>26</sup>

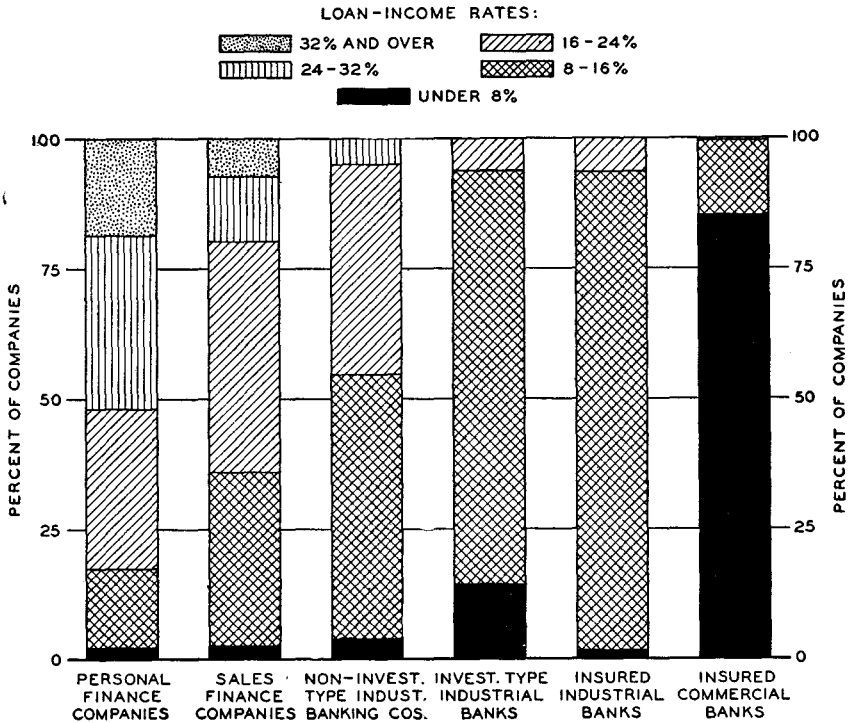
<sup>23</sup> The extent to which ability or inability to collect charges "earned" affects the rates of individual companies cannot be determined; in a small proportion of cases this may be substantial. See footnote 15, above.

<sup>24</sup> No data are available on the loan-income rates of individual credit unions.

<sup>25</sup> Averages covering all licensees, by states, show a substantial degree of geographic variation. See Russell Sage Foundation, *Regulation of the Small Loan Business*, by Louis N. Robinson and Rolf Nugent (New York 1935) pp. 240-41.

<sup>26</sup> A slight distortion does result, however, from the growth trend in personal finance company outstandings during this period; at the end of 1936 outstandings were 7.6 percent higher than the average of month-end figures. See Appendix A.

CHART VIII  
 LOAN-INCOME RATES OF CONSUMER INSTALMENT FINANCING  
 AGENCIES AND COMMERCIAL BANKS, 1936<sup>a</sup>



<sup>a</sup> Represents percentage distribution of companies, arranged according to loan-income rates. For personal finance, sales finance and non-investment type industrial banking companies, and for investment type industrial banks, based on tabulations prepared by the Income Tax Study; in regard to these agencies loan-income rates represent total income (composed predominantly of loan-income) in percent of total year-end loans outstanding. For insured industrial and commercial banks, based on data from Federal Deposit Insurance Corporation, pertaining to the year 1938 for commercial banks. In regard to insured banks loan-income rates represent income on loans in percent of average loans outstanding, net after deduction of hypothecated deposits for insured industrial banks. In regard to insured banks that were members of the Federal Reserve System, loans are averages of figures for ca'l dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included with insured commercial banks. Each rate group is inclusive of the lower limit and exclusive of the upper.

Both the 27 percent average for the entire personal finance group (income tax sample) and the rates reported by the majority of individual companies were materially less than the maximum permitted licensed small loan companies in most states. One reason is that some companies charge less than the legal maximum on all paper, and most companies charge less than the maximum on some paper.

The difference in rates on individual loans corresponds to differences in size of loan, in type of security, in liberality of loan and collection policy or in size and frequency of repayments. Furthermore, charges collected are always less than charges "earned," the proportion of charges "earned but not collected" being materially higher in a year like 1933 than in one like 1929 or 1936.<sup>27</sup> M. R. Neifeld's data for licensees in those states in which the permitted monthly maximum was 3.5 percent show that between 1929 and 1936 the average rate collected ranged between 2.35 and 2.99 percent.<sup>28</sup>

About one-sixth of the personal finance companies, those with assets of \$250,000 or less, reported loan-income rates of less than 16 percent. This return—low for personal finance companies—may indicate improper classification of the companies concerned; temporary investments in retail paper; specialization in low-rate business;<sup>29</sup> or a competitive situation that tended to obliterate the distinction between personal finance and industrial banking companies. This last probably existed in Pennsylvania, where a large number of personal finance companies showed relatively low average rates of return.

Nearly half of the sales finance companies covered in Chart VIII reported rates ranging from 16 to 24 percent; about one-fifth reported rates higher than 24 percent, and some even higher than 32 percent. The largest companies showed a slight tendency toward a lower rate.

<sup>27</sup> See footnote 15, above.

<sup>28</sup> Neifeld, *op. cit.*, p. 225.

<sup>29</sup> Comaker and other endorsed loans tend to carry lower rates than loans secured by chattels; also, loans to specific classes of borrowers (teachers, for example) are often made at preferential rates. The extent to which unsecured and various types of secured loans were extended by personal finance licensees in 16 selected states, in 1937, is shown in National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (New York 1940) p. 50; the use of preferential rates to attract preferred risks, and the extent to which loss data appear to justify special rates to teachers, are there discussed on pp. 68 and 92-95, respectively.

For sales finance companies, total income in relation to year-end loans outstanding represents, on the whole, a certain overstatement of the average effective rate of charge on retail instalment paper, for practically all of these companies reported some income from insurance activities.

The variation in rates from one company to another arises from variations in insurance income, but partly also from differences in charges on comparable types of sales finance paper, in the relative amounts of wholesale (low-rate) and retail (higher-rate) paper, and in the proportion of business involving used as contrasted with new articles.

Some companies were undoubtedly affected by seasonal fluctuations in the dominant industry of the community. In such cases loans outstanding on December 31 might grossly understate or overstate the average for the year, and thus exaggerate or minimize the rate of income. Had average holdings throughout the year been available they would have provided a more accurate measure of rates.

Possibly some of the companies that reported particularly high rates were improperly classified, and were actually predominantly engaged in the extension of small cash loans. Probably, however, a good many of them had large proportions of high-rate business, such as the financing of second-hand commodities, chiefly automobiles. They may also have made a practice of rediscounting their loans with other institutions or selling them on a non-recourse basis.<sup>30</sup> If figures on the total amount of paper handled by sales finance companies during the year had been available, it would have been possible to determine to what extent the reported rates resulted from rediscounting.

Very few of the non-investment type industrial banking companies in Chart VIII showed loan-income rates of less than 8 or more than 24 percent. Over half reported rates of 8 to 16 percent, and about two-fifths reported rates of 16 to 24 percent—proportions fairly characteristic of all three years covered by the income tax sample. A substantial number of non-investment type industrial

<sup>30</sup> In regard to paper sold on a non-recourse basis the usual accounting procedure is to eliminate the loans from the balance sheet; the result is a correspondingly lower denominator for the computation of the rate. If the paper were rediscounted, and the asset removed from the books, the same result would follow. In regard to rediscounted paper, however, or paper sold on a recourse basis, it is considered more correct accounting procedure not to remove the asset from the books.

banking companies were qualified to operate under small loan laws, and it is probable that the companies showing the higher rates of return were engaged in a combination type of business, their activities overlapping to a considerable extent with those of personal finance companies.

Four-fifths of the investment type industrial banks in the income tax sample showed rates between 8 and 16 percent, with some tendency toward a lower rate among the largest companies. Even if correction were made for hypothecated deposits the proportion of banks in the intermediate rate group would not be materially affected, though there would be more banks with rates of 16 to 24 percent and fewer with rates under 8 percent.

In 1936, as shown in Chart VIII, over nine-tenths of the insured industrial banks showed loan-income rates of 8 to 16 percent (income from loans in percent of average loans, net after deduction of hypothecated deposits). Further data show that from 70 to 85 percent of these banks received rates of 10 to 14 percent during the period 1936-41, with a tendency for fewer banks to receive higher rates and more banks to receive lower rates in later years.

Banks located in centers of over 100,000 population tended to have lower-than-average loan-income rates, those in New York and Chicago showing averages slightly below the rates in other large centers. The six largest insured industrial banks, however, regardless of location, showed a lower average than all industrial banks in New York and Chicago. These and other findings are evidence of a tendency among the insured industrial banks faced with active competition from commercial banks or with a surplus of lendable funds, to increase the proportion of non-consumer loans bearing lower rates than consumer loans.<sup>31</sup>

Table 13 shows the average loan-income rate of all insured commercial banks to have been about 4½ percent during the years 1934-41. From Chart VIII it is evident that nearly seven-eighths of these banks had rates of less than 8 percent in 1938, practically all of the remainder having rates of less than 16 percent; supplementary data show that well over nine-tenths of the banks had rates ranging from 4 to 10 percent.

<sup>31</sup> Among the industrial banks whose loan-income rate was less than 10 percent in 1941 non-consumer loans averaged 35 percent of total loans at the end of that year; among the banks whose rate was more than 14 percent such loans averaged 6.1 percent of the total.

A commercial bank's effective rate of income on loans depends on the character and average size of the loans it extends, and on the amount and character of its charges. These in turn are influenced by a number of factors, the chief measurable ones on which data are available<sup>32</sup> being the size of the bank, the size of the center in which the bank is situated, the geographic location, and the proportion of loans in the form of consumer instalment paper.<sup>33</sup>

These factors operate, of course, in widely differing combinations, as is indicated by the fact that there were some banks during 1938-41 that received rates far outside the characteristic span—ranging from less than 2 to more than 20 percent. But on the whole there was a high degree of stability in commercial banks' loan-income rates. Their distribution according to this factor was almost identical in the four years 1938-41 and, significantly, there was very little variation from year to year in the average rate received by any one bank.<sup>34</sup> This consistency indicates that while the relative weights of factors that influence rates may differ widely from one bank to another, they change very little in a given bank.<sup>35</sup>

Available data indicate a strong relationship between size of bank and effective rate of income on loans: the larger the bank the lower the rate. Since there is a strong association between size of bank and size of center it is not surprising to find also, in general, that the larger the center the lower the rate.

Rates of income on loans, however, appeared to vary more with changes in size of bank than with any other measurable variable:<sup>36</sup> the rate tended to decline as size of bank increased, irrespective of the size of center,<sup>37</sup> but there was no conclusive relationship between

<sup>32</sup> For example, the relative volume of small loans, chiefly to consumers, which are not repaid in regular instalments has a significant effect, but no data are available on this factor.

<sup>33</sup> For distributions of insured commercial banks (including those designated in this study as insured industrial banks) by loan-income rate and size of bank, and by loan-income rate and size of center, 1941, see *Annual Report of the FDIC for 1941*, p. 171.

<sup>34</sup> Over two-thirds of the banks showed less than 1 percent change in effective rate from year to year during 1938-40.

<sup>35</sup> The principal variable that may cause relatively abrupt changes in any one bank's loan-income rate is the proportion of business represented by consumer loans; in some banks this proportion grew rapidly over the last few years of the period.

<sup>36</sup> As was shown in Chapter 3, this was true also in regard to the proportion of total assets in the form of loans.

<sup>37</sup> The exceptions occur principally where the number of banks is too small to provide a reliable average.



size of center and loan-income rates, once the influence of size of bank was eliminated. As size of center increased there was apparent some tendency for loan-income rates to rise in smaller banks and to decline in larger banks, but this was not so clear-cut as the decline in rates in any one center as bank size increased.

Differences among banks of different size, and among banks in centers of different size, have in recent years been due largely to differences in the average size of loans, in turn reflecting the average size of the customer concerns.<sup>38</sup> There is a high correlation between size of bank and the size of concerns with which the major portion of the bank's lending business is regularly transacted.

As a rule the largest concerns in an area tend to deal with the largest banks (even though these banks may lend also to a great many smaller concerns).<sup>39</sup> Smaller banks likewise tend to deal with smaller concerns for the major portion of their non-consumer loan business, and so on down. This procedure is dictated by statutory as well as sound business limitations on the proportion of resources an individual bank may extend in the form of a loan to a single customer.

The size of the banking center also delimits the size of a bank's loans. Large concerns, which may be big borrowers, are generally located in large towns. Thus, in so far as it reflects the size of the concerns with which a bank may deal, the size of the center may influence the average rate of income on loans.

Large loans made to large concerns are generally made at lower rates than small ones.<sup>40</sup> Therefore, a bank with a preponderance of large loans extended at lower rates will show a low average, even

<sup>38</sup> The average rate of income on loans is also dependent on the proportion of business conducted with "non-customers." Such business consists of special types of so-called low-risk paper which is included in, and reported as part of, the loan category; for example, bankers' acceptances, commercial paper and crop storage loans made in cooperation with the Commodity Credit Corporation. The rates on commercial paper are influenced to some extent by the size of the total loan to the borrower even though more than one creditor participates in that loan.

<sup>39</sup> A survey of commercial loans made by member banks from April 16, 1942, to May 15, 1942, reveals that the bulk of the loans of central reserve city banks, by dollar volume, was to borrowers with assets of more than \$500,000; most of those of reserve city banks were to borrowers with assets of from \$50,000 to 5 million dollars; while in the country banks, over three-fourths of all loans were to borrowers with assets of less than \$500,000. See *Federal Reserve Bulletin* (August 1942) p. 772.

<sup>40</sup> These low rates are due partly to competitive forces and partly to the lower expense involved in the extension of larger loans. Also, in the analysis of risk factors there has probably been a tendency to confuse size of concern and proportion of equity. In this discussion, though emphasis is placed on other factors, it is recognized that rates are usually graduated to the anticipated risk on individual loans.

though the bank extends some small loans at higher rates. Conversely, a bank that has a majority of small loans exhibits a high average rate, even though it handles some larger loans at low rates.

There are no data for all insured commercial banks either on the number of loans held at any one time, or on their average size.<sup>41</sup> In lieu thereof, the average rate of income on loans may be regarded as an indication of the principal type of lending business undertaken by any one bank.

Geographic factors also bear an important relationship to rates of income. Rates follow broad geographic patterns, tending away from a low level in the older, more developed, industrial and financial centers of the north and east to a high level in the agricultural and more recently developed communities of the south and west. This distinct geographic pattern is evident whether banks are grouped according to regions or according to states. The divergence reflects differences in stage of economic development; differences in custom and accepted practices, interrelated in turn with the maximum rate of interest allowed by law; actual or generally accepted differences in risk among communities of differing economic characteristics.<sup>42</sup>

<sup>41</sup> Since this study was prepared a survey has appeared by G. L. Bach (*Federal Reserve Bulletin*, November 1942, pp. 1089-97), which is substantially in agreement with this analysis. Bach's survey covered all commercial loans (in excess of \$1000, \$2500 and \$5000, respectively, in banks of varying size) made by member banks between April 16, 1942, and May 15, 1942, and disclosed the following pertinent facts:

A strong relationship existed between size of borrower and rate of charge—companies with assets over 5 million dollars paid, on the average, rates that were only about one-third of those paid by borrowers with assets of \$50,000 or less;

Since large firms generally borrowed much larger amounts than did small ones, the relationship between size of borrower and rate of charge was probably equally indicative of a relationship between size of loan and rate of charge;

Geographic differences in rates reflected largely a varying size distribution of borrowers, or of loans, since borrowers of like size generally paid closely similar rates, regardless of industry or geographic location;

Consistent differentials in rates paid by borrowers in various industries indicated that difference in industry accounts for part of the geographic variation in reported rates;

Smaller banks, on the average, charged somewhat higher rates than did large banks to borrowers of comparable size, but this difference might have disappeared if a larger number of size groups for borrowers had been used. Bach concludes that, "using size as one possible measure of the credit standing of borrowers, it appears, therefore, that differences of this nature were perhaps the major factor accounting for the wide differentials in rates paid on different commercial loans" (p. 1090).

<sup>42</sup> Though any one state or geographic region may consist predominantly of agricultural, industrial, trading or mining communities, many states are composed of widely varying types of communities. No other, more satisfactory, units are readily available, however, for measuring differences in economic characteristics.

When the average rates of income on bank loans are arranged by size and by states and geographic areas, both geographic and size differences persist.<sup>43</sup> There is almost as much variation in rates from one state or area to another, among banks of the same size, as there is from one bank-size group to another within the same state or area. The difference in rates between states and areas tends to be less among the larger banks than among the smaller ones, and reflects the wider choice of credit sources available to larger borrowers.

The higher-than-average geographic differences among the small banks are readily understandable. Located predominantly in small centers, presumably in agricultural areas, these banks are relatively far from the easy money centers; and since a large proportion of their loans are made at the maximum rate, their averages tend to depend, in large part, upon variations in the maximum legal rates of interest in the various states.<sup>44</sup>

In some small communities, however, the average rate of income from loans is unduly depressed, because the banks acquire commercial paper when there is a lack of demand for loans in the immediate community; and even a relatively small amount of commercial paper sharply affects a small bank's average rate of income on loans.

One reason for the lack of a demonstrable relationship between commercial banks' loan-income rates and their relative holdings of consumer instalment paper is the anomalous character of some of their loans, particularly those of small banks. In the preceding chapter it was noted that a group of small banks attributed their higher-than-average rate of income on loans to the fact that they held a high proportion of small loans. While such loans are similar in character to consumer instalment paper, and carry comparable charges, many of them are not so reported, because they provide for repayment on

<sup>43</sup> There is an apparent contradiction in the tendency, found in some of the southern and western states, for banks with deposits of 10 to 50 million dollars to receive a lower rate of income from loans than banks of the same size in the eastern and northern states. This may be attributed, however, to the fact that in the south or west a bank of this size is likely to have a larger proportion of correspondent balances, and therefore to keep a larger proportion of its loans in low-rate commercial paper, than a bank of the same size in the east or north.

<sup>44</sup> Most states have maximum legal rates of interest prescribed by state law for state banks, and by federal statute such rates are applicable to national banks (*U. S. Code Annotated*, Title 12, Sect. 85; *U. S. Revised Statutes*, Sect. 5197). The legal rate is mainly about 6 percent in the eastern states; from 6 to 10 percent in the southern states; either 7 or 8 percent in the midwestern states; 10 percent in the western states; and from 8 to 12 percent in the Pacific states.

terms other than the usual equal instalments at regular intervals; this is for the convenience of the borrowers, mainly farmers, whose income is seasonal and erratic and not easily adjustable to instalment terms.

Another reason why such a relationship is not evident from the data is that if the commercial banks' loan-income rate is to be materially affected by the proportion of consumer instalment loans, that proportion must be fairly high and the rate on such loans must materially exceed the average on all other loans. In a great many instances these conditions are not fulfilled, and then other factors exert an influence strong enough to overshadow any definable relationship between rate of income on loans and the proportion of total loans represented by consumer instalment paper.

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## Cost of Loan Operations

OPERATING costs, excluding interest payment on borrowed funds, increased in relation to total income in each type of consumer instalment financing agency and in commercial banks over the period 1929-41. Among the specialized agencies the increase reflected higher costs; among commercial banks it reflected lower income. In relation to loans outstanding, operating costs fluctuated during the period, but, in general, decreased slightly.

The rate of operating costs varied widely among the types of agencies and among individual institutions within each type, the variation depending on the character and quality of the loans extended. Size of enterprise, as such, appears to have had little bearing on operating efficiency.

Operating costs are considered exclusive of interest payments on borrowed funds, in order to indicate the relative efficiency of these enterprises in managing the funds at their disposal. The use of this concept facilitates an appraisal of the relative return received from assets invested in the business enterprise, or operating profit. Interest payments are treated as a deduction from operating profit prior to determining the share of income accruing to equity capital, that is, net profit.

The measurement of operating costs in this analysis is based upon an examination from two points of view: from that of corporate management, in which primary emphasis falls on the share of total income absorbed by costs; and from that of the relationship of costs to the effective rate of return received on loans, in which primary emphasis falls on the amount of costs in relation to loans outstanding. The first measure is called the burden of operating costs and the second, the rate of operating cost.

As a rule, and for general purposes, the figure of total assets is the best base for this rate, since it is best adapted for presentation of earnings, expense, asset, equity and liability ratios in a uniform manner. Total outstanding loans, however, are used as a base for

all items of income and expense, on the assumption that the acquisition, management and collection of loans constitute the chief activities causing variations in expenses; in the case of the consumer instalment financing agencies almost all of their assets do, in fact, consist of loans. Furthermore, just as the use of loans as a base in the case of the loan-income rate provides a measure of average charge, so in the case of operating costs it provides a measure—if not of “necessary costs”—of expense actually incurred, stated in a fashion comparable to the effective rate of charge.

Included in the expenses of operation in any business that extends credit is an element of costs which arises from the inability to foresee exactly which of a group of applicants for credit will fulfill the obligations assumed, and which will not. This cost element, the possible loss, is limited only by the total credit extended, and its potential importance as a component of total costs makes it well worth examining.

The use of loans as a base for determining the significance of losses or charge-offs is justified in the case of the consumer instalment financing agencies since loans constitute the chief if not the sole form of asset upon which loss is sustained in the regular course of operations.<sup>1</sup> But when comparisons are made with commercial banks, which hold large proportions of other forms of assets, chiefly securities, upon which losses are sustained in the regular course of operations, it will become necessary to distinguish between the banks' charge-offs on all forms of assets and not only on loans.

Particularly in discussing the operations of commercial banks it will be desirable to distinguish between gross and net charge-offs, the latter differing from the former in the reduction of recoveries on assets previously charged off.<sup>2</sup>

#### DISTRIBUTION OF OPERATING COSTS

There is no evidence of any great difference in the internal distribu-

<sup>1</sup> Amounts reported by the consumer instalment finance companies as worthless securities charged off have been purposely excluded from the amount of charge-offs in the income tax tabulations, in order that the latter might be more representative of bad-debt losses incident to the financing of consumer loans. See Appendix A.

<sup>2</sup> Data on losses are not available separately for the National Credit Office sample; in most of the companies, recoveries were included in gross income. Data covering the companies in the income tax sample consist only of gross charge-offs minus recoveries, that is, net charge-offs. For differences in the forms in which the data for various samples of institutions are available see Appendix A.

tion of operating costs (other than interest payments on borrowed money) between consumer instalment financing agencies and commercial banks.<sup>3</sup> Salaries have been the most significant single component of operating costs in all of these institutions, ranging from two-fifths of operating costs in industrial banks to one-half in commercial banks and personal finance companies,<sup>4</sup> and to two-thirds in credit unions. Rent and depreciation of fixed assets, insurance, taxes and fees have constituted other important types of cost in all the agencies (except federal credit unions) as well as in commercial banks.

Advertising has been a more important cost item in personal finance and industrial banking companies (and probably also in sales finance companies)<sup>5</sup> than in commercial banks or credit unions. Net charge-offs, which in personal finance companies were a larger item of cost than in industrial banks, have constituted a smaller and less erratic item in the specialized agencies than in commercial banks. Sundry operating expenses, including printing, stationery, postage, office supplies, telephone and telegraph, have usually amounted to considerably less than one-fourth of total operating costs.

#### INCOME ABSORBED BY OPERATING COSTS

During 1929 and 1930, as can be seen from Table 14, total operating costs (excluding interest on borrowed capital) absorbed from two-fifths to three-fifths of total income in each type of specialized agency and in commercial banks. In the succeeding depression years the proportion rose rapidly, reflecting, on one hand, a decline in the ability to collect interest charges, and, on the other, a steady in-

<sup>3</sup>Distributions of operating costs are presented in Appendix Tables B-6 to B-9, for personal finance companies (1929-39), insured industrial banks (1934-41), federal credit unions (1935-41) and all national banks (1929-41). Distributions for various other samples of industrial banking companies are presented in National Bureau of Economic Research (Financial Research Program), *Industrial Banking Companies and Their Credit Practices*, by Raymond J. Saulnier (New York 1940) pp. 155, 158, 160. Detailed distributions of costs of member banks in the First Federal Reserve District have been published by the Federal Reserve Bank of Boston since 1921. Data covering sales finance companies are not readily available.

<sup>4</sup>In M. R. Neifeld, *Personal Finance Comes of Age* (New York 1939) are presented the proportions of total expenses represented by salaries, bad debts and insurance against loss, advertising, rent and taxes, for licensees reporting in a selected group of states, 1929-36 (pp. 229-34), and also percentage distributions of total expenses, by items, for selected years, 1929-36, for reporting licensees in Canada and in 22 individual states (pp. 278-99).

<sup>5</sup>See National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by Wilbur C. Plummer and Ralph A. Young (New York 1940) pp. 75, 286.

TABLE 14

OPERATING COSTS OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES  
AND COMMERCIAL BANKS, 1929-41, IN PERCENT OF TOTAL INCOME<sup>a</sup>

Sample	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>b</sup>	44.8%	47.6%	55.4%	57.5%	55.5%	50.6%	47.5%	48.9%	50.7%	51.5%	55.6%	60.4%	64.8%
2 to 4 regional <sup>b</sup>	42.2	49.7	54.7	70.2	62.3	58.0	53.3	55.8	58.8	62.4	63.1	63.6	67.9
9 to 32 local <sup>b</sup>	51.0	59.9	61.5	69.5	63.8	56.3	57.7	57.8	57.5	67.8	66.8	66.2	66.5
202 local <sup>a</sup>	52.3	..	..	..	70.9	..	..	60.7	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>d</sup>	..	53.5	60.1	64.8	66.3	70.0	64.7	64.8	63.8	65.6	66.9	69.1	73.6
2 to 5 regional <sup>d</sup>	52.5	55.0	63.4	101.9	67.4	67.4	65.9	63.9	61.8	68.2	66.0	66.7	71.1
5 to 7 local <sup>d</sup>	..	..	..	..	..	71.8	69.3	69.6	66.2	72.6	70.5	66.2	69.9
153 local <sup>a</sup>	58.2	..	..	..	76.2	..	..	69.3	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>e</sup>	53.8	..	..	..	81.1	..	..	62.6	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>a</sup>	52.9	..	..	..	72.3	..	..	69.5	..	..	..	..	..
6 largest insured <sup>a</sup>	..	..	..	..	..	73.5	67.5	62.8	65.9	60.4	63.5	67.3	69.0
All other insured <sup>a</sup>	..	..	..	..	..	72.0	64.4	63.3	61.1	66.3	62.9	69.6	68.0
37 insured <sup>a</sup>	58.7	..	..	..	74.0	..	..	59.1	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>f</sup>	..	..	..	..	..	..	45.5	29.7	30.1	34.5	34.7	34.7	37.7
<i>Commercial banks</i>													
All national banks <sup>g</sup>	44.5	52.2	70.9	84.4	109.4	97.2	60.9	45.8	58.4	61.7	56.9	59.9	60.2
All insured banks <sup>g</sup>	..	..	..	..	..	102.0	68.2	51.3	62.2	66.5	62.3	63.0	62.8

(footnotes on following page)



crease in bad-debt losses plus an inability to reduce salaries and other costs proportionately.

Either 1932 or 1933 appears to have marked the high point in absorption of total income by operating costs. The proportion declined in the immediate post-depression years, though not to the 1929 level, and showed a rising tendency in the last years of the period ending in 1941.

In commercial banks operating costs over the period 1929-41 were influenced by fluctuations in the amount of charge-offs on securities and other assets as well as on loans, and in the amount of profits on securities sold. Other operating costs—excluding the effect of charge-offs, recoveries and profits on assets sold<sup>a</sup>—represented a materially smaller proportion of total income in 1929 than was characteristic of the specialized agencies; the increase in the relative burden of such costs from 1929 to 1933 was also less drastic. But while the specialized agencies showed some improvement between 1933 and 1936 in the proportion of total income absorbed by these "other" operating costs, the commercial banks, taken as a unit, did not, and this relationship became more unfavorable with each year, through 1941.

Systematic differences among types of agencies, except credit unions, in the proportion of total income absorbed by total operating costs were not apparent over the period 1929-41. In general,

<sup>a</sup> The exclusion of net charge-offs provides a preferable basis for comparison with the consumer instalment financing agencies, because in commercial banks the total of net charge-offs is composed of heterogeneous elements, the amount of which, in any one year, is the result of a number of diverse and in part arbitrary factors.

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FOOTNOTES TO TABLE 14

\* Operating costs include net charge-offs (bad-debt expense minus recoveries) and all expenses other than interest payments. The number of companies for each year may be found in Appendix Table B-1.

<sup>b</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income.

<sup>c</sup> Based on tabulations prepared by the Income Tax Study.

<sup>d</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income.

<sup>e</sup> Based on data from Federal Deposit Insurance Corporation. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

<sup>f</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts.

<sup>g</sup> Based on data in Annual Reports of the Comptroller of the Currency.

the proportion was somewhat lower for the sales finance companies than for personal finance or industrial banking companies, but this tendency was irregular.

A materially smaller proportion of total income was absorbed by operating costs in federal credit unions than in any other type of institution, because of their very small salary and rental expense. Many of the services of these cooperative organizations are gratuitously performed by officers, or else represent an indirect subsidy in the form of services performed during working hours, where membership is confined to a single government or business establishment. In general, too, office space is provided gratuitously or at nominal cost.

Net charge-offs on loans, though characteristically they absorbed a very low proportion of total income in the specialized agencies, increased materially in the depression period and decreased sharply again in the recovery period. Figures for these agencies compare favorably with those for commercial banks, even though the data for the income tax sample cover only the years 1929, 1933 and 1936, and other data are fragmentary.

As is shown in Table 15, net bad-debt expense, or losses and charge-offs minus recoveries on loans, of the specialized agencies included in the income tax sample absorbed from 5 to 9 percent of total income in 1929, and from 12 to 23 percent in 1933, after the depression had struck. During the same years, net charge-offs on all the assets of national banks rose from 9 percent of total income in 1929—the highest figure among the specialized agencies—to 65 percent in 1933.

By 1936 losses for all types of agencies stood at about the 1929 level except those of personal finance companies, which constituted a proportion of total income considerably higher than in 1929, and those of insured industrial banks which represented a proportion considerably lower, while national banks showed net recoveries and profits on assets due entirely to substantial recoveries and profits on securities.

The extreme rise in the proportion of net charge-offs of non-investment type industrial banking companies in 1933 may be due to the fact that some of these companies' loans took the form, not of small loans to consumers, but of loans to business establishments unable to obtain accommodation at commercial banks. On this

TABLE 15

NET CHARGE-OFFS ON LOANS OF CONSUMER INSTALMENT FINANCING AGENCIES IN PERCENT OF TOTAL INCOME AND OF YEAR-END LOANS OUTSTANDING, 1929, 1933, 1936<sup>a</sup>

<i>Agency</i>	1929	1933	1936
NET CHARGE-OFFS IN % OF TOTAL INCOME			
202 sales finance companies	7.7%	12.5%	7.6%
153 personal finance companies	6.0	13.9	11.4
79 non-invest. type indust. bkg. cos.	8.8	22.7	8.4
93 invest. type indust. banks			
56 noninsured	4.8	16.5	6.6
37 insured	8.0	12.0	2.4
NET CHARGE-OFFS IN % OF YEAR-END LOANS OUTSTANDING			
202 sales finance companies	1.5%	2.3%	1.2%
153 personal finance companies	1.5	3.6	3.0
79 non-invest. type indust. bkg. cos.	1.4	3.1	1.3
93 invest. type indust. banks			
56 noninsured	.5	1.7	.7
37 insured	.8	1.2	.2

<sup>a</sup> Based on tabulations prepared by the Income Tax Study. Net charge-offs are bad-debt expense (charge-offs and losses on loans) minus recoveries.

paper the degree of fluctuation in charge-offs actually exceeded that characteristic of commercial banks.

In each of the years some companies represented in the income tax sample reported net recoveries, that is, recoveries exceeding charge-offs; but a larger number (except among the industrial banking companies in 1933 and 1936) reported neither net recoveries nor net charge-offs.<sup>7</sup> In 1929, nearly half of the companies that reported net bad-debt expense reported net charge-offs of less than 5 percent of total income, or net recoveries; two-fifths reported net charge-offs of 5 to 15 percent of total income; and only one-eighth reported net bad-debt expense in excess of 15 percent.

In 1933, however, in each type of institution more than two-fifths of the companies reporting net bad-debt expense (more than one-half among the non-investment type industrial banking companies) reported net charge-offs on loans in excess of 15 percent of total

<sup>7</sup> In most of these cases charge-offs were probably reported improperly under some other caption, but it is not likely that this would have occurred—unintentionally—unless the amounts concerned were insignificant. It seems reasonable, therefore, to consider these cases as substantially correct, particularly since the number reporting in this manner in 1933 and 1936 was considerably less than half as large as in 1929.

income. In 1936, in all types of institutions, the variation was greater than in 1933 or 1929, and all types showed an increase over 1929 in the proportion of companies reporting net recoveries.

### THE RATE OF OPERATING COST

The operating costs of personal finance companies represented the highest rates on loans throughout the period 1929-41, reaching a level two to three times that of the other principal types of consumer instalment financing agencies. The figures are shown in Table 16. From 1929 to 1933 the operating costs of personal finance companies increased from about 15 or 20 to between 20 and 25 percent of outstanding loans, and never subsequently reverted to the earlier level.

While the 1929-33 increase in the national and regional companies as well as in those included in the income tax sample may be attributed almost entirely to a higher rate of charge-offs (minus recoveries) on uncollectable accounts,<sup>8</sup> there is evidence that the companies were unable to reduce other operating costs to keep pace with the decline in loans. The failure of operating costs to decline materially after the depression, in terms either of total loans outstanding or of total income (Table 14, above), may indicate the acquisition of a larger proportion of higher-cost loans, without a commensurate increase in income.

Also, although net charge-offs decreased during this period it is likely that other operating costs continued on a higher level: increased advertising expenses occasioned by more intense competition from other types of agencies for higher-quality consumer loans; higher taxes and license fees; higher salaries for operating personnel as the entry of more commercial banks into the consumer loan field brought other offers of employment, and higher head office salaries as this business continued to acquire greater respectability.<sup>9</sup>

Operating costs of the sales finance companies included in the income tax sample rose from 10 percent of total year-end loans outstanding in 1929 to 13 percent in 1933, and returned to 10 percent

<sup>8</sup> The very high figure for regional companies in 1932 is attributable to high charge-offs in that year, occasioned by the sale and closing of a large number of offices by one of these companies.

<sup>9</sup> The distinction between branch office and head office personnel is made because the degree of increase in costs of operations shown by Tables 14 and 16, based on the small samples and the income tax data, appears to be somewhat greater than that indicated by Appendix Table B-6, which is based on expenses reported by individual operating offices to state supervisors.

TABLE 16

OPERATING COSTS OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES  
AND COMMERCIAL BANKS IN PERCENT OF LOANS OUTSTANDING, 1929-41<sup>a</sup>

Sample	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>b</sup>	7.9%	7.3%	8.1%	8.4%	9.2%	8.9%	7.1%	6.5%	6.1%	5.5%	6.1%	6.0%	6.6%
2 to 4 regional <sup>b</sup>	7.3	8.5	9.4	11.8	11.5	11.9	10.4	9.9	9.2	8.0	9.1	8.1	7.9
9 to 32 local <sup>b</sup>	12.2	12.4	12.9	13.0	12.8	11.9	12.0	10.9	10.5	10.6	11.5	10.7	10.6
202 local <sup>c</sup>	10.2	..	..	..	13.3	..	..	9.9	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>d</sup>	..	17.5	19.7	21.6	23.2	24.3	22.0	21.5	21.6	20.9	21.4	21.5	22.5
2 to 5 regional <sup>d</sup>	19.5	19.5	18.5	36.3	22.4	23.9	24.2	23.2	21.9	22.8	21.2	21.7	23.6
5 to 7 local <sup>d</sup>	..	..	..	..	..	23.0	23.6	21.8	21.0	21.4	21.6	21.6	22.0
153 local <sup>e</sup>	14.8	..	..	..	19.8	..	..	18.5	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>g</sup>	8.4	..	..	..	11.1	..	..	9.5	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured banks <sup>g</sup>	5.5	..	..	..	7.5	..	..	7.2	..	..	..	..	..
6 largest insured <sup>g</sup>	..	..	..	..	..	10.3	7.5	7.5	8.1	7.7	7.8	7.6	7.4
All other insured <sup>g</sup>	..	..	..	..	..	10.3	8.6	8.9	8.5	9.0	8.4	9.0	8.4
37 insured <sup>g</sup>	5.9	..	..	..	7.4	..	..	5.5	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>f</sup>	..	..	..	..	..	..	2.8	2.3	2.7	3.3	3.3	3.4	4.0
<i>Commercial banks</i>													
All natl. banks (including net charge-offs) <sup>h</sup>	2.9	3.2	4.0	4.7	5.4	4.6	2.6	1.9	2.4	2.5	2.3	2.3	2.2
All natl. banks (excluding net charge-offs) <sup>h</sup>	2.4	2.5	2.3	2.5	2.3	2.4	2.3	2.3	2.3	2.4	2.3	2.3	2.1

(footnotes on opposite page)

in 1936. After that, according to the National Credit Office sample, the rate of operating cost fluctuated, with no evidence of a trend for national or local companies but with regional companies showing a slight decline. If cognizance could be taken of changes in operating and accounting practices since 1933, the rate would show an increase after that year.<sup>10</sup>

Industrial banking companies included in the income tax sample showed lower rates of operating cost in 1929, 1933 and 1936 than local sales finance companies, the investment type being considerably lower than the non-investment type.<sup>11</sup> Their rates showed about the same trend during those years. The rate of operating cost of all insured industrial banks—adjusted for hypothecated deposits—amounted to about 10 percent of year-end loans outstanding in

<sup>10</sup> See Chapter 4, footnote 17.

<sup>11</sup> The extent of the understatement resulting from lack of adjustment for hypothecated deposits among the investment type companies included in the income tax sample can be estimated from data submitted to the FDIC covering the 37 insured industrial banks. On the basis of the 1936 income tax reports the operating expenses (excluding charge-offs) of these companies amounted to 5.3 percent of year-end loans outstanding (as reported, that is, presumably not corrected for hypothecated deposits); on the basis of reports submitted to the FDIC, corrected for hypothecated deposits, the operating expenses amounted to 8.5 percent of year-end loans, or 9 percent of the average of month-end loans.

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FOOTNOTES TO TABLE 16

\* Operating costs include net charge-offs (bad-debt expense minus recoveries) and all expenses other than interest payments. The number of companies for each year may be found in Appendix Table B-1.

<sup>1</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income. Here the denominator is the average of loans outstanding at the beginning and end of year.

<sup>2</sup> Based on tabulations prepared by the Income Tax Study. The figures represent operating costs in percent of year-end loans outstanding.

<sup>3</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income. Here the denominator is the average of loans outstanding at the beginning and end of year.

<sup>4</sup> Based on data from Federal Deposit Insurance Corporation. The figures represent operating costs in percent of average of loans outstanding at beginning, middle and end of year, except for 1934 and 1935, when year-end loans outstanding are used as base; deposits accumulated for the repayment of loans have been deducted from total loans.

<sup>5</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts. The figures represent operating costs in percent of year-end loans outstanding.

<sup>6</sup> Based on data in Annual Reports of the Comptroller of the Currency. Here the denominator is the average of loans and investments outstanding at call dates during the year.

1934, declining in subsequent years to a level of around 8 percent of average outstanding loans.

In relation to year-end loans outstanding, as in relation to total income, the operating costs of federal credit unions, at a level of about 3 percent or a little more,<sup>12</sup> were much lower than those of any other type of specialized agency during the period under consideration. The reasons for this low level have already been explained.

In commercial banks the level of operating costs, including net charge-offs, in relation to the average of *total earning assets* outstanding, followed a very erratic course from 1929 to 1941, as a result of fluctuations in charge-offs on loans, securities and other assets, fluctuations in recoveries on assets previously charged off, and more especially in profits on securities sold. But operating costs exclusive of net charge-offs represented, as shown in Table 16, an almost constant proportion of average loans and investments outstanding, remaining at a level slightly above 2 percent through the entire period.

Net charge-offs of national banks from 1929 to 1941 averaged 0.8 percent of total earning assets.<sup>13</sup> Their average rate of total operating costs over this period was thus slightly more than 3 percent, or approximately the same as the rate of operating costs on the principal earning asset—loans—of federal credit unions; approximately half the level shown by national sales finance companies in 1941; less than half the level shown by insured industrial banks in 1941; and about one-seventh the level shown by personal finance companies since the depression.

Operating costs, other than net charge-offs, incurred by commercial banks *in the making of loans* are not so much lower than those of the consumer instalment financing agencies as these comparisons would indicate. Since there has been an increase in the proportion of securities, particularly short-term United States government securities, whose acquisition and handling costs can be expected to be lower than those on loans, the burden of other operating costs attributable to the acquisition, handling and collection of loans—if these

<sup>12</sup> Francis E. Wilcox, in *A Statistical Study of Credit Unions in New York* (Chicago 1940) p. 56, reports that disbursements of 145 state-chartered credit unions for salaries and wages, committee fees, rent and printing, stationery and postage amounted to 3.1 percent of average loans outstanding in 1936.

<sup>13</sup> This is slightly below the average rate of 0.97 for the twenty-year period 1918-38.

could be distributed—would represent a higher percentage of loans in recent years.<sup>14</sup>

#### THE RATE OF LOSS ON LOANS

As mentioned above, the most striking characteristic of losses on loans has been their high degree of variation since 1929. The available data on consumer instalment financing agencies are not sufficiently precise or complete to make possible an accurate determination of the various agencies' rates of loss in relation to outstanding loans. It is probable, however, that the losses of personal finance companies, non-investment type industrial banking companies and sales finance companies have averaged between 1 and 2 percent of loans, and that those of the industrial banks have been significantly lower.

For the consumer instalment financing agencies included in the income tax sample the amount of net charge-offs in percent of year-end loans outstanding was presented above, in Table 15, for the years 1929, 1933 and 1936. Attention should be called, however, to the danger of using such data on net charge-offs for single years only.

Charge-offs are very largely a postponable charge, for the inability to collect a particular account or loan can usually be recognized by the management at any time over a considerable period; the management may also, without being subject to undue criticism, exercise discretion with respect to the time at which a charge-off is acknowledged in the company's books. And as for anticipated losses, the management is subject to conflicting forces, resulting in overestimation in some cases and underestimation in others; this is particularly true in a period in which excessive losses are to be anticipated.

When figures for a large number of companies are combined, the operative influences tend to cancel, but since this is not likely to be

<sup>14</sup> Although banks report separately the amount of income on loans, the amount of income on securities and the amount from other sources, they do not report operating costs in such a manner as to permit a segregation of costs applicable to loan operations from those applicable to security or other operations. The average of operating costs incurred by commercial banks on their consumer loans probably does not differ greatly from that of the consumer agencies. Fragmentary evidence on operating costs of personal loan departments of reporting state banks in New York, 1937-38, may be found in National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit*, by John M. Chapman and Associates (New York 1940) pp. 171-82.



true of data covering smaller groups of companies, too much weight should not be placed upon the figures for a single year, particularly one such as 1933.

Rates of loss (in relation to loans) of companies included in the income tax sample rose sharply from 1929 to 1933 and fell again by 1936. It is probable that the "peak" of losses was attained in 1931 or 1932. For after the decline in business activity starting in 1929 credit continued to be extended for some time on standards previously in use, but as the crisis deepened, higher standards were enforced, with the result that losses on business secured in the later years of the depression were lower.

While the loss ratios of personal finance companies compared favorably with those of sales finance companies in 1929, they increased considerably more during the depression and failed to show a significant decrease by 1936, when net charge-offs were 3 percent of year-end loans outstanding. We know that the business of personal finance companies showed only a slight contraction from 1929 to 1933, whereas the loan volume of sales finance and industrial banking companies decreased sharply; and it may have been because at this time they extended a higher proportion of loans of doubtful quality, thus increasing their charge-offs.

The use of figures for these widely separated single years entails, however, the possibility of significant error; in any case these scattered figures appear to overstate a rate typical of a longer period. One of the two largest units in the personal finance field has reported its average net charge-offs for the thirteen-year period 1929-41 as 1.5 percent of average customers' notes.<sup>15</sup>

Although the rate of losses in sales finance companies was high in both 1929 and 1933, it rose less between those two years than did that of any other type of agency except insured industrial banks. This confirms the earlier conclusion that these companies were aggressive and efficient in handling their default problems during the depression.<sup>16</sup>

The sales finance companies' high level of losses in 1929 may have been due to a reluctance to show repossessions on their books and a

<sup>15</sup> Household Finance Corporation, *Annual Report* for 1941, p. 7. Gross charge-offs were reported as 2.3 percent and recoveries as 0.8 percent of average customers' notes.

<sup>16</sup> It was pointed out at the end of Chapter 3 that during the depression the proportion of miscellaneous assets—including repossessions—rose least among sales finance companies.

tendency to charge off repossessions in full, when acquired; or these local companies may have failed to follow the practice, almost universal among the larger companies, of protecting themselves with recourse contracts.<sup>17</sup> Among companies that did use recourse contracts the high ratios could have resulted from lack of attention, during a period of competitive expansion, to the solvency of retailers who subsequently failed to fulfill their contracts.

The loss ratios of non-investment type industrial banking companies were about the same as those of sales finance companies in 1929 and 1936, though they showed a somewhat greater increase between 1929 and 1933. By 1936 both were slightly lower than their pre-depression level.

There appears to be ample justification for the belief that loans made by industrial banks constitute a high grade of risk. In 1929 and 1936 net charge-offs of banks included in the income tax sample (Table 15) averaged approximately 0.5 of 1 percent of year-end loans outstanding; in 1933 the average for the group was approximately 1.5 percent, and charge-off rates did not vary much as between size classes.

Between 1934 and 1935 the loss ratio of insured industrial banks was cut in half, and thereafter fluctuated under 0.7 of 1 percent of average loans. That these rates certainly do not understate, and may even overstate, the losses characteristic of the field is suggested by the experience of one of the larger insured industrial banks, whose average rate of gross loss over approximately a quarter century approximated 0.6 of 1 percent of loan extensions; recoveries on loans previously charged off ranged from about 25 to about 75 percent of gross charge-offs, resulting in net charge-offs of about 0.3 of 1 percent of loan extensions for the entire period.

Federal credit unions' losses on charged-off loans are not reported on an annual basis, and are not included in the reported total of operating costs. From their inception to the end of 1941 their net losses amounted to 0.07 of 1 percent of loans made.<sup>18</sup>

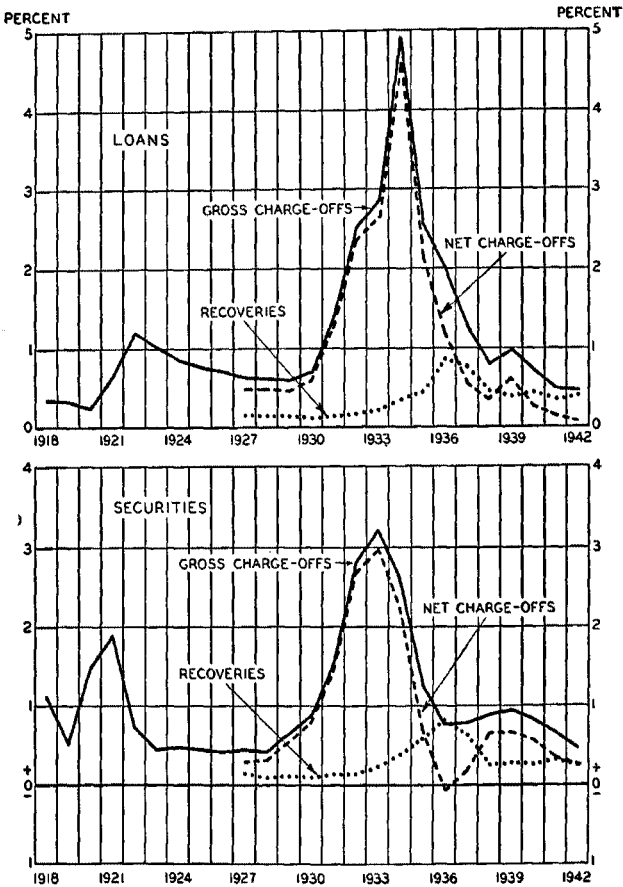
Available evidence indicates that losses on consumer loans compare favorably with average losses sustained by commercial banks

<sup>17</sup> Non-recourse contracts developed irregularly during the 1920's. In many of these, hidden clauses *actually* protected the companies to a greater extent than was readily apparent.

<sup>18</sup> See Federal Deposit Insurance Corporation, *Federal Credit Unions: Annual Report on Operations*, December 31, 1941.

CHART IX

RATES OF GROSS CHARGE-OFFS, RECOVERIES AND NET CHARGE-OFFS  
ON LOANS AND SECURITIES OF NATIONAL BANKS, 1918-42\*



\* Rates represent charge-offs or recoveries during the year ending June 30 in percent of mid-year holdings of loans or securities. Based on Annual Reports of the Comptroller of the Currency. Recoveries were not itemized by class of asset before 1927. The figures for 1933-36 pertaining to recoveries on securities have been adjusted for estimated profits on securities sold, which were reported with recoveries for the period July 1, 1932 to December 31, 1935; see text footnote 24.

on holdings of all types of loans and securities. Chart IX reveals that for national banks, whose highest rate of net charge-offs on loans occurred in 1934, both gross and net losses or charge-offs in each of the years 1931-36 (ending June 30) exceeded 1 percent of mid-year loans outstanding. Recoveries, itemized by class of asset only since 1927, remained reasonably consistent at first but rose sharply after gross charge-offs on loans had been high for several years.

Chart IX also presents comparable data covering losses sustained by national banks on securities. Gross losses or charge-offs on securities amounting to more than 1 percent of mid-year holdings occurred in 1918, 1920 and 1921, as well as in all of the years 1931-35. In both periods the increase in the rate of gross charge-offs, and the peaks in the rates, occurred earlier for securities than for loans; following the peaks the rate declined more rapidly for securities than for loans.<sup>19</sup>

Averages of annual rates of gross and net charge-offs on loans and securities of national banks over the period 1927-41, by type of bank, are presented in Table 17. Throughout this period the rates of net loss on loans were lowest in reserve city national banks in about 100 urban centers throughout the country, and were slightly higher in country banks. Rates for the latter reflect the losses sustained by banks in agricultural communities during the early years when agricultural values were declining. The highest rates were sustained by central reserve city national banks, the large metropolitan banks in New York City and Chicago.

For the period 1927-41 the average annual rate of loss on securities sustained by national banks was less than their average rate of loss on loans. Both net and gross charge-offs on securities were lowest for reserve city banks, and highest for country banks. The materially higher rate of charge-offs shown by country national banks was probably due, in part, to the greater likelihood of the smaller banks' charging off, in a lump sum, premiums on bonds purchased, and then reporting them as a part of charge-offs. All of

<sup>19</sup> For the period July 1, 1932 to December 31, 1935, the Comptroller of the Currency reported recoveries on securities, and profits on securities sold, as a combined figure. For the purpose of this analysis an estimated breakdown was made of that figure. Although there is no very satisfactory basis for making such an estimate, and the margin of error is wide, the error is much less than that entailed by the use of the combined figure.

TABLE 17

GROSS AND NET CHARGE-OFFS ON LOANS AND SECURITIES OF ALL NATIONAL BANKS IN PERCENT OF MID-YEAR LOANS OUTSTANDING AND MID-YEAR HOLDINGS OF SECURITIES, AVERAGE FOR 1927-41, BY TYPE OF BANK<sup>a</sup>

<i>Type of Bank</i>	<i>Charge-Offs on Loans in % of Mid-Year Loans Outstanding</i>		<i>Charge-Offs on Securities in % of Mid-Year Holdings of Securities</i>	
	Gross	Net	Gross	Net <sup>b</sup>
Central reserve city banks	1.8%	1.3%	1.1%	.7%
Reserve city banks	1.1	.9	.9	.6
Country banks	1.4	1.1	1.5	1.2
ALL NATIONAL BANKS	1.4%	1.1%	1.2%	.8%

<sup>a</sup> Based on Annual Reports of the Comptroller of the Currency. The figures are averages of annual data for fiscal years, ending June 30.

<sup>b</sup> Partly estimated.

the large central reserve city banks, on the other hand, and most of the reserve city banks, are likely to amortize bond premiums over the life of the bonds, deducting them from the reported amount of interest income on securities.<sup>20</sup>

#### INFLUENCE OF CHARACTER OF LOANS ON COSTS

In all of the years studied, income tax data show a very pronounced relationship between income rate and operating costs in percent of year-end loans outstanding. Chart X shows that without any significant exceptions, the higher the rate of income, the higher the rate of operating costs,<sup>21</sup> indicating that the type of paper which produces a higher rate of income entails a higher rate of cost for acquisition, servicing and collection.

The higher operating costs of companies that received a higher-

<sup>20</sup> Some understatement of losses of large central reserve city and reserve city banks—although the amount cannot be determined—results from the general practice followed by these banks in the early 1930's of setting up a contingency reserve against possible market losses on securities by a transfer from surplus or from undivided profits; later, when this "surplus reserve" was utilized, direct charges made to it were, in some cases, not reported as losses or charge-offs on securities.

<sup>21</sup> The exceptions occur in groups containing a very small number of companies, chiefly in those containing companies whose income rate was less than 8 percent. Some of the companies in the latter groups may have held paper that potentially produced a higher average rate, but failed to collect a significant proportion of charges.

than-average rate of income may be attributed, in part, to a lower average size of loan. Some operating costs are about the same for all loan accounts, but others are higher for small loans; the rate of income, too, is sometimes higher on loans of smaller amounts.<sup>22</sup> Among sales finance companies the proportion of wholesale paper, carrying a low rate of charge, has a significant relation to the average income rate, and probably also affects the rate of operating costs, since the average size of such notes is considerably larger than most consumer instalment accounts.

In relation not only to year-end loans outstanding but also to total income the operating costs of the companies in the income tax sample increased with rising rates of income. The increase was not sufficient, however, to eliminate all of the advantage resulting from the higher rate of income. As we shall see in the next chapter, these higher income companies enjoyed a higher-than-average rate of profitability.

It can be seen from Chart X that in every income class the rate of operating costs (in relation to year-end loans outstanding) was higher in 1933 than in 1929. These cost rates for 1933 reflect several factors: higher charge-offs, due to greater difficulty in collecting principal; higher collection costs, occasioned by strenuous efforts to collect interest and principal; and a higher rate of other costs, resulting from an inability to reduce overhead as rapidly as loan volume fell.

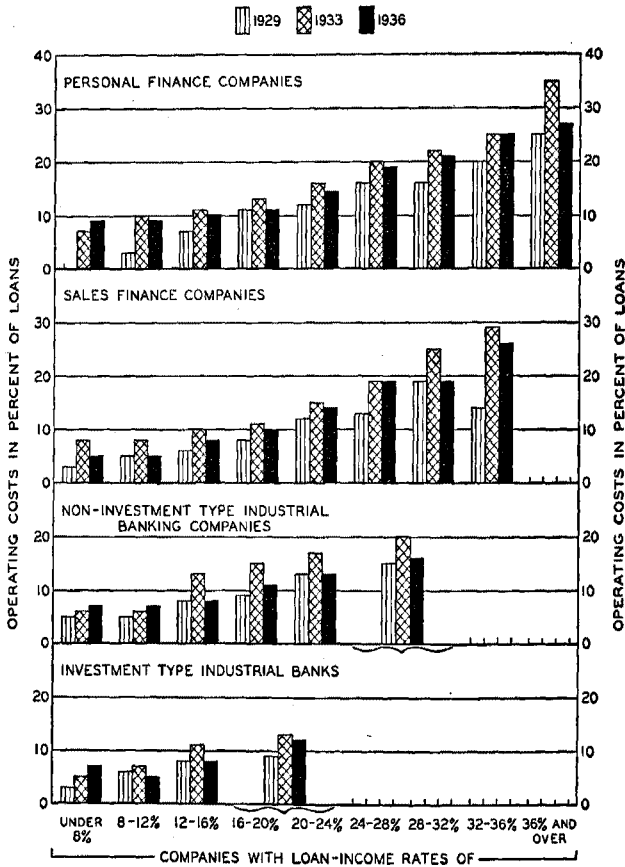
It must be recognized, however, that in 1933, because of difficulty in collecting the usual proportion of charges on loans, there were probably a good many companies in lower-than-customary income groups.<sup>23</sup> In view of this shift of companies from one income group to another, the indicated increase in total costs from 1929 to 1933 represents an overstatement of the typical increase

<sup>22</sup> In a large number of states the small loan law provides for a higher maximum rate on smaller than on larger loans; and even in other states those companies that charge less than the maximum rates permitted are likely to charge a higher average rate on smaller than on larger loans. In either case the result is a higher average rate of gross income for a company with a higher proportion of smaller loans than for one with a higher proportion of larger loans, even though the character of the loans is otherwise the same. The usual practice of industrial banks, of charging a fixed investigation fee per loan in addition to the interest charges, also brings about a higher average rate of income for the company with a smaller average size of loan.

<sup>23</sup> While the shift of companies into lower-than-customary income groups can occur in any year, the number of instances in a year like 1929 is likely to be so small as not to affect seriously the representativeness of the cost rates.

CHART X

RATES OF OPERATING COSTS OF CONSUMER INSTALMENT FINANCING AGENCIES, BY LOAN-INCOME RATES, 1929, 1933, 1936\*



\* Rates of operating costs represent averages of operating costs, which include net charge-offs (bad-debt expense minus recoveries) and all expenses other than interest payments, in percent of total year-end loans outstanding. Loan-income rates represent total income (composed predominantly of loan income) in percent of total year-end loans outstanding; each rate group is inclusive of the lower limit and exclusive of the upper. Based on tabulations prepared by the Income Tax Study.

in the lower income groups and an understatement of that in the higher.<sup>24</sup>

In almost all income classes and types of agencies the rate of operating costs was higher for 1936 than for 1929, both years of relative prosperity. The reason may have been either a reduction in the rate of charge of some companies with no change in the character of the loans held and no change in their costs; or a general increase in operating costs affecting all companies, regardless of the character of paper held. Both influences might have stemmed from increased competition in the consumer instalment credit field.

In commercial banks, too, there has been a very strong relationship between the rate of income on loans and the level of operating costs, excluding net charge-offs. Banks' operating costs, however, are influenced by the great variation in types of assets held, as indicated by the proportion of total assets in the form of loans. Since a very high loan proportion has been characteristic of all the specialized companies, it is not necessary to consider the effect of this factor on their rate of operating cost; moreover, those companies that held large amounts of other assets were excluded from the income tax sample in the analysis of income and expenses.

The influence of the proportion of total assets in the form of loans can be isolated by examining cost rates of banks with approximately the same rate of income on loans; and, conversely, the influence of the rate of income on loans can be isolated by examining cost rates of banks with approximately the same proportion of total assets in the form of loans. The results are pictured in Chart XI, which shows that average operating costs<sup>25</sup> increase consistently and materially with increases in each of these factors. The higher cost rates found for banks with higher loan

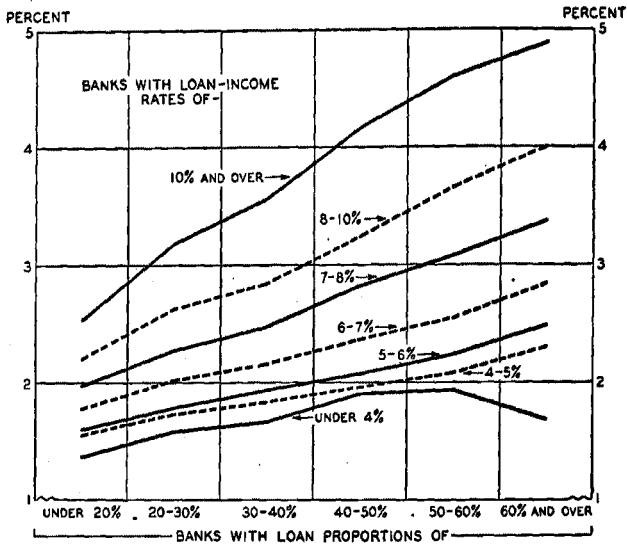
<sup>24</sup>The overstatement occurs with respect to any group into which companies have shifted, and the understatement occurs for any group from which companies have shifted.

<sup>25</sup>Net charge-offs and profits on assets sold have here been excluded from operating costs, because commercial banks' losses, charge-offs and recoveries on securities, and profits on securities sold, were so erratic from year to year and from bank to bank that their inclusion would provide unsatisfactory results. For this calculation the use of total assets as a base for computing the cost rate was more feasible than the use of loans outstanding. It is also more satisfactory, because—in spite of the high proportion of assets other than loans—it gives a better indication of the strength of the relationships under consideration.



CHART XI

RATES OF "OTHER" OPERATING COSTS OF INSURED COMMERCIAL BANKS,  
BY LOAN PROPORTIONS AND LOAN-INCOME RATES, 1940<sup>a</sup>



<sup>a</sup> Rates of "other" operating costs represent all expenses other than interest payments and net charge-offs, in percent of total assets; figures used are averages of rates of individual banks. Loan proportions represent loans outstanding in percent of total assets. Loan-income rates represent income on loans in percent of loans outstanding. Points were plotted for each average rate of "other" operating costs, and points for banks having substantially the same loan-income rate were then joined. The slope of the resultant lines shows the increase in "other" operating costs with increases in loan proportions. The increase in "other" operating costs with increases in loan-income rates is shown within a single vertical column of the chart, by the higher levels of the successive lines.

Based on data from Federal Deposit Insurance Corporation. In regard to banks that were members of the Federal Reserve System loans outstanding and total assets are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Loan-income rate groups and loan-proportion groups are inclusive of the lower limit and exclusive of the upper.

proportions<sup>26</sup> may be explained by the fact that the investment of funds in securities, or their retention in the form of cash assets, entails less operating expense than the investment of funds in loans.

The higher cost rates that accompany higher loan-income rates, regardless of the proportion of loans held, are indicative of the differences in expense entailed in the extension of different types of loans. It may be presumed that the loans of banks represented in the chart by any one line are fairly similar in character, for all such banks receive the same average loan-income rate, and the income produced by loans is strongly influenced by the character and quality of the paper.

#### INFLUENCE OF CHARACTER OF LOANS ON LOSSES

In each of the consumer instalment financing agencies net charge-offs, in percent of year-end loans outstanding, bore a direct relation to loan-income rate in the years covered by the income tax data.<sup>27</sup> But while companies that received higher-than-average income rates sustained higher-than-average losses, the increase in charge-offs was not commensurate with the increased income.<sup>28</sup> In other words, the higher losses did not amount to more than a small proportion of the higher rates charged.

For example, in 1936 those personal finance companies whose average loan-income rate was between 12 and 16 percent of year-end loans outstanding reported average net charge-offs of 0.7 of 1 percent, whereas those whose average loan-income rate was between 32 and 36 percent reported average net charge-offs of 4.2 percent; thus an income rate 20 percentage points higher was accompanied by a loss rate 3.5 percentage points higher. This was reflected in the proportion of total income absorbed by losses, which was small for both high-rate and low-rate companies.

<sup>26</sup> The only deviation from the pattern is the decline in cost rate among the banks that had loans of more than 60 percent of total assets, and loan-income rates of less than 4 percent. There was only a small number of banks, however, in this category.

<sup>27</sup> This tendency was consistent in each type of agency in each year, with practically no significant exceptions in 1929 or 1936. The 1933 figures showed a greater degree of irregularity, though the tendency was discernible. See Appendix Table B-10.

<sup>28</sup> In some cases the increase in charge-offs of the companies holding high-rate loans was proportionally greater than the increase in income rate; in other cases the opposite was true; and in still other cases the increase in charge-offs was in proportion to the increase in income rate.

Sales finance and non-investment type industrial banking companies showed rates of loss reasonably similar to those reported by the personal finance companies, in comparable income classes. The same was true of investment type industrial banking companies, when allowance was made for hypothecated deposits. Thus

TABLE 18

GROSS CHARGE-OFFS, RECOVERIES AND NET CHARGE-OFFS ON LOANS OF INSURED COMMERCIAL BANKS IN PERCENT OF AVERAGE LOANS OUTSTANDING, AND NET CHARGE-OFFS IN PERCENT OF INCOME ON LOANS, 1940, BY LOAN-INCOME RATES<sup>a</sup>

Loan-Income Rates <sup>b</sup>	Number of Banks	In % of Average Loans Outstanding			Net Charge-Offs In % of Income on Loans
		Gross Charge-Offs	Recoveries	Net Charge-Offs	
Less than 3%	97	.25%	.24%	.01%	.73%
3-4	351	.50	.34	.16	4.41
4-5	1,433	.55	.34	.21	4.69
5-6	4,049	.58	.31	.27	4.82
6-7	3,505	.65	.40	.25	3.87
7-8	1,731	.79	.56	.23	3.16
8-9	949	.99	.73	.26	3.11
9-10	445	1.11	.81	.30	3.15
10-11	218	1.22	.85	.37	3.57
11-12	135	1.25	.88	.37	3.24
12-15	134	.91	.69	.22	1.65
15 or more	25	1.43	.74	.69	4.00
ALL BANKS	13,072	.69%	.44%	.25%	3.90%

<sup>a</sup> Based on data from Federal Deposit Insurance Corporation. Figures are averages of rates of individual banks. Loan-income rates represent income on loans in percent of loans outstanding. In regard to banks that were members of the Federal Reserve System loans outstanding are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included.

<sup>b</sup> Each level is inclusive of the lower limit and exclusive of the upper.

it appears that when these consumer instalment financing companies competed in the same narrowly-defined market, they charged about the same rate and had about the same losses, regardless of type of company.

Among insured commercial banks, while the rate of gross

charge-offs on loans varied in direct relation to the rate of loan income and the character of the loans, the rate of recoveries on loans previously charged off tended to vary in the same way. Therefore the rate of net charge-offs, although tending slightly to increase with higher loan-income rates, varied little. For example, as can be seen from Table 18, commercial banks with an average loan-income rate of 4.5 percent in 1940 sustained net charge-offs of 0.21 percent of average loans outstanding; banks with an average income rate of 10.5 percent sustained net charge-offs of 0.37 percent.

Whether average rates of net charge-offs for identical banks throughout an entire business cycle, or over a long period of years, would show a materially greater degree of variation cannot be determined. But available data covering all insured commercial banks for 1938 and 1939, and the smaller group of insured commercial banks submitting reports to the FDIC for 1936 and 1937, support the conclusion that the degree of variation in rate of net charge-offs is characteristically very small in relation to the degree of variation in the rate of income from loans.

#### INFLUENCE OF SIZE

There are wide variations in the size of individual institutions within any one type of agency or bank. It is pertinent to inquire, therefore, into the degree to which large-scale operations in these fields make for an increase in efficiency.

For each type of company in the income tax sample, operating costs, in relation to year-end loans outstanding, were lower among the larger than among the smaller companies.<sup>29</sup> The degree of variation accompanying size differences was minor, however, in comparison with that shown when the companies were grouped according to rate of income.<sup>30</sup> There is good reason to doubt, therefore, that size differences reflect the influence of size *per se*;<sup>31</sup> it is more likely that they reflect the effect of differences in aver-

<sup>29</sup> This was true also of operating costs in relation to total income, but there the variation was less marked, and the tendency was not so regular or so consistent. In none of the years covered by the income tax tabulations was a relationship evident between size of company and proportion of total income absorbed by net charge-offs.

<sup>30</sup> See Chart X.

<sup>31</sup> An irreducible minimum volume of operations is necessary, of course, in any company; a smaller volume will result in a very high rate of operating costs.

age rate of income characteristic of companies in particular size groups.

This conclusion is fortified by data in the smaller samples obtained from the National Credit Office, Inc. Almost without exception the rates of operating cost were higher in the local sales finance companies than in the regional, and higher in the regionals than in the nationals.<sup>32</sup> Although this variation may indicate that a higher degree of efficiency characterizes large-scale operations, it probably resulted mainly from the higher proportion of wholesale and factoring paper discounted by the national and regional companies.

In the National Credit Office samples of personal finance companies during the period 1929-41 no consistent differences in costs were found for national, regional and local companies.<sup>33</sup> Reports of licensed lenders in Illinois and New Jersey, for 1937, reveal a tendency (not, however, without exceptions) for larger offices to have a lower level of operating costs than smaller offices;<sup>34</sup> and available data on personal finance licensees in New York State indicate that in 1939 some decrease in rates of operating cost was associated with larger-scale operation, that is, with a larger volume of loans handled through a single office and branch offices.<sup>35</sup> But these lower costs are attributable, in part at least, to the tendency of the larger offices and the larger chains to make a higher proportion of relatively large loans, and a smaller proportion of very small loans.<sup>36</sup>

Among insured industrial banks operating costs (in relation to average loans outstanding) showed a much greater tendency to vary with variations in rate of income than with variations in size of institution.

<sup>32</sup> See Chapter 4, footnote 18. Also see Table 16. The variation among national, regional and local companies in the proportion of total income absorbed by operating costs was irregular, as shown in Table 14.

<sup>33</sup> See Tables 14 and 16.

<sup>34</sup> See National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (New York 1940) pp. 116-17.

<sup>35</sup> Detailed operating costs in percent of average loans outstanding of 204 licensed lenders in New York, classified by size of office, are presented in State of New York Banking Department, *Second Special Report of the Superintendent of Banks Relative to Licensed Lenders* (1941) pp. 14, 29. These data cover the individual offices for which licenses have been granted; some companies operate a number of offices.

<sup>36</sup> *Ibid.*, Tables 3A, 3B, 3C, 3D, pp. 30-32.

TABLE 19

RATES OF "OTHER" OPERATING COSTS OF INSURED COMMERCIAL BANKS WITH LOANS OF 30 TO 40 PERCENT OF TOTAL ASSETS, 1940, BY LOAN-INCOME RATES AND AMOUNT OF DEPOSITS<sup>a</sup>

Deposits <sup>b</sup>	Loan-Income Rates <sup>c</sup>						
	Under 4%	4-5%	5-6%	6-7%	7-8%	8-10%	10% or Over
\$100,000 or less	..	(3.1)%	(5.7)%	(4.3)%	(3.4)%	3.9%	4.1%
100,000-250,000	(3.0)%	2.0	2.3	2.5	2.9	3.1	3.8
250,000-500,000	(2.0)	2.1	2.0	2.3	2.5	2.8	3.3
500,000-1,000,000	1.8	1.8	1.9	2.0	2.2	2.6	3.2
1,000,000-2,000,000	1.9	1.8	1.8	2.0	2.3	2.6	(2.8)
2,000,000-5,000,000	1.6	1.8	1.8	2.1	(2.3)	(2.3)	..
5,000,000-10,000,000	(1.7)	1.7	1.9	2.0	(3.3)	(3.1)	..
10,000,000-50,000,000	1.5	1.9	1.9	(1.8)	..	..	..
Over 50,000,000	1.4	1.6	(2.0)	..	..	..	..

<sup>a</sup> Based on data from Federal Deposit Insurance Corporation. Rates of "other" operating costs represent costs of operation, exclusive of net charge-offs and interest payments, in percent of total assets; figures are averages of rates of individual banks, and pertain only to banks whose loans outstanding amounted to 30-40 percent of total assets. Loan-income rates represent income on loans in percent of loans outstanding. In regard to banks that were members of the Federal Reserve System loans outstanding, total assets and deposits are averages of figures for call dates during the year; and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Parentheses indicate groups containing 10 banks or fewer.

<sup>b</sup> Each level is exclusive of the lower limit and inclusive of the upper.

<sup>c</sup> Each level is inclusive of the lower limit and exclusive of the upper.

The same was true of commercial banks, as is evident from Table 19, which pertains to banks whose average loans outstanding in 1940 were between 30 and 40 percent of total assets. Except among the smallest banks—those with deposits of \$500,000 or less—the cost rates (in this instance operating costs exclusive of net charge-offs as well as interest payments, and computed in percent of total assets) declined only slightly and irregularly among banks with approximately the same loan-income rate as size of bank increased.

But irrespective of size, the cost rates shown by banks with similar loan proportions exhibited a decided tendency to rise as loan-income rates increased.<sup>37</sup> Thus in commercial banks, as in the specialized agencies, available evidence indicates that character and size of loan have much more influence on operating costs than size of operating unit.

<sup>37</sup> The same tendency was found as loan proportions increased; see Appendix Table B-11. That table indicates no marked relationship between size of bank and rate of operating costs (except among the smallest banks) for banks with the same loan-income rate and approximately the same loan proportions, but it shows a very marked relationship between cost rates and the proportion of total assets in the form of loans for banks of approximately the same size, and with the same loan-income rate.

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## Profitability of Operations

OPERATING profit—the income produced by the entire amount of assets used in an enterprise before the payment or allocation of any return to those who have furnished the funds—is the complement of operating costs; and in each type of consumer instalment financing agency and in commercial banks it decreased over the period 1929-41.

For both the specialized agencies and commercial banks, operating profit in relation to total funds invested in the business—called the rate of operating profit<sup>1</sup>—fluctuated considerably in various phases of the business cycle, but over the period as a whole showed a marked decline.

The rate of operating profit provides one of the best measures of the success of a business as an operating unit;<sup>2</sup> it is the most commonly used measure of profitability in the field of regulated industries—the public utilities and railroads. Its use brings into sharper focus the influence exerted upon the rate of net profit on equity capital by the rate of compensation paid for borrowed funds and by the extent to which the owners' equity, through choice or necessity on the part of the management, is used in the enter-

<sup>1</sup>In the literature on the operations of personal finance companies the rate of operating profit, while purporting to be related to total assets, is actually based indirectly on the amount of loans. For example, in the formula developed by the Russell Sage Foundation, which sets the amount of "necessary and useful" assets in the personal finance business as 115 percent of loans. See Chapter 3, footnote 3.

<sup>2</sup>Professor Paton speaks of this concept, which he calls the earning rate on total capital, as follows: "Of the various possible measures of earning power, that which expresses income from the standpoint of the entire capital of the business, regardless of the form of capitalization, is doubtless the most significant, particularly when comparisons among individual enterprises and between special groups or fields are desired. It is the rate of return realized on all the capital committed to the undertaking, as opposed to the earning power of the stockholders' equity, that indicates the degree of success attending the activity of the concern as an operating unit" National Bureau of Economic Research, *Corporate Profits as Shown by Audit Reports*, by W. A. Paton, New York, 1935, p. 18). Paton uses the rate of profit to stockholders' equity to indicate "earning power from the standpoint of stockholders" (*ibid.*, p. 41).



prise.<sup>3</sup> In comparing two industries, however, it should be borne in mind that a difference in the level of their rates of operating profit does not necessarily indicate differences in efficiency of management, but may be the consequence, as in the case of commercial banks, of differences inherent in the industries.<sup>4</sup>

#### PORTION OF TOTAL INCOME RETAINED AS OPERATING PROFIT

During 1929-41, as is shown in Table 20, the portion of total income represented by operating profit was higher, in general, for the sales finance companies than for the personal finance companies; among industrial banks it tended to fluctuate at an intermediate level, and was notably highest in federal credit unions. Approximately two-thirds of total income was retained by federal credit unions during 1938-41, as compared with from one-third to less than one-half retained by the other agencies. This was due to the credit unions' very low expenses.

During the depression all types of specialized agencies, but especially personal finance and non-investment type industrial banking companies, showed a decrease in the portion of total income represented by operating profit. In general, the subsequent increase did not restore it to the pre-depression level, and after 1936 operating profit represented a declining proportion.

In commercial banks the portion of total income represented by operating profit was as high as in sales finance companies in 1929, but during the depression it declined much more drastically than in the specialized agencies, at one point becoming actually an operating loss. This downward swing was the result of the

<sup>3</sup> Professor Crum uses the "return on equity," a ratio of "profits to equity of stockholders," as the basis of his study of corporate earning power (William Leonard Crum, *Corporate Size and Earning Power*, Cambridge, Mass., 1939, p. 18). Epstein employs the term "profit to total capital" for the ratio of profit before interest payments on long-term debt to net worth plus funded debt, and the term "income to capitalization" for the ratio of net profit to equity capital (National Bureau of Economic Research, *Industrial Profits in the United States*, by Ralph C. Epstein, New York, 1934, p. 50).

<sup>4</sup> The maintenance of a significant portion of total assets in the form of cash and liquid assets has been necessitated by the singular status of the commercial bank as the originator of the most important component of the monetary system—demand deposits. Over the last decade the credit policy of the Board of Governors of the Federal Reserve System has resulted in an increase in the amount of such legally required reserves against deposits, and has thereby reduced the ability of the individual bank to invest its funds in income-producing assets.

TABLE 20

## OPERATING PROFIT OF SELECTED SAMPLES OF CONSUMER INSTALLMENT FINANCING AGENCIES AND COMMERCIAL BANKS IN PERCENT OF TOTAL INCOME, 1929-41\*

<i>Sample</i>	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>b</sup>	55.2%	52.4%	44.6%	42.5%	44.5%	49.4%	52.5%	51.1%	49.3%	48.5%	44.4%	39.6%	35.2%
2 to 4 regional <sup>b</sup>	57.8	50.3	45.3	39.8	37.7	42.0	46.7	44.2	41.2	37.6	36.9	36.4	32.1
9 to 32 local <sup>b</sup>	49.0	40.1	38.5	30.5	36.2	43.7	42.3	42.2	42.5	32.2	33.2	33.8	33.5
202 local <sup>b</sup>	47.7	..	..	..	29.1	..	..	39.3	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>d</sup>	..	46.5	39.9	35.2	33.7	30.0	35.3	35.2	36.2	34.4	33.1	30.9	26.4
2 to 5 regional <sup>d</sup>	47.5	45.0	36.6	-1.9	32.6	32.6	34.1	36.1	38.2	31.8	34.0	33.3	28.9
5 to 7 local <sup>d</sup>	..	..	..	..	..	28.2	30.7	35.4	33.8	27.4	29.5	33.8	30.1
153 local <sup>e</sup>	41.8	..	..	..	23.8	..	..	30.7	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>g</sup>	46.2	..	..	..	18.9	..	..	37.4	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>g</sup>	47.1	..	..	..	27.7	..	..	30.5	..	..	..	..	..
6 largest insured <sup>g</sup>	..	..	..	..	..	26.5	32.5	37.2	34.1	39.6	36.5	32.7	31.0
All other insured <sup>g</sup>	..	..	..	..	..	28.0	35.6	36.7	38.9	33.7	37.1	30.4	32.0
37 insured <sup>g</sup>	41.3	..	..	..	26.0	..	..	40.9	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>f</sup>	..	..	..	..	..	..	54.5	70.3	69.9	65.5	65.3	65.3	62.3
<i>Commercial banks</i>													
All national banks <sup>h</sup>	55.5	47.8	29.1	15.6	-9.4	2.8	39.1	54.2	41.6	38.3	43.1	40.1	39.8
All insured banks <sup>g</sup>	..	..	..	..	..	-2.0	31.8	48.7	37.8	33.5	37.7	37.0	39.2

(footnotes on following page)

large volume of charge-offs on loans, securities and other assets, while the sharp rise in 1936 was due chiefly to recoveries and profits on securities. After 1936 operating profit again represented about the same proportion of total income in national banks as in sales finance companies.

#### RATE OF OPERATING PROFIT

Throughout the period 1929-41, personal finance companies had the highest rate of operating profit of any type of institution under consideration. Figures are shown in Table 21. From a high pre-depression level of 10 to 15 percent, their rate of operating profit declined by almost one-half, reaching its low point probably in 1932; in subsequent years, though it rose again somewhat, it did not regain the earlier level,<sup>5</sup> and after 1937 it showed an irregular but marked decline.

In most of the years under review sales finance companies reported a rate of operating profit scarcely more than one-half that of personal finance companies. Here again the rate tended downward, after its slight peak in 1934-35, and in 1941, in fact, was lower than its depression level and half or less than half its 1929 level.

Industrial banking companies included in the income tax

<sup>5</sup>This is also indicated by the average of figures on reporting licensees in a large group of states. In comparable years the personal finance companies included in the income tax sample reported a somewhat lower rate of operating profit. In regard to the negative rate for regional personal finance companies in 1932, see Chapter 5, footnote 8.

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#### FOOTNOTES TO TABLE 20

\* Operating profit designates the amount of profit after the payment of all costs except the cost of borrowed funds. The number of companies for each year may be found in Appendix Table B-1.

<sup>2</sup>Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income.

<sup>3</sup>Based on tabulations prepared by the Income Tax Study.

<sup>4</sup>Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income.

<sup>5</sup>Based on data from Federal Deposit Insurance Corporation. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

<sup>6</sup>Data obtained from U. S. Farm Credit Administration, Division of Finance and Accounts.

<sup>7</sup>Based on data in Annual Reports of the Comptroller of the Currency.

TABLE 21

OPERATING PROFIT OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES  
AND COMMERCIAL BANKS IN PERCENT OF TOTAL ASSETS, 1929-41<sup>a</sup>

<i>Sample</i>	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>b</sup>	8.1%	6.8%	5.4%	4.8%	5.9%	7.2%	6.7%	6.0%	5.3%	4.6%	4.2%	3.5%	3.2%
2 to 4 regional <sup>b</sup>	8.6	7.3	6.5	4.0	5.3	7.0	7.7	6.7	5.5	4.0	4.4	4.0	3.3
9 to 32 local <sup>b</sup>	9.5	6.6	6.8	4.7	6.0	7.7	7.5	6.8	6.6	4.2	4.7	4.6	4.6
202 local <sup>c</sup>	8.1	..	..	..	4.5	..	..	5.6	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>d</sup>	..	13.4	11.3	10.0	10.0	9.1	10.6	10.4	10.8	9.5	9.2	8.6	7.3
2 to 5 regional <sup>d</sup>	15.0	13.6	9.7	-6	9.2	9.8	10.2	11.0	11.5	8.9	9.2	9.2	8.1
5 to 7 local <sup>d</sup>	..	..	..	..	..	7.9	9.0	10.6	9.7	7.2	7.9	9.5	8.1
153 local <sup>e</sup>	9.9	..	..	..	5.5	..	..	7.3	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>e</sup>	6.6	..	..	..	2.3	..	..	5.2	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>e</sup>	4.6	..	..	..	2.5	..	..	2.8	..	..	..	..	..
6 largest insured <sup>e</sup>	..	..	..	..	..	2.3	2.8	3.4	3.2	3.7	3.3	2.8	2.6
All other insured <sup>e</sup>	..	..	..	..	..	2.9	3.6	4.0	4.3	3.5	3.7	3.0	3.0
37 insured <sup>e</sup>	3.7	..	..	..	2.2	..	..	3.3	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>f</sup>	..	..	..	..	..	..	2.6	4.3	5.1	5.0	4.9	4.9	4.3
<i>Commercial banks</i>													
All national banks <sup>g</sup>	2.7	2.2	1.2	.7	-.4	.1	1.2	1.5	1.2	1.1	1.1	.9	.9
All insured banks <sup>g</sup>	..	..	..	..	..	-.1	1.0	1.4	1.1	1.0	1.0	.9	.9

(footnotes on following page)

sample had lower rates of operating profit than sales finance companies in all three years for which data are available. The rate of non-investment type industrial banking companies, higher in 1929 than that of investment type banks, showed a larger proportionate drop from 1929 to 1933 than that of the other types of companies; but in 1936 it was only slightly lower than it had been in 1929. From 1935 to 1939 the rate of insured industrial banks—the lowest of any of the specialized agencies—fluctuated at a fairly stable level, but declined appreciably in 1940-41.

From 1937 to 1940 the operating profit of federal credit unions showed a high degree of stability, about 5 percent of total assets. This high level, which in 1938-40 exceeded that attained by any type of agency except the personal finance company, is due entirely to the credit unions' low level of operating expenses, since their rate of total income on loans is comparable to, or lower than, that of insured industrial banks. In 1941 their rate of operating profit dropped somewhat.

Over the entire period 1929-41, commercial banks showed a rate of operating profit materially lower than that of the specialized agencies. This may be attributed primarily to the difference in asset composition, since cash and other non-income-producing assets, as well as investments in lower-rate securities, characteristically constitute a larger proportion of total assets of com-

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FOOTNOTES TO TABLE 21

\* Operating profit designates the amount of profit after the payment of all costs except the cost of borrowed funds. The number of companies for each year may be found in Appendix Table B-1.

<sup>b</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. Here the denominator is the average of total assets at the beginning and end of year.

<sup>c</sup> Based on tabulations prepared by the Income Tax Study. The figures represent operating profit in percent of year-end assets.

<sup>d</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. Here the denominator is the average of total assets at the beginning and end of year.

<sup>e</sup> Based on data from Federal Deposit Insurance Corporation. Total assets are averages of figures for beginning, middle and end of year, except for industrial banks in 1934 and 1935, when year-end figures are used; deposits accumulated for the repayment of loans have been deducted from total assets of industrial banks. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

<sup>f</sup> Data obtained from U. S. Farm Credit Administration, Division of Finance and Accounts. The figures represent operating profit in percent of year-end assets.

<sup>g</sup> Based on data in Annual Reports of the Comptroller of the Currency. Total assets are averages of figures for call dates during the year.

mercial banks than of the other agencies.<sup>6</sup> After 1934 the rate of operating profit of commercial banks remained fairly steady, at approximately 1 percent of total assets,<sup>7</sup> but earlier it had swung from 2.7 percent in 1929 to an operating loss of 0.4 of 1 percent in 1933. These extreme fluctuations were caused by the large amount of charge-offs taken in the depression years. The more recent lower rates, as compared with 1929, can be credited in part to lower total income, accompanied by lower but not commensurately lower, operating expenses (both resulting from a decreased volume of lending business), and in part to an increase in assets other than loans.

#### INFLUENCE OF CHARACTER OF LOANS ON THE RATE OF OPERATING PROFIT

In general, individual institutions with higher-than-average rates of income on loans also showed higher-than-average rates of operating profit, indicating that the charges made on high-rate paper more than covered the higher losses and other incidental operating costs.

In the preceding chapter it was pointed out that in general the higher the rate of total income on loans, the larger the proportion of total income absorbed by operating costs. Since the balance of total income not absorbed by operating costs is operating profit, it follows that the higher the rate of total income the lower the proportion of total income retained as operating profit.

But companies with lower-than-average rates of income on loans, though they retained higher-than-average proportions of total income as operating profit, showed lower-than-average operating profit—in relation to total assets. The relatively low operating costs on low-rate paper were not sufficiently low to offset the influence of the higher rate of total income on high-rate loans. Table 22 shows that almost without exception the *rate* of operating profit among the companies included in the income tax sample increased with each increase in the rate of total income in 1936.<sup>8</sup>

This tendency is consistent with the finding that national and

<sup>6</sup> See footnote 4, above.

<sup>7</sup> Except in 1936, when it jumped to 1.5 percent, because of an unusually large amount of recoveries and of profits on securities sold.

<sup>8</sup> Practically no exceptions were shown in 1929 by groups containing more than ten companies; in 1933 there were a few irregularities.

regional sales finance companies had a lower rate of operating profit than the locals (Table 21), even though their operating profit constituted a higher proportion of total income (Table 20). To an increasing degree in recent years the national and regional companies have shown a lower rate of total income than the local

TABLE 22

OPERATING PROFIT OF CONSUMER INSTALMENT FINANCING AGENCIES IN PERCENT OF YEAR-END TOTAL ASSETS, 1936, BY LOAN-INCOME RATES<sup>a</sup>

Loan-Income Rates <sup>b</sup>	Sales Finance Companies	Personal Finance Companies	Industrial Banking Cos.	
			Non-Invest. Type	Invest. Type
Under 8%	(1.6)%	(-1.9)%	(-.8)%	-.1%
8-12	4.6	(1.9)	3.5	3.3
12-16	5.5	3.7	4.8	5.0
16-20	6.7	6.1	5.7	} (5.8)
20-24	6.0	6.5	8.6	
24-28	6.2	7.1	} (9.6)	..
28-32	(9.3)	8.2		..
32-36	(6.1)	8.1	..	..
36 or over	(4.7)	10.4	..	..
ALL COMPANIES	5.6%	7.3%	5.2%	3.1%
Number of companies	202	153	79	93

<sup>a</sup> Based on tabulations prepared by the Income Tax Study. Parentheses indicate groups containing 10 companies or fewer.

<sup>b</sup> Total income (composed predominantly of loan income) in percent of total year-end loans outstanding. Each level is inclusive of the lower limit and exclusive of the upper.

companies as a result of their acquisition of a larger proportion of wholesale and other low-rate paper.<sup>9</sup>

Data on operating profit in percent of employed assets of personal finance licensees in Illinois, New Jersey and New York (Table 23) also illustrate the influence of differences in rate of total income. New Jersey licensees, that showed lower rates of total income than Illinois and New York licensees in almost all the size groups, also showed lower rates of operating profit.

<sup>9</sup> In Chapter 5 attention was called to the positive relationship between the rate of total income on loans and the proportion of total income absorbed by operating expenses. Although the proportion of total income retained as operating profit on low-rate paper is higher, the amount of operating profit per \$100 of low-rate paper is lower.

TABLE 23

RATES OF OPERATING PROFIT AND TOTAL INCOME OF PERSONAL FINANCE LICENSEES IN ILLINOIS AND NEW JERSEY, 1937, AND NEW YORK, 1938, BY YEAR-END EMPLOYED ASSETS<sup>a</sup>

Employed Assets	Operating Profit in % of Year-End Employed Assets			Total Income in % of Year-End Employed Assets			Operating Profit in % of Total Income		
	Ill. <sup>b</sup>	N. J. <sup>c</sup>	N. Y. <sup>d</sup>	Ill. <sup>b</sup>	N. J. <sup>c</sup>	N. Y. <sup>d</sup>	Ill. <sup>b</sup>	N. J. <sup>c</sup>	N. Y. <sup>d</sup>
\$10,000 or less	6.7%	..	} 8.6%	27.4%	..	} 26.6%	24.6%	..	} 32.4%
10,000-25,000	3.9	(-8.5)%		23.1	(16.7)%		16.8	(-50.9)%	
25,000-50,000	5.9	1.7		26.1	15.1		22.7	11.2	
50,000-75,000	8.7	1.9		26.2	18.9		33.0	10.1	
75,000-100,000	7.9	(2.0)		26.2	(17.5)		30.1	(11.4)	
100,000-200,000	8.6	7.4	10.4	25.6	22.5	27.8	33.5	33.1	37.5
200,000-300,000	9.8	9.6	10.9	27.3	24.7	27.7	35.7	38.9	39.5
300,000-400,000	10.8	11.4	11.9	26.5	25.8	27.6	40.7	44.1	42.9
Over 400,000	10.9	(9.2)	11.7	31.3	(21.5)	26.9	34.9	(42.6)	43.3
<b>ALL LICENSEES</b>	<b>9.4%</b>	<b>8.4%</b>	<b>11.3%</b>	<b>27.2%</b>	<b>22.7%</b>	<b>27.4%</b>	<b>34.6%</b>	<b>36.9%</b>	<b>41.1%</b>

<sup>a</sup> Parentheses indicate groups containing 10 companies or fewer.

<sup>b</sup> Based on Illinois, Division of Small Loans, *Analysis of Reports Filed by Personal Finance Companies, 1937*, Schedule I, p. 16. The total year-end employed assets of the 353 offices was about \$11,200,000.

<sup>c</sup> Based on individual reports of small loan licensees in the New Jersey *Annual Report of Commissioner of Banking and Insurance* (1937) pp. 90-101. The total year-end employed assets of the 103 offices was about \$18,400,000.

<sup>d</sup> Based on *Special Report of the Superintendent of Banks of the State of New York Relative to Licensed Lenders* (1940) p. 14. The figures used are average estimated employed assets, and represent 115 percent of average loans outstanding throughout the year. The total average employed assets of the 200 offices was about \$52,300,000.



Within any one of these states those offices having lower average rates of total income also showed lower average rates of operating profit. This relationship between rate of total income and rate of operating profit was particularly evident when the differences between rates of total income were large.<sup>10</sup>

In an analysis prepared by the Superintendent of Banks of the State of New York it was shown that personal finance company offices in small communities were more profitable than those in large cities, a situation "due primarily to the maintenance generally of maximum rates in smaller communities."<sup>11</sup> This finding not only confirms the earlier conclusion concerning the relation of rate of total income on loans to rate of operating profit, but draws attention to the fact that differences in rate of total income on loans are indicative of differences in competitive status, as well as in size and character of loans.

Among insured industrial banks there was an unmistakable relationship in most of the years 1936-41, between rate of income on loans and average rate of operating profit.<sup>12</sup> Since, however, it was most pronounced in 1936 and least pronounced in later years, one may ask whether this connection has not been giving way before new competitive conditions in the field of consumer installment credit.

As in the case of the consumer agencies, insured commercial banks with higher loan-income rates showed higher average rates of operating profit, even though operating costs absorbed a larger proportion of total income. Figures for differences in operating profit among individual insured commercial banks are not available, but a study has been made of the factors affecting the rate of net earnings on total assets.<sup>13</sup> Conclusions based on the relation

<sup>10</sup> It must be recognized that for some licensees lower rates of total income may reflect inability to collect charges levied, and thus directly indicate less efficiency rather than lower charges, larger loans, or a higher quality of loan. To the extent that this is the case, the degree of the relationship between size of office and rate of operating profit which appears in Table 23 would be strengthened, even after cognizance were taken of the influence of differences in rate of total income. But in Illinois only the licensees with offices having employed assets of \$50,000 or less, and in New York and New Jersey only those with assets of \$100,000 or less, showed rates of operating profit materially below those of the other size-of-office groups.

<sup>11</sup> State of New York Banking Department, *Special Report of the Superintendent of Banks Relative to Licensed Lenders* (1940) p. 12.

<sup>12</sup> See Appendix Table B-12.

<sup>13</sup> The most commonly used concepts of profitability in the field of commercial banking are net earnings and net profit. In considering the profitability of banking

between the rate of net earnings and other factors may be considered representative of the relation between the rate of operating profit and the same factors.<sup>14</sup>

Chart XII indicates that the profitability of commercial banking operations, as revealed by the rate of net earnings on total assets, depends in large part upon the proportion of loans held by the individual bank and upon the average rate of income received on average loans outstanding. In 1940, among banks with the same ratio of loans to total assets, average net earnings in percent of total assets increased almost without exception with higher rates of income on loans. Among banks earning the same average rates of income on loans the rate of average net earnings also increased with increases in the proportion of loans.<sup>15</sup>

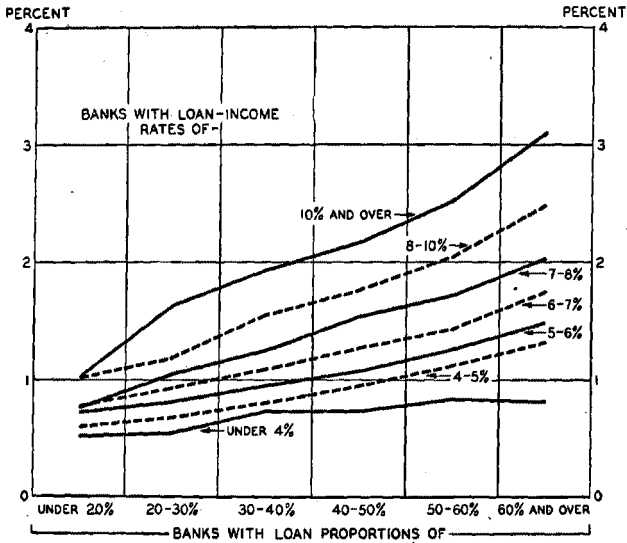
<sup>14</sup> The amount of "operating profit" equals the net earnings plus interest on borrowed funds (in recent years consisting almost exclusively of time and savings deposits) minus net charge-offs. Since interest on deposits (in relation to total assets) has in recent years borne a consistent, positive relationship to the rate of net earnings, a "correction" for this item in each individual case would raise the level of, and augment the relationships shown by, the rates of net earnings. Net charge-offs (in relation to total assets) may show sharp and irregular variation in any single year in an *individual* institution, as pointed out in the preceding footnote, but there is no reason for believing that the deduction of net charge-offs would affect the relationships shown for the rate of net earnings. For 1940 (and for 1938 and 1939) the ratio of net charge-offs to total assets showed no consistent or regular variation with variation in size of bank, in size of center, in rate of net earnings, or in rate of income on loans.

<sup>15</sup> Except for banks earning less than 4 percent on loans; but in these cases no consistent relationship was to be expected, since the rate of return on loans was approximately equal to or below the rate of return on securities, and the share of total income derived from loans tended to be equal to or less than that derived from securities.

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operations for a single year, particularly for individual institutions, the figure of net earnings from current operations is more significant than that of net profit. Net earnings from current operations indicate the extent to which the total income of the bank, after covering interest on deposits and other operating expenses exclusive of net charge-offs, is available to provide for net charge-offs on assets and for a return on capital. Since the figures of net earnings are relatively stable from year to year in an individual institution, they provide satisfactory data for analysis of factors related to differences among individual banks. Net profit consists of net earnings from current operations, plus recoveries on assets previously charged off, reductions in valuation allowances, and profits on securities sold, minus charge-offs on assets and additions to valuation accounts. In any one year the figure of net profit is affected by the amount of losses or recoveries on assets that happened to be taken in that year. Inasmuch as the items upon which losses or recoveries are taken accumulate over a period of years, the amounts that happen to be charged off or recovered in any one year may not necessarily bear any relation to operations in that year. Moreover, the erratic nature of the amount of net charge-offs in an individual institution makes the use of the figure of net profit for a single year unsatisfactory for the analysis of factors affecting the profitability of operations of individual institutions.

CHART XII  
 RATES OF NET EARNINGS OF INSURED COMMERCIAL BANKS, BY  
 LOAN PROPORTIONS AND LOAN-INCOME RATES, 1940\*



\* Rates of net earnings represent net earnings from current operations in percent of total assets; figures used are averages of rates of individual banks. Loan proportions represent loans outstanding in percent of total assets. Loan-income rates represent income on loans in percent of loans outstanding. Points were plotted for each average rate of net earnings, and points for banks having substantially the same loan-income rate were then joined. The slope of the resultant lines shows the increase in rate of net earnings with increases in loan proportions. The increase in rate of net earnings with increases in loan-income rates is shown within a single vertical column of the chart, by the higher levels of the successive lines.

Based on data from Federal Deposit Insurance Corporation. In regard to banks that were members of the Federal Reserve System loans outstanding and total assets are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Loan-income rate groups and loan-proportion groups are inclusive of the lower limit and exclusive of the upper.

Conclusions drawn from the average rates of net earnings on total assets of insured commercial banks are supplemented by a survey of the distribution of the banks according to rate of net earnings of banks having varying loan proportions and varying average loan-income rates. For example, among banks with low proportions of loans (less than 30 percent of total assets) and low average rates of income on loans (less than 5 percent of total loans), 76 percent showed net deficits or net earnings of less than 1 percent of total assets; while among banks with high loan proportions (50 percent or more of total assets) and high loan-income rates (10 percent or more of total loans), 88 percent showed net earnings of 2 percent or more of total assets, and of these considerably more than one-half showed net earnings of 3 percent or over.

Rates of profitability of commercial banking institutions are thus subject to the same factors that influence the rates of income on loans (discussed in Chapter 4) and the proportion of total assets in the form of loans (discussed in Chapter 3).<sup>16</sup>

#### INFLUENCE OF SIZE

Although evidence indicates that rates of operating profit were influenced by the quality and character of the paper held, there was little indication that these rates were higher among larger than among smaller enterprises.

No conclusive relationship between size of institution and either the share of income retained or the rate of operating profit was shown by the companies included in the income tax sample. Among sales finance companies the smaller institutions showed higher rates of operating profit in 1929, whereas in 1933 the rates were quite irregular, and in 1936 the larger institutions showed the higher rates. Among personal finance and non-investment type industrial banking companies the larger companies tended to show a higher rate of operating profit, but this tendency was subject to a number of irregularities.

Moreover, the differential between rates of operating profit

<sup>16</sup> The average portion of total income retained as operating profit did not differ materially among insured commercial banks in centers of different sizes, but the average ratio of operating profit to total assets showed consistent and material decreases with increasing size of center; this indicates that operating profit is, in general, subject to the same influence as rates of income on loans and percentages of loans to total assets.

shown by the larger and the smaller institutions was small in comparison with that which appeared when companies were grouped by rate of total income on loans. Therefore it is likely that size differences, or lack of differences, in rates of operating profit were influenced materially by differences in rates of total income.

The fact that throughout most of the period, national and regional sales finance companies showed a lower rate of operating profit than the local companies may be attributed to the larger proportion of low-rate paper acquired by the larger companies, the influence of which was particularly noticeable in the last few years. In the same way, the generally lower rate of operating profit shown by the six largest insured industrial banks reflects the influence of the larger banks' lower average rate of total income.

In Illinois collateral evidence indicates that the size of licensed personal finance company offices showed a marked relation to rate of profitability in some of the years 1929-40, and suggests that the smaller offices were less able to recover after the depression.<sup>17</sup> In the first two years there was no evidence of a relationship, but when the rate of operating profit fell to a low in all size groups in 1933 or 1934, the decline affected the offices with assets of less than \$200,000 to a much greater extent than it did the larger offices. In addition, by 1936 the larger offices had regained more of their depression losses than the smaller offices.

The poorer showing made by the smaller offices in the depression years may probably be laid to a greater rate of loss and to a lesser ability to control operating expenses.<sup>18</sup> Failure to attain their pre-depression position in 1936 and subsequent years may have been due to an inability to adjust themselves to increased competition in the consumer instalment financing field, effecting higher costs on loans without a commensurate rise in rate of total income.

Among insured industrial banks with deposits of less than \$500,000 the average rate of operating profit appears to have been substantially higher than among the larger banks. In each of the years 1936-41 the rate of operating profit of banks with deposits of

<sup>17</sup> Figures for 1929-36 are presented in M. R. Neifeld, *Personal Finance Comes of Age* (New York 1939) p. 240; comparable figures for 1937-40 were supplied to me by Mr. Neifeld.

<sup>18</sup> It may have resulted also from the lesser ability of the smaller companies to contract total funds with contraction in business.

\$250,000 to \$500,000 was sharply above that of banks in the next higher size group. This suggests that the larger industrial companies were increasingly engaged in activities characteristic of commercial banks.

The rate of operating profit of insured commercial banks appears to have stood in inverse relationship to size of institution, whether the rates were based on aggregates or on figures for individual banks. However, large banks tend to hold more of their assets in the form of cash and low-yield government securities, and more of their loans are made to large business concerns at a low rate of return. Thus the element of size relationship disappears when banks are grouped according to other factors that have been found to be important determinants of rates of profitability.

Among banks of approximately the same size the average ratio of *net earnings* to total assets showed consistent and regular increase with increases in both the rate of income on loans and the percent of loans; but when size of bank was varied and the percentage of loans and rate of income were approximately the same, the variation in average net earnings with increases in size of bank was irregular.

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## Interest Payments: The Cost of Borrowed Funds

ALL consumer instalment financing agencies and commercial banks benefited by the decline in interest rates over the period 1929-41. But whereas in 1929 rates of interest paid on borrowings varied materially among the specialized agencies and commercial banks, by 1941 only relatively small differences were apparent.<sup>1</sup>

The burden of interest payments—measured by the portion of total income they absorbed—also declined over the period in all types of agencies and in banks, primarily because rates declined as the proportion of borrowed funds increased. The burden of interest payments varied considerably among the different types of agencies, in accordance not only with different timing in rate reductions, but also with differences in the proportion of borrowed funds between types of companies.

The cost of borrowed funds is measured by the rate of interest paid on borrowings,<sup>2</sup> in relation to the total amount of debt presumably subject to interest. Some understatement of the interest rate results from this calculation, because some debt is included upon which no interest was actually paid; but except in the case of industrial banks and, to a lesser extent, of sales finance companies, this understatement is not believed to be serious.<sup>3</sup>

<sup>1</sup> Except for local personal finance companies and credit unions. The average rate of interest paid by federal credit unions was considerably higher than that paid by the other agencies; but the credit unions borrowed only a negligible portion of their funds and these borrowings were principally from other credit unions.

<sup>2</sup> The term "interest" is here used to include fees that are a part of the cost of borrowed funds. Thus the figures for interest include not only trustees' fees on collateral trust notes (which were relatively significant in the case of companies in the National Credit Office sample) and amortization of discount on bonds sold, but also, in several instances, a significant amount of unamortized discount on bonds called for redemption prior to maturity.

<sup>3</sup> The error results from the extent to which accounts payable, dealers' deposits, demand deposits, and hypothecated deposits upon which no interest has been paid, have been included in total debt; it probably does not exceed 5 percent of the figures shown, except in the case of the investment type industrial banks included in the

## RATE OF INTEREST PAID ON BORROWINGS

Table 24 reveals that during 1929-41 interest cost, in percent of total debt presumably subject to interest, showed marked variation from year to year and from one type of company to another.<sup>4</sup> At the beginning of the period there was a sharp divergence between rates of interest paid on borrowings by agencies whose funds were derived from depositors or the sale of investment certificates—industrial and commercial banks—and those whose funds were derived from banks, from the sale of bonds, or in the open market—the sales finance, personal finance and non-investment type industrial banking companies. The latter group, regardless of type or size of company, paid from 6 to 8 percent for borrowed money, whereas the former paid approximately half as much.

All types of agencies (except credit unions) benefited substantially from the reduction in interest rates after 1929, although that reduction made itself felt at different times. By 1941 the specialized agencies, on the average, were paying interest rates of between 1 and 3 percent—only slightly above the rate paid on time and savings deposits by commercial banks.

In 1929 sales finance companies paid as high a rate of interest on borrowed funds as any other type of agency. Even the very largest companies included in the National Credit Office sample,

<sup>4</sup>Too much emphasis should not be placed upon the year-to-year fluctuations in the rate of interest as computed for these companies, for the degree of representativeness may vary from year to year. See Appendix A for a discussion of how the ratios may be influenced by the asset and liability figures that have been used as representative of average figures. In regard to the companies included in the income tax sample, the year-end borrowings used as the base may in a great many cases have been materially below the averages for the year, as a result of the pressure under which these companies were placed to reduce borrowings during the early years of the 1930's. A counteracting influence may also have affected the ratios: the nonpayment of interest due during the year—by companies whose income tax was reported on a cash basis—resulted in an indicated reduction in the computed rates which cannot be distinguished from an actual reduction in the average contractual rates.

income tax sample, which probably did not pay interest on their hypothecated deposits. If purity of the data could have been assumed, accounts payable should have been excluded, since it is not the general practice—though instances may exist—to pay interest on accounts payable, particularly with respect to current items. But the existence of large amounts of accounts payable in some instances in the income tax data—in spite of the fact that the amount of accounts payable may be expected to be insignificant in consumer instalment financing companies—appears to justify the assumption that these were improperly reported or tabulated. In the other samples accounts payable were not included.



TABLE 24  
 INTEREST PAYMENTS OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES  
 AND COMMERCIAL BANKS IN PERCENT OF DEBT, 1929-41\*

Sample	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>b</sup>	6.4%	5.2%	4.0%	5.0%	3.2%	2.8%	1.9%	1.8%	2.0%	2.2%	1.9%	1.4%	1.2%
2 to 4 regional <sup>b</sup>	7.5	6.2	5.3	5.4	5.4	4.0	2.4	1.8	1.9	1.6	1.6	1.5	1.6
9 to 32 local <sup>b</sup>	8.3	6.6	7.1	6.6	6.0	6.2	4.4	3.6	3.3	3.0	2.9	2.6	2.4
202 local <sup>c</sup>	6.3	..	..	..	4.8	..	..	2.7	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>d</sup>	..	7.0	6.5	5.8	5.1	4.1	4.8	2.0	2.1	1.8	2.0	2.1	2.2
2 to 5 regional <sup>d</sup>	7.5	7.3	7.4	8.0	5.7	5.6	4.6	3.9	2.9	2.6	2.2	2.1	2.1
5 to 7 local <sup>d</sup>	..	..	..	..	..	5.6	6.9	3.8	4.3	3.8	3.8	4.1	3.6
153 local <sup>e</sup>	5.7	..	..	..	6.1	..	..	5.8	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>o</sup>	6.3	..	..	..	6.4	..	..	4.7	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>o</sup>	2.9	..	..	..	2.8	..	..	2.2	..	..	..	..	..
6 largest insured <sup>o</sup>	..	..	..	..	..	3.0	2.4	2.3	2.2	2.0	1.9	1.9	1.7
All other insured <sup>o</sup>	..	..	..	..	..	2.6	2.3	2.4	2.3	2.1	2.0	2.0	1.9
37 insured <sup>o</sup>	2.7	..	..	..	2.5	..	..	1.5	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>f</sup>	..	..	..	..	..	..	1.4	2.4	3.6	4.2	3.8	4.2	5.5
<i>Commercial banks</i>													
All national banks <sup>g</sup>	3.4	3.4	3.1	2.9	2.6	2.5	2.0	1.7	1.7	1.6	1.5	1.4	1.2
All insured banks <sup>g</sup>	..	..	..	..	..	2.4	2.0	1.7	1.6	1.6	1.4	1.3	1.2

(footnotes on opposite page)

those having access to the open market, were then paying as high a rate as the smaller companies included in the income tax sample, whose sources of funds were presumably more limited. But in the immediately succeeding years the effect of the high regard that sales finance companies in general had acquired among credit sources, as well as the pressure among banks for outlets for funds, began to be noticeable. By 1934, sales finance companies engaged in nationwide and regional operations had so benefited by the reduction in open-market borrowing rates that they were paying a rate of about one-half the 1929 level.

By 1936, however, both the local companies included in the National Credit Office sample, which were presumably borrowing in the open market, and the 202 local companies in the income tax sample, presumably restricted to local sources for credit, were also borrowing at about one-half the 1929 rates. By the end of the period national sales finance companies were paying an average rate on long- and short-term borrowed funds combined, which was as low as the rate paid by commercial banks on time and savings deposits. Regional and local companies with access to the open market were paying somewhat higher average rates, and so, probably, were the smaller local companies with more restricted sources of funds.

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**FOOTNOTES TO TABLE 24**

\* The number of companies for each year may be found in Appendix Table B-1.

† Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. Here the denominator is the average of debt at the beginning and end of year.

‡ Based on tabulations prepared by the Income Tax Study. The figures represent interest payments in percent of year-end debt.

§ Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. Here the denominator is the average of debt at the beginning and end of year.

¶ Based on data from Federal Deposit Insurance Corporation. Interest payments include all interest reported paid on time and savings deposits, postal savings deposits and borrowed money. Figures represent interest payments in percent of average of time and savings deposits (including postal savings deposits) for beginning, middle and end of year, except for industrial banks in 1934 and 1935, when year-end figures are used; deposits accumulated for the repayment of loans have been deducted from time and savings deposits of industrial banks. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

‡ Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts. The figures represent interest payments in percent of year-end debt.

¶ Based on data in Annual Reports of the Comptroller of the Currency. Interest payments include all interest reported paid on time and savings deposits (except time deposits of other banks), postal savings deposits and borrowed money. Figures represent interest payments in percent of average of time and savings deposits (including postal savings deposits) for call dates during the year.

For the large personal finance companies engaged in operations on a nation-wide, regional and local scale, recognition of a high degree of creditworthiness came a little more slowly than for the comparable sales finance companies. From 1936 on, however, the rate of interest paid by national personal finance companies approximated only about 2 percent, and that of the locals 4 percent.

The differentials evident through most of the period in rates paid by the national, regional and local personal finance companies bespoke the lag in recognition of the creditworthiness of smaller institutions. They may also have resulted from the smaller institutions' practice of borrowing funds from sources allied with management or stockholder interests, which deliberately required rates in excess of those available from competitive sources; possible indication of such a practice is seen in the fact that for local companies included in the income tax sample the computed rate for 1936 exceeded that for 1929.<sup>5</sup>

The rate of interest paid by federal credit unions does not appear to have been affected by easy money conditions in the later years of the period. This may be partly attributed to the fact that these organizations have done a large portion of their borrowing from other credit unions, a source not likely to be responsive to changes in short-term interest rates.<sup>6</sup>

<sup>5</sup> Although these computed rates may be influenced by the nature of the data, the distribution of the individual companies included supports the representativeness of the average. Examination of the individual personal finance companies reveals that the rate of interest payments on year-end debt is meaningless in a number of instances, but that these are not sufficiently important to bias the results; the rate is therefore reasonably representative. In several instances the amount of interest paid during the year exceeded the debt outstanding at the end of the year, and in several no debt was outstanding at the end of the year. Repayment of all or of a large proportion of the debt outstanding at the beginning of the year is the most reasonable explanation for such cases, although some of the institutions concerned may have kept their books on a cash basis, and made payments during the year which covered interest for a number of years.

Conversely, there were a number of instances in which debt was reported at the end of the year, but no interest payments during the year; these cases could result from the original issuance of interest-bearing obligations during the year, on which no interest was paid or accrued, or from a failure to pay or to accrue interest on debt that had been outstanding throughout the year. Since all of the companies concerned were small, with total assets of less than \$100,000, it is possible that holders of the stock and of the debt obligations were identical, and that no interest was actually paid.

<sup>6</sup> The much lower rates shown for 1935 and 1936 are believed to represent payment of interest for only a portion of those years, a situation resulting in part from the rapid growth in number of federal credit unions at that time.

Since the sources of funds of non-investment type industrial banking companies and personal finance companies were somewhat alike, it is not surprising to find similarity in both the level of, and changes in, their rates of interest paid on borrowings.

Early in the period the rate of interest paid by industrial banks included in the income tax sample was the lowest to be found among consumer financing agencies. During the latter years, however, the rate paid by insured industrial banks was in excess of that paid by the large sales finance companies. This differential reflects the difference between the primary source of funds of industrial banks and of other types of companies.<sup>7</sup>

Since the great bulk of the borrowed funds of industrial banks takes the form of time and savings deposits, the level of interest rates, and their trend, are subject to the competitive influence of rates on similar deposits in commercial banks. Nevertheless, the average rate paid by insured industrial banks, adjusted for hypothecated deposits, was considerably in excess of the average paid by insured commercial banks. This was true even of the larger insured industrial banks located in very large centers, in which interest rates were materially affected by easy money conditions.

To obtain an adequate and growing volume of deposit, these banks paid rates of interest on time and savings deposits in excess of those paid by larger commercial banks that were their competitors. They were enabled to do so by the satisfactory returns they received on loans; and their rates of net earnings and net profit remained materially above those of the average commercial bank. This suggests that the greater prestige attached to the maintenance of an account with a commercial bank is sufficient to prevent

<sup>7</sup> It must be recognized that the rate of interest paid on deposits by industrial and commercial banks does not represent a true comparison with the rate of interest paid on borrowings by the other types of consumer instalment financing agencies, because a portion, or all, of the cost of running the time and savings deposit department—rent, light, heat, and personnel—should properly be considered a cost of borrowing. Figures of departmental costs vary greatly, depending upon the method of the individual investigator. Some indication of the magnitude of these costs may be derived, however, from figures covering 83 Massachusetts banks for 1937, which showed the following savings department expenses, in percent of time and savings deposits: salaries, 0.22 percent; advertising, 0.01 percent; operating expenses, 0.16 percent; occupancy expenses, 0.10 percent; and total expenses, 0.49 percent (Driscoll, Millet & Company, *Supplementary Report on Survey of Commercial Banks in Massachusetts for the Year 1938*, Philadelphia).

transfer of a significant amount of deposits to an industrial bank, a transfer which an assumption of pure competition would imply.<sup>8</sup>

During the late 1920's the average rate of interest paid on time and savings deposits by commercial banks ranged between 3 and 3½ percent. The decline in rates began in the early thirties, and was marked and steady until 1936. The impetus in the decline may be traced to limitations imposed by the Banking Act of 1933,<sup>9</sup> but its continuance must be ascribed to the influence of the general decline brought about by the easy condition of the money market. By 1941 the interest rate, as shown in Table 24, approached one-third that prevailing in the late twenties.

Data on the rates of interest paid by individual insured commercial banks for 1939, 1940 and 1941 reveal considerable variation from bank to bank, but parallel other data indicating a relative shortage or relative plethora of funds in the communities concerned. In general, banks that paid higher rates of interest on time and savings deposits were the banks with higher proportions of assets in the form of loans producing good rates of interest. For the most part, they were small banks or banks in small communities, and they paid relatively high rates of interest because it was worth their while, apparently, to do so in order to attract additional funds in the form of time deposits. Yet despite the higher rates paid on deposits, they were able to show the best rates of earnings.

The lowest rates of interest paid on time and savings deposits were found among banks in the larger cities, where interest rates generally were very low, where high-rate loans represented a very small proportion of total assets, and where cash, reserves with other banks, and low-yield securities represented a large proportion of total assets.<sup>10</sup> Here free funds in the form of demand deposits

<sup>8</sup> The difference in the rates paid by the insured and the noninsured investment type industrial banks can probably be attributed to the added safety resulting from the insurance of deposits by the Federal Deposit Insurance Corporation.

<sup>9</sup> This act prohibited the payment of interest on demand deposits, with certain minor exceptions, and gave the Board of Governors of the Federal Reserve System power to limit the rates of interest paid on time and savings deposits by national and state banks that were members of the Federal Reserve System. The same power over insured state banks not members of the Federal Reserve System was granted to the Board of Directors of the Federal Deposit Insurance Corporation by the Banking Act of 1935.

<sup>10</sup> The regulation of interest on deposits by clearing house agreements in the larger centers, and the effective absence of such agreements in the smaller centers, may

were plentiful, and there was no incentive to try to attract additional funds. These banks, in spite of their very low rates of interest on deposits, showed the lowest rates of net earnings.

The rate of interest *received* on loans by consumer instalment financing agencies and commercial banks, and the rate of interest *paid* by these institutions, represent a cost of money to different segments of the economy. To a certain extent both rates are subject to factors that affect the availability of lendable funds. But during the period under consideration, the effect of easy money conditions upon rates *paid* by these agencies and by commercial banks was much greater than upon average rates *collected* from their respective customers, so that the differential in favor of the agencies and banks increased.

The extent of this differential, and the changes in it, are best seen from the ratio of average rate of interest on loans to average rate of interest paid on borrowings.<sup>11</sup> At the beginning of the period the average rate of interest received on loans represented, in personal finance companies, about 4.5 to 5 times the average rate paid on borrowings. Comparable ratios for the other consumer instalment financing groups were as follows: investment type industrial banks, 3.5 to 4; sales finance companies, 2.5 to 3.5; non-investment type industrial banking companies, 2.5.

In succeeding years the rapid decrease in the rate of interest paid on borrowings increased these ratios in each type of company,<sup>12</sup> but the relative relationship between rates collected on consumer loans and rates paid for borrowed funds remained essentially the same from one type of company to another: the largest ratio, about 8 to 15, shown by the personal finance companies, was followed

<sup>11</sup> See Appendix Table B-14.

<sup>12</sup> It should not be overlooked that the rates paid by the customers of these companies cover a materially greater element of service than is inherent in the rates paid for the larger amounts borrowed by the companies.

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be considered an incidental factor. See the statement in the *Annual Report* of the FDIC for 1939, p. 54. The distribution of insured commercial banks according to the rate of interest paid on average time and savings deposits, and by the rate of net earnings in 1939, the rate of income on loans, and the ratio of loans to total assets, is presented in Table 146 of the same report, p. 188. The distribution of insured commercial banks according to the rate of interest paid on average time and savings deposits, and by the ratio of time and savings deposits to total deposits, the amount of deposits, and the population of center in which located, is presented in Table 147 of the same report, p. 189. Similar distributions are shown in the Annual Reports for 1940, pp. 200, 202, 203, and 1941, pp. 169-72.

by sales finance companies, 6 to 9; insured industrial banks, 5 to 6; and credit unions, 2.

Figures covering all national banks indicate a comparable but less drastic change in the ratio of average rate of interest received on loans to average rate of interest paid on time and savings deposits, the commercial banks' chief source of interest-bearing funds. In 1929 the average rate of income on loans was 1.8 times the average rate of interest paid on time and savings deposits, while in 1936 the ratio was 2.6 and by 1941 it had become 3.5, resulting in a striking shift in the importance of interest cost to commercial banks. During 1929-34 interest paid on deposits and borrowings amounted to more than 50 percent of income received from loans, but it amounted to less than 30 percent in 1941.

#### INCOME ABSORBED BY INTEREST

From Table 25 it can be seen that in all the specialized agencies, as in commercial banks, the payment of interest exacted a more significant proportion of total income at the beginning than at the end of the period 1929-41. Data on the income tax sample show that among sales finance companies and investment type industrial banks interest payments absorbed more than one-fifth of total income in 1929, while as a result of smaller proportions of outstanding debt, they absorbed only 14 percent among non-investment type industrial banking companies and less than 7 percent among personal finance companies. By 1936, with the decline in interest rates, the burden of interest payments had lessened in all the agencies except personal finance companies.

Despite the increase in proportion of borrowings and the decrease in rate of total income on loans, the force of the decline in interest rates on borrowings was so great in the sales finance companies that between 1929 and 1936 the proportion of total income absorbed by interest payments was reduced to nearly half in the local companies, and to about one-fourth in the national and regional companies. In subsequent years it continued to decline for the smaller sample of local companies, and although it increased somewhat for the regionals and nationals, by 1941 it had returned to the 1936 level.

For the income tax sample of personal finance companies the portion of total income absorbed by interest payments was higher

TABLE 25

INTEREST PAYMENTS OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES AND COMMERCIAL BANKS IN PERCENT OF TOTAL INCOME, 1929-41<sup>a</sup>

<i>Sample</i>	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>b</sup>	32.8%	25.1%	19.3%	20.6%	9.8%	9.3%	8.2%	9.4%	12.5%	15.7%	12.2%	10.9%	9.5%
2 to 4 regional <sup>b</sup>	29.6	23.9	20.0	20.3	14.0	10.6	7.7	6.9	8.9	8.4	7.4	8.6	10.2
9 to 32 local <sup>b</sup>	25.6	23.9	24.2	22.1	15.8	18.2	15.3	14.2	13.8	13.4	11.7	11.8	11.3
202 local <sup>c</sup>	20.8	..	..	..	13.3	..	..	11.6	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>d</sup>	..	6.0	7.2	6.2	4.3	3.6	2.3	2.2	2.5	2.2	2.5	2.9	3.3
2 to 5 regional <sup>d</sup>	9.3	6.3	13.8	9.7	5.3	6.7	5.6	4.9	3.9	3.8	3.4	3.4	3.5
5 to 7 local <sup>d</sup>	..	..	..	..	..	4.4	5.8	3.2	5.2	5.5	5.0	5.5	5.4
153 local <sup>e</sup>	6.6	..	..	..	4.8	..	..	7.6	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>g</sup>	13.9	..	..	..	10.4	..	..	10.2	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>h</sup>	20.9	..	..	..	20.4	..	..	17.2	..	..	..	..	..
6 largest insured <sup>h</sup>	..	..	..	..	..	26.5	21.7	19.4	18.6	16.9	16.5	16.3	14.8
All other insured <sup>h</sup>	..	..	..	..	..	15.6	14.9	13.6	14.0	13.6	13.2	13.1	13.3
37 insured <sup>h</sup>	22.6	..	..	..	19.8	..	..	13.9	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>f</sup>	..	..	..	..	..	..	1.1	1.0	1.1	1.3	1.1	1.0	.9
<i>Commercial banks</i>													
All national banks <sup>g</sup>	34.7	35.8	33.8	32.0	26.3	21.8	19.1	16.2	15.1	14.6	13.5	12.2	10.7
All insured banks <sup>g</sup>	..	..	..	..	..	20.4	17.8	15.3	14.5	14.6	13.4	12.3	11.0

(footnotes on following page)



in 1936 than before the depression, due to the increase in proportion of borrowings and the continued high rate of interest on them. But for the national or regional companies, whose rate of interest paid on borrowings fell off sharply after 1929, there was a marked drop in the amount of total income absorbed by interest expense; after 1937 it showed no material change.

The very low proportion of borrowings of federal credit unions accounts for absorption of only about 1 percent of those organizations' total income by interest expense in 1935-41, the lowest figure for any type of agency. For the insured industrial banks this proportion decreased gradually from year to year after 1934, with the decrease in the rate of interest paid on deposits.

More than one-third of the total income of commercial banks was required to meet interest payments in 1929, a substantially higher proportion than was generally required in any of the specialized agencies. It began to decline, however, in 1932, and thereafter its fall was very rapid, following the prohibition of interest payments on demand deposits and regulation of interest rates on time and savings deposits.<sup>13</sup>

By 1941 only about one-tenth of the total income of commercial banks was absorbed by interest payments, a figure about equal to that of sales finance companies and somewhat lower than that of insured industrial banks. The downward trend in this proportion was due almost entirely to the decline in interest rates paid on

<sup>13</sup> See footnote 9, above.

FOOTNOTES TO TABLE 25

<sup>a</sup> The number of companies for each year may be found in Appendix Table B-1.

<sup>b</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income.

<sup>c</sup> Based on tabulations prepared by the Income Tax Study.

<sup>d</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income.

<sup>e</sup> Based on data from Federal Deposit Insurance Corporation. Interest payments include all interest reported paid on time and savings deposits, postal saving deposits and borrowed money. Cash depositories and banks in this study designated as insured industrial banks are included with all insured commercial banks.

<sup>f</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts.

<sup>g</sup> Based on data in Annual Reports of the Comptroller of the Currency. Interest payments include all interest reported paid on time and savings deposits (except time deposits of other banks), postal savings deposits and borrowed money; before 1935 they include, in addition, interest on demand deposits.

deposits, a decline more drastic in commercial than in insured industrial banks.

In general, among companies included in the income tax sample, the larger the company the higher the proportion of total income absorbed by interest cost. Predominant in effecting this relationship was the disposition shown by the larger companies to borrow a higher proportion of funds than the smaller companies. Only among sales finance companies in 1936 was the payment of decisively lower rates of interest by the larger companies a factor strong enough to counteract the influence of heavier borrowing and eliminate all relationship between size of company and the proportion of total income absorbed by interest.<sup>14</sup>

This tendency for larger companies to show higher interest cost in relation to total income was not clear-cut among the smaller samples. After 1930 regional sales finance companies showed a lower proportionate interest cost than the locals, but the national companies moved erratically, exceeding both regionals and locals in some years and falling below both in other years. This lack of a conclusive size-interest cost relationship was due primarily to the fact that differences in the proportion of borrowings in these companies, all borrowers in the open market, were not consistent with scope of operations. Among personal finance companies in the National Credit Office sample the relative burden of interest expense was consistently lower for the national than for the regional companies throughout the period; and after 1936 it was lower for the regionals than for the locals.

#### INFLUENCE OF CHARACTER OF LOANS ON THE RATE OF INTEREST PAID ON BORROWINGS

In Chapter 5 it was pointed out that companies receiving higher-

<sup>14</sup>In 1929 and 1933 the positive relationship between the size of sales finance companies and the proportion of total income absorbed by interest was reasonably consistent, and resulted from the lower rate of gross income and the higher proportion of borrowings shown by the larger companies. Personal finance companies and non-investment type industrial banking companies also showed a positive relationship between size of company and the proportion of total income absorbed by interest cost, but with varying degrees of regularity in each year. The greatest regularity for personal finance companies was shown in 1935; in each of the years the higher proportion of borrowings shown by the larger companies was the predominant influence upon the importance of interest as a cost-component. Investment type industrial banks showed a very pronounced relationship in 1933 and 1936; in 1929 it was less regular.

than-average rates of income from loans sustained higher-than-average rates of operating costs, including charge-offs. Similarly, it appears from the data presented in Table 26 that the higher the rate of income received on loans, the higher the rate paid by the company on its own borrowings.

TABLE 26

INTEREST PAYMENTS OF CONSUMER INSTALMENT FINANCING AGENCIES IN PERCENT OF YEAR-END DEBT, 1936, BY LOAN-INCOME RATES<sup>a</sup>

Loan-Income Rates <sup>b</sup>	Sales Finance Companies	Personal Finance Companies	Industrial Banking Cos.	
			Non-Invest. Type	Invest. Type
Under 8%	(1.8)%	(8.0)%	.6%	1.7%
8-12	2.6	3.7	4.9	1.7
12-16	2.2	3.5	4.8	2.4
16-20	3.6	4.6	4.2	} (3.1)
20-24	3.5	4.5	4.8	
24-28	5.1	7.8	} (8.5)	..
28-32	(4.6)	5.4		..
32-36	(5.9)	7.1	..	..
36 or over	(6.8)	5.7	..	..
ALL COMPANIES	2.7%	5.8%	4.7%	1.8%
Number of companies	202	153	79	93

<sup>a</sup> Based on tabulations prepared by the Income Tax Study. Parentheses indicate groups containing 10 companies or fewer.

<sup>b</sup> Total income (composed predominantly of loan income) in percent of total year-end loans outstanding. Each level is inclusive of the lower limit and exclusive of the upper.

This positive relationship between rate of income on loans and rate of interest on borrowings probably derives from the willingness of companies with a large proportion of loans that produce high rates of income to pay high rates to obtain additional funds.<sup>15</sup> It may also be due in some cases to the borrowing of funds, at higher cost, from sources closely allied to the management, and in others to the prejudice in some quarters against institutions engaged in high-rate lending.

The relation of rate of income on loans to rate of interest on borrowings was most evident among sales finance companies, but it was fairly clear, though with more exceptions, among personal

<sup>15</sup> This was pointed out above, with respect to insured banks.

finance companies. Among industrial banking companies the apparent relationship was based on so few groups that it would be considered inconclusive in the absence of proof of a similar relationship in the other agencies.

The burden of interest payments, however, did not increase with increases in the rate of income from loans. The reason for this is that, just as in the case of the rate of operating costs, the rate of interest paid on borrowings, while higher among the higher income rate groups, was not nearly so much higher as the rate of income. In addition, the companies with a higher-than-average rate of total income generally showed a smaller proportion of borrowings. Thus the interest payments of the higher loan-income rate companies accounted for only a portion of the higher rates received, and did not absorb higher proportions of total income.

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## Net Profit and Cash Dividends: The Share of the Owners

THROUGHOUT the period 1929-41, net profit—the amount available to stockholders after all operating costs and interest payments have been met—was a high percentage of net worth for the consumer instalment financing agencies as compared with commercial banks or with other corporations generally. Likewise, their dividend payments to stockholders were higher percentages of net worth than those of banks or other corporations. However, as a result of the higher level of net profit among the specialized agencies, the amounts paid out in dividends generally represented a smaller proportion of net profit than they did for commercial banks or other corporations.

### NET PROFIT

#### *Rate of Net Profit*

The average rate of net profit on the book value of ownership equity invested in the business declined sharply during the depression for the consumer instalment financing agencies, but in general it remained positive; after reaching pre-depression levels during the recovery in 1936 and 1937, it declined in 1938, rallied in the subsequent years and remained at a high level.<sup>1</sup> On the other hand, the average rate of net profit on net worth of commercial banks, although better than that of corporations in general, was lower than that of the consumer agencies in the good years, and in the depression was a negative figure. Figures are shown in Table 27.

Sales finance companies for the period as a whole showed almost

<sup>1</sup> A considerable variation was shown in the rates of net profit reported by individual companies in the income tax sample, but the distribution of individual companies, presented in Appendix Table B-14, confirms the inferences based on average rates of net profit.

TABLE 27

NET PROFIT OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES  
AND COMMERCIAL BANKS IN PERCENT OF NET WORTH, 1929-41\*

Sample	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>b</sup>	15.9%	11.4%	8.9%	5.8%	9.6%	15.3%	17.9%	20.2%	20.4%	14.1%	12.1%	12.3%	14.1%
2 to 4 regional <sup>b</sup>	16.4	13.0	11.5	3.6	6.4	11.8	18.5	19.2	15.6	9.6	10.1	10.7	8.9
9 to 32 local <sup>b</sup>	13.4	8.0	7.4	3.1	6.9	11.0	15.0	16.0	16.1	7.5	9.0	10.8	11.6
202 local <sup>a</sup>	11.9	..	..	..	4.7	..	..	12.1	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>d</sup>	..	16.3	14.1	12.2	12.0	11.3	13.5	14.9	16.6	14.4	13.8	13.5	11.8
2 to 5 regional <sup>d</sup>	20.6	16.4	12.8	-6.3	10.8	12.7	14.0	16.3	18.2	14.0	15.1	15.4	14.5
5 to 7 local <sup>d</sup>	..	..	..	..	..	9.2	10.4	13.7	13.8	10.2	11.4	14.5	12.8
153 local <sup>e</sup>	11.8	..	..	..	5.4	..	..	8.3	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>o</sup>	7.3	..	..	..	1.3	..	..	5.9	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>o</sup>	9.7	..	..	..	2.0	..	..	4.9	..	..	..	..	..
6 largest insured <sup>o</sup>	..	..	..	..	..	..	6.3	12.1	12.5	19.2	16.7	13.4	13.4
All other insured <sup>o</sup>	..	..	..	..	..	4.1	7.3	8.2	10.0	8.0	9.8	7.8	8.7
37 insured <sup>o</sup>	8.9	..	..	..	1.8	..	..	10.8	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>f</sup>	..	..	..	..	..	..	2.6	4.3	5.1	5.0	4.9	4.9	4.3
<i>Commercial banks</i>													
All national banks <sup>g</sup>	7.8	4.0	-1.5	-5.0	-9.6	-5.2	5.1	10.0	7.1	6.1	7.4	7.0	7.5
All insured banks <sup>o</sup>	..	..	..	..	..	-5.5	3.4	8.4	6.0	4.7	6.0	6.1	6.7

(footnotes on following page)

as high a rate of net profit on net worth as personal finance companies, despite a relatively low rate of operating profit on total funds. Their net profit rate showed sharper fluctuations, however, with changes in the business cycle, falling during the depression and rising in the years immediately following 1933; and its year-to-year pattern diverged materially from the rate of operating profit on total assets. These relationships emphasize the importance, as factors in the rate of net profit, of the sales finance companies' high proportion of borrowed funds, and of the interest rate paid on them.

In 1929 the rate of interest paid by sales finance companies on borrowed funds was only slightly below the rate of operating profit; nevertheless, the high proportion of borrowed funds provided sufficient leverage to lift the rate of net profit on equity capital. When the rate of operating profit fell, from 1930 to 1933, the rate of interest paid on borrowed funds fell also, but less rapidly, so that the rate of net profit dropped more sharply than the rate of operating profit. From 1933 to 1936 the rate of net profit rose spectacularly, much more rapidly than the rate of operating profit, because of the continued sharp fall in the interest rate on borrowed funds, and the rise in the proportion of such funds. From 1938 to 1941, despite a decline in the rate of operating profit, the rate of net profit was fairly stable, thanks to the continued decline in the rate of interest on borrowings and in the proportion of equity capital.

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FOOTNOTES TO TABLE 27

<sup>a</sup> The number of companies for each year may be found in Appendix Table B-1.

<sup>b</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. Here the denominator is average net worth at the beginning and end of year.

<sup>c</sup> Based on tabulations prepared by the Income Tax Study. The figures represent net profit in percent of year-end net worth.

<sup>d</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. Here the denominator is average net worth at the beginning and end of year.

<sup>e</sup> Based on data from Federal Deposit Insurance Corporation. Net worth is the average of figures for beginning, middle and end of year, except for industrial banks in 1934 and 1935, when year-end figures are used. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

<sup>f</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts. The figures represent net profits in percent of year-end net worth.

<sup>g</sup> Based on data in Annual Reports of the Comptroller of the Currency. Net worth is the average of figures for call dates during the year.

<sup>h</sup> Less than 0.05 percent.

In personal finance companies, whose proportion of borrowed funds was lower than that of sales finance companies, fluctuations in the rate of net profit on net worth followed those in the rate of operating profit on total assets more closely. In addition, as long as the rate of personal finance companies' operating profit was high, the decline in the interest rate paid on borrowed funds, and the increase in the proportion of such funds, had a less noticeable effect on the rate of net profit. By 1937, however, the rate of operating profit had decreased sufficiently to allow the influence of these factors to be reflected in the rate of net profit. After 1937, despite the continued decline in the rate of operating profit, the rate of net profit was relatively stable.

For industrial banking companies included in the income tax sample the average rate of net profit in 1929 was somewhat below that of sales finance and personal finance companies, and by 1933 it had dropped still further. This fall was sharper than that in the rate of operating profit, since the cost of borrowed capital had remained relatively constant. During the subsequent upturn, 1933-36, the rate of net profit of non-investment and of noninsured investment type industrial banking companies failed to reach 1929 levels, since the rate of operating profit did not show sufficient recovery nor the rate of interest on borrowed capital sufficient decline.

This was in sharp contrast to the experience of insured industrial banks, which exceeded their 1929 level in 1936 and subsequent years, as a result of the expansion in proportion of deposits to equity capital and the decrease in rate of interest paid on deposits.<sup>2</sup>

Since the proportion of borrowed capital in federal credit unions has always been insignificant, the rate of net profit—about 5 percent of year-end net worth—was only fractionally higher during the period under review than the rate of operating profit on year-end total assets. As in the case of all data covering federal

<sup>2</sup>Figures for a group of reporting Morris Plan banking companies—almost all of which are investment type companies, and a number of which are insured banks, included in the income tax sample—show a higher rate of net profit throughout the period than the other samples of industrial banks. In this series, the fluctuations from year to year, however, are in general agreement with those indicated by the other samples. See National Bureau of Economic Research (Financial Research Program), *Industrial Banking Companies and Their Credit Practices*, by Raymond J. Saulnier (New York 1940) Table 47, p. 164.



credit unions, the average rate of net profit of those units that have operated throughout the respective years was somewhat higher than indicated by reported figures, which are affected by the rapid growth in the number of federal credit unions during this period.

Over the period 1890-1929 national banks experienced an average rate of net profit of 7.8 percent of net worth,<sup>3</sup> the same as that shown in 1929. The fact that despite a substantially lower rate of operating profit, this net profit rate was almost as high as that of investment type industrial banking companies, and about two-thirds that of local sales finance and personal finance companies, may be attributed to the high proportion of demand deposits, on which no interest or a very low rate of interest was paid.<sup>4</sup>

The national banks' rate of net profit dropped sharply to a negative figure of almost 10 percent in 1933, as a result of continued payment of interest, which absorbed over one-quarter of total income at a time when the rate of operating profit had declined beyond the vanishing point. This drastic drop in rate of operating profit may be laid to the huge increase in the rate of gross and net charge-offs on loans and securities.<sup>5</sup>

With the subsequent recovery the rate of operating profit for national banks fluctuated around 1 percent of total assets, a level less than one-half that of the late twenties. At the same time, however, there was a further decline in the proportion of total funds represented by net worth,<sup>6</sup> a prohibition of interest payments on demand deposits, and a sharp decrease in the rate of interest paid on time and savings deposits.<sup>7</sup> In consequence, during the six-year period ending in 1941, the rate of net profit of all national banks averaged about 7.5 percent, only slightly below the rate for 1929 and the average for the years 1890-1929.<sup>8</sup>

<sup>3</sup> See Chart XV, below.

<sup>4</sup> The rate of operating profit was less than 3 percent of total assets, and the rate of interest paid on time and savings deposits was in excess of the rate of operating profit.

<sup>5</sup> See Chart IX, Chapter 5.

<sup>6</sup> See Chart III, Chapter 2.

<sup>7</sup> See Chapter 7, especially footnote 9.

<sup>8</sup> The only practical method of determining the *rate of profitability* (on net worth) is by the use of book figures of net worth. It should be noted that as a result of the disappearance of a substantial portion of the net worth of the entire banking system, through bank failures in the early thirties, the total *dollar amount* of net profit (and of dividends) of the banking system was lower, in relation to the previous decade, than the data on *rates* indicate.

*Comparison with Other Industries*

It is difficult, if not impossible, to obtain an adequate measure of the profitability of consumer instalment financing agencies and commercial banks in relation to that of other types of corporations. Figures are available, however, from income tax returns for the years 1930-39, covering the rate of net profit (book) to net worth for all active corporations and for banks and trust companies.<sup>9</sup> In Chart XIII these are juxtaposed to figures on the rate of net profit to net worth of the National Credit Office samples of sales finance and personal finance companies, and to figures covering insured industrial banks. Although the data are not entirely comparable, one set being prepared for published statements, supervisory authorities, or credit purposes, and the other for income tax purposes, the indicated levels of net profit rates reveal that throughout the period consumer agencies earned materially higher rates of net profit on owners' equity than banks or corporations in general.<sup>10</sup>

Figures prepared from income tax returns of banks and trust companies,<sup>11</sup> and of all corporations, are more readily comparable to each other than to the other series shown in the chart. The banks' rate of net profit on net worth appears to have been more favorable than that of all corporations except in 1933 and 1934, and for the period as a whole banks showed a net profit of 2.5 percent of net worth, as compared with 2.1 percent for all corporations.

Banks were able to continue profitable operations through 1931, one year longer than all corporations, and did not emerge from their unprofitable situation until after 1934, again a year later than all corporations. This supports the view that the effect of

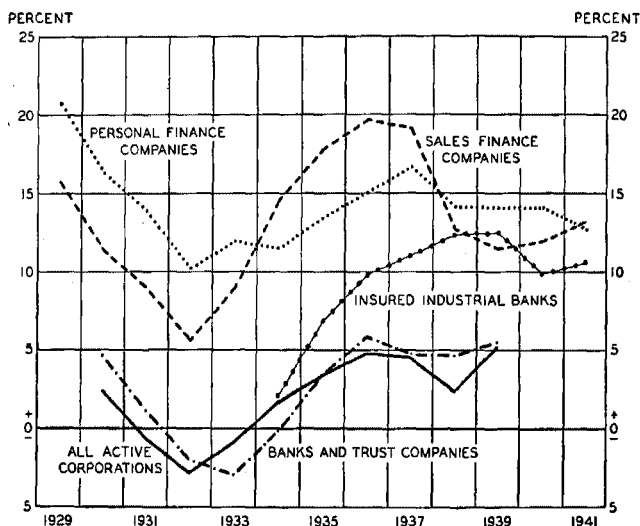
<sup>9</sup> In presenting figures from income tax returns the Internal Revenue Bureau separates returns of companies and banks into those with "net income" and those with "no net income." These have been combined here.

<sup>10</sup> In order to simplify the presentation the rates of national banks have not been included in the chart. They showed more extreme variation than the rates of all banks and trust companies filing income tax returns, being lower in 1930-34 and higher in subsequent years. The figures are available for comparison in Table 27.

<sup>11</sup> The classifications used were, for 1930-37, "national banks" and "state banks and trust companies," and, for 1938-39, "banks and trust companies." Although the categories used by the Internal Revenue Bureau include some enterprises not encompassed in our definition of commercial banks (and apparently exclude industrial banks), the differences are not sufficiently significant to affect our conclusions.

CHART XIII

RATES OF NET PROFIT OF CONSUMER INSTALMENT FINANCING AGENCIES,  
COMMERCIAL BANKS AND ALL CORPORATIONS, 1929-41<sup>a</sup>



<sup>a</sup> Represents net profit in percent of net worth. For sales finance and personal finance companies, based on data from the National Credit Office, Inc., combining national, regional and local companies; net worth is the average of figures for beginning and end of year. For industrial banks, based on data from Federal Deposit Insurance Corporation covering insured industrial banks; net worth is the average of figures for beginning, middle and end of year, except in 1934 and 1935, when year-end figures are used; banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. The number of the above companies for each year may be found in Appendix Table B-1.

For all active corporations filing income tax returns based on data in *Statistics of Income*. For active banks and trust companies filing income tax returns based on data in the *Source Book* of the Bureau of Internal Revenue. Returns were filed on a fiscal or calendar year basis. The comparability of these sets of data for the various years is discussed in *Statistics of Income, 1938*, Part 2, pp. 6-8, 241-83.

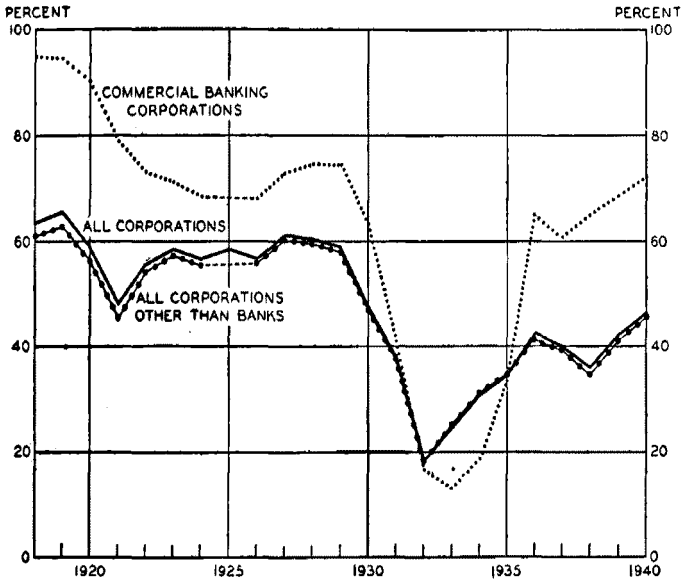
the business cycle on banks tends to come later than that on the national economy as a whole.

Further data from the income tax returns are presented in Chart XIV, which shows the proportion of corporations reporting taxable net income for each of the years 1918-40.<sup>12</sup> This chart reveals

<sup>12</sup> Taxable net income differs from net profit, as tabulated from income tax returns, by the amount of tax-exempt income and by the amount of income, excess profits taxes, and surtaxes.

CHART XIV

## PERCENTAGE OF CORPORATIONS FILING RETURNS THAT REPORTED TAXABLE NET INCOME, 1918-40\*



\* Based on data in *Statistics of Income*, and in the *Source Book* of the Bureau of Internal Revenue covering income tax returns of all active corporations filed on a fiscal or calendar year basis. Prior to 1927, inactive corporations were included, their returns being compiled among those showing no taxable net income. Except for "all corporations" figures are not available for 1925. In 1938 there was a slight change in classification of "commercial banking corporations."

that during the first war a greater proportion of national and state banks and trust companies enjoyed profitable operations than all other corporations taken as a whole. Moreover, the proportion of banks whose operations were profitable is probably understated, primarily because in banks interest from tax-exempt securities is an important component of total income.<sup>13</sup>

<sup>13</sup> The importance to banks of income from tax-exempt securities is indicated by the following percentages of income on government obligations in 1938 (both wholly and partially tax-exempt) to total income ("total compiled receipts"):

	All Corps.	Banks	All Corps. Other Than Banks
All corporations	0.6%	23.2%	0.2%
Corporations with taxable net income	0.5	24.1	0.1
Corporations with no taxable net income	0.8	20.6	0.6

While the advantage of banks over other corporations diminished materially after 1920, under the pressure of agricultural difficulties on many small country banks, it lasted nevertheless until 1930. In 1931 and 1932 the proportion of enterprises showing net income rapidly became smaller, reaching a low point for all corporations in 1932 and for banks in 1933, when only one bank in eight reported taxable net income. From 1932 through 1935 the proportion of enterprises showing taxable net income continued lower among banks than among other corporations, but this relationship was reversed in 1936, and from that year through 1940 the differential in favor of banks was greater than it had been during the twenties.

From data on the proportion of companies reporting taxable net income for the period 1918-40, and on rates of net profit on net worth for the shorter period 1930-39, it appears that the profitability of capital invested in banking is higher than that of corporate enterprises in general. However, there is no doubt that in some specific industrial groups a higher proportion of corporations enjoyed profitable operations, or that certain industrial groups as a whole had higher average rates of net profit on net worth.<sup>14</sup>

#### *Profitability and Size of Institution*

There is little indication of a direct relationship between size of enterprise and rate of net profit among the specialized companies included in the income tax sample.

Since the relation of size of company to rate of operating profit on total assets was slight,<sup>15</sup> any relationship existing between size of company and rate of net profit must be attributed to variation in the rate of interest paid on borrowings, or to variation in the relationship between borrowed and owners' capital.

We have seen that there was little connection between size of company and rate of interest paid on borrowed capital among the companies included in the income tax sample,<sup>16</sup> but that for both

<sup>14</sup> Six-year averages of rates of return for industrial groups, over the period 1931-36, presented in William Leonard Crum, *Corporate Size and Earning Power* (Cambridge, Mass., 1939) p. 25, lead to the conclusion that the public utility, food, liquor, tobacco, leather, rubber, paper, printing, chemical, and metal groups had higher rates of net profit than commercial banks during this period.

<sup>15</sup> See the concluding section of Chapter 6.

<sup>16</sup> See Chapter 7.

sales finance and personal finance companies included in the smaller samples, the degree of variation among companies engaged in nation-wide, regional and local operations differed considerably from year to year during the period 1929-41.<sup>17</sup>

It appears, therefore, that any correspondence between size of enterprise and rate of net profit on net worth shown by these companies would be due almost entirely to variations in the proportion of total funds represented by owners' equity. But although the relationship between size of institution and proportion of net worth was marked,<sup>18</sup> the influence of the latter upon rate of net profit (to net worth) was largely dissipated by the counter-influence of rate of operating profit and rate of interest on borrowings, both of which bore an irregular relationship to size of institution. The influence of size on the rate of net profit was thus negligible.

National bank data collected by the Federal Reserve Committee on Branch, Group, and Chain Banking for the years 1926-30, inclusive, show a rate of net profit on net worth markedly higher for the larger than for the smaller banks, when banks are grouped according to size, as measured by loans and investments.<sup>19</sup> These data have been widely interpreted and quoted as proving a causal relationship between size of institution and rate of profit.<sup>20</sup> There is every indication, however, as pointed out in a later study,<sup>21</sup> that

<sup>17</sup> See Chapter 7, especially Table 24.

<sup>18</sup> See Chapter 2, especially Chart II.

<sup>19</sup> *Banking Profits, 1890-1930* (material prepared for the information of the Federal Reserve System by the Federal Reserve Committee on Branch, Group, and Chain Banking): *Documents, Vol. 22, 73rd Congress, 1933-34.*

<sup>20</sup> See, for example, Twentieth Century Fund, *How Profitable is Big Business?* (New York 1937) pp. 160-61, which concludes as follows: "A study of banking profits shows clearly that the larger institutions had more favorable operating results than the smaller ones. . . ." "The comparison between the profitability of large and small banks leaves little doubt that the advantage is with the former. Nevertheless, the largest banks are by no means always the most profitable. Neither should it be assumed that operation on a small scale cannot be made fairly profitable. Many of the smallest institutions must be looked upon, however, as uneconomic units and as constituting weak links in the banking system." See also Chapter 9 and pp. 150-53.

<sup>21</sup> See Donald S. Thompson, "Trends of Bank Earnings and Expenses," *Journal of the American Statistical Association*, vol. 33 (June 1938) pp. 327-33. This study shows that the figures on profits of small banks were dominated by figures of banks in agricultural and rural regions, particularly in the midwest and south, and that the figures on large banks were dominated by the results of banks in industrial and financial centers, particularly in the north and east. During the period covered by the study, banks in agricultural regions were still subject to the effects of postwar adjustments in agriculture; many of their loans were in default and the banks were taking substantial charge-offs on assets. Industry and finance, on the other hand, were active and prosperous. "The loss experience of the larger banks was charac-

the figures not only reflect the economic circumstances in which banks operated during that period, but are greatly influenced by variations in the proportion of total funds represented by net worth.

Among insured commercial banks in the years 1939-41 the relation of total net worth to total assets was much more important in determining the rate of net profit on net worth than was size of bank. This is evident from Table 28, which presents average net profit in percent of total net worth of insured commercial banks, grouped by amount of deposits and percentage of net worth, for the calendar year 1939.

When the percentage of net worth is held constant (reading down in the table) there is a tendency for smaller banks to show higher rates of net profit than larger banks, exactly the reverse of the conclusions attributed to the Federal Reserve Committee study. Differences between rates of net profit in any one group of banks with the same net worth proportion are not nearly so marked, however, as are differences between rates of net profit in any one size group (reading across the table) with varying net worth proportions.

#### *Influence of Character of Loans on the Rate of Net Profit*

We have seen in Chapter 6 that in consumer instalment financing companies included in the income tax sample there was a close relationship between rate of operating profit on total assets and rate of total income on loans—the rough measure of the character of the paper held; and that this was true also of commercial banks, where the relationship was computed between rate of net earnings on total assets and rate of income on loans.

This influence of character of paper on rate of operating profit (or net earnings) was sufficiently strong to carry over to the rate of net profit on net worth. True, the relationship between character of paper and rate of net profit was subject to a number of irregularities, due to the intervening influence of lower rates of interest on borrowed capital in low-rate companies, and of their higher proportion of borrowed funds. Nevertheless, in general, the greater

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teristic of a period of prosperity; that of the small banks appeared to be characteristic of a period of depression. It seems, certainly in retrospect, that the situation was not at all a characteristic one and was of such a nature as to result in an unfavorable showing of small banks as compared with large banks."

TABLE 28

**RATES OF NET PROFIT OF INSURED COMMERCIAL BANKS, 1939, BY NET WORTH PROPORTIONS  
AND AMOUNT OF DEPOSITS\***

Deposits	All Banks	Net Worth in Percent of Total Assets								
		Under 5%	5-7½%	7½-10%	10-12½%	12½-15%	15-20%	20-25%	25-30%	30% or Over
\$100,000 or less	3.4%	..	..	..	(-.9)%	7.0%	4.3%	3.8%	3.7%	1.6%
100,000-250,000	6.0	..	(8.5)%	8.4%	7.7	6.8	6.1	5.2	3.7	2.7
250,000-500,000	7.6	(15.6)%	6.0	10.2	8.9	7.6	6.1	5.2	5.3	2.5
500,000-1,000,000	7.6	(16.9)	10.8	10.1	8.7	7.2	5.7	3.8	.6	-.8
1,000,000-2,000,000	7.2	(26.9)	10.8	9.5	7.7	6.1	5.2	3.6	3.2	.3
2,000,000-5,000,000	6.4	(13.9)	9.4	7.9	7.1	5.2	4.5	2.8	3.2	(4.8)
5,000,000-10,000,000	6.4	(7.2)	8.5	8.2	6.1	6.0	3.7	2.1	(1.6)	(4.6)
10,000,000-50,000,000	7.4	(6.4)	10.3	8.5	6.6	6.7	3.5	(4.2)	(-12.4)	(4.0)
Over 50,000,000	6.4	..	6.8	7.2	5.6	4.8	(1.8)	(5.3)	(6.3)	..
<b>ALL BANKS</b>	<b>6.9%</b>	<b>11.9%</b>	<b>9.5%</b>	<b>9.3%</b>	<b>8.0%</b>	<b>6.8%</b>	<b>5.6%</b>	<b>4.6%</b>	<b>3.4%</b>	<b>1.9%</b>

\* Based on data from Federal Deposit Insurance Corporation. Rates of net profit represent net profit in percent of net worth; figures are averages of rates of individual banks. In regard to banks that were members of the Federal Reserve System net worth, total assets and deposits are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Net-worth rate groups are inclusive of the lower limit and exclusive of the upper; deposits groups are exclusive of the lower limit and inclusive of the upper. Parentheses indicate groups containing 10 banks or fewer.



degree of trading on equity in low-rate companies did not offset the higher rate of operating profit in high-rate companies, which showed higher rates of net profit on net worth.

#### PAYMENT OF CASH DIVIDENDS

##### *Rate of Dividends*

The rate of cash dividends paid by consumer agencies during the period 1929-41 was subject to much less severe fluctuation than the rate of net profit. It did decline, however, from 1929 to 1933, spurted upward in the subsequent recovery and was reasonably stable from 1938 to 1941, at a level generally above that recorded at the beginning of the period. For the most part, those groups of companies whose net profit showed greater fluctuation displayed greater variation in dividend rates than those whose profits were more stable.

Amounts of cash dividends in percent of net worth for the period 1929-41, covering selected samples of consumer instalment financing agencies and commercial banks, and, for 1934-39, all corporations and banks and trust companies filing income tax returns, are presented in Table 29.<sup>22</sup> The figures based on income tax returns for 1934-39, while not entirely comparable to the other series, indicate that "banks and trust companies" paid rates of dividends somewhat lower than "all corporations," and much lower than sales finance and personal finance companies.

In fact, dividends of sales finance and personal finance companies were at higher average levels than those of any of the other groups studied. Sales finance companies, however, showed materially greater variation than personal finance companies; their more noticeable decline during the depression and their subsequent skyrocketing coincided with greater fluctuations in their net profits.

Among industrial banking companies in the income tax sample average rates of dividends paid dropped sharply during the depression, but by 1936, like those of the other specialized agencies, exceeded on the whole their 1929 level. After 1936 insured indus-

<sup>22</sup> Throughout this section the terms "dividends paid" and "dividend payments" are used for simplicity and brevity. They generally refer, however, to cash dividend declarations (or authorizations, in the case of credit unions) within the calendar or fiscal year; ordinarily the dividend payment occurs within a month after the dividend declaration.

TABLE 29

## CASH DIVIDENDS OF SELECTED SAMPLES OF CONSUMER INSTALLMENT FINANCING AGENCIES AND COMMERCIAL BANKS IN PERCENT OF NET WORTH, 1929-41\*

<i>Sample</i>	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
3 national <sup>b</sup>	8.4%	10.2%	7.3%	6.6%	6.3%	8.1%	14.3%	17.7%	17.3%	13.2%	12.4%	11.9%	12.0%
3 to 4 regional <sup>b</sup>	5.3	5.2	4.0	4.5	3.5	4.6	5.6	10.8	9.7	6.1	6.6	7.3	6.2
10 to 32 local <sup>b</sup>	6.9	6.3	6.3	4.3	4.3	6.2	7.5	10.9	10.6	6.6	6.4	6.9	7.2
202 local <sup>a</sup>	5.2	..	..	..	3.1	..	..	8.4	..	..	..	..	..
<i>Personal finance companies</i>													
1 to 2 national <sup>d</sup>	8.8	10.8	10.7	10.9	10.2	10.0	10.7	12.2	12.4	10.5	10.6	10.3	9.6
2 to 5 regional <sup>d</sup>	7.2	9.7	8.4	9.0	7.9	8.2	9.1	11.9	16.4	13.7	12.9	12.8	12.4
2 to 7 local <sup>d</sup>	..	..	..	5.8	5.1	11.6	7.5	7.4	10.3	10.7	7.2	7.2	8.0
153 local <sup>a</sup>	5.5	..	..	..	4.9	..	..	7.2	..	..	..	..	..
79 non-invest. type indust. blg. cos. <sup>a</sup>	4.4	..	..	..	2.1	..	..	5.8	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>a</sup>	5.1	..	..	..	2.7	..	..	6.3	..	..	..	..	..
6 largest insured <sup>a</sup>	..	..	..	..	..	1.1	2.9	4.1	4.8	6.3	6.2	7.0	6.7
All other insured <sup>a</sup>	..	..	..	..	..	3.3	3.4	4.2	4.4	4.5	4.5	4.5	4.3
37 insured <sup>a</sup>	4.8	..	..	..	2.0	..	..	4.5	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>d</sup>	..	..	..	..	..	..	1.0	2.0	2.6	2.9	2.9	3.0	2.6
<i>Commercial banks</i>													
All national banks <sup>a</sup>	6.0	5.4	5.1	4.1	2.4	3.1	3.7	3.8	3.8	3.7	3.9	3.8	3.7
All insured banks <sup>a</sup>	..	..	..	..	..	3.0	3.4	3.6	3.5	3.5	3.6	3.6	3.5
Banks and trust companies <sup>b</sup>	..	..	..	..	..	3.1	3.1	3.1	2.9	2.9	2.9	..	..
All corporations <sup>b</sup>	..	..	..	..	..	3.4	4.2	5.4	5.1	3.5	4.1	..	..

(footnotes on following page)

trial banks, except for the six largest, reported an almost constant rate of dividends on net worth, at about 4.5 percent. That of the six largest increased steadily between 1934 and 1940, but showed a slight decline in 1941.

The rate of dividends authorized by federal credit unions rose throughout the period 1935-41 except, again, for a slight decline in the latter year; but it was lower in percent of net worth than that of any agency, or of banks or corporations. Although credit union

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FOOTNOTES TO TABLE 29

\* Represents total cash dividends declared or authorized during year (whether or not paid in same year or based on earnings of same year) of companies paying dividends, in percent of average or year-end total net worth of all companies. The number of companies for each year may be found in Appendix Table B-1, except as noted in footnotes below.

<sup>b</sup> Based on data from the National Credit Office, Inc. Net worth is the average of figures for the beginning and end of year. These samples differ from those used in other tables because, in order to increase the coverage, all companies that reported on dividends are here included, regardless of whether complete statements of income, expenses, interest and profits were available. In 1929 one national company, and in 1929-32 one regional company, reported on dividends, though not otherwise reporting a complete statement. The sample of local companies differs in each year, the numbers in the sample for each year being as follows: 1929, 10; 1930, 10; 1931, 13; 1932, 15; 1933, 18; 1934, 25; 1935, 28; 1936, 30; 1937, 32; 1938, 31; 1939, 29; 1940, 29; 1941, 29. Some of the local companies are included in the 202 local companies of the income tax sample.

<sup>c</sup> Based on tabulations prepared by the Income Tax Study. Net worth is the year-end figure.

<sup>d</sup> Based on data from the National Credit Office, Inc. Net worth is the average of figures for the beginning and end of year. These samples differ from those used in other tables for reasons given in footnote b above. Companies that reported on dividends, though not otherwise reporting a complete statement, were as follows: in 1929 one national; in 1930-31 and 1935-36 one regional; in 1932-34 two regionals; in 1932-33 two locals; and in 1934-35 one local. Some of these companies are included in the 153 local companies of the income tax sample.

<sup>e</sup> Based on data from Federal Deposit Insurance Corporation. Net worth is the average of figures for the beginning, middle and end of year, except for industrial banks in 1934 and 1935, when year-end figures are used. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

<sup>f</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts. Represents dividends authorized in percent of year-end net worth of all reporting federal credit unions.

<sup>g</sup> Based on data in Annual Reports of the Comptroller of the Currency. Net worth is the average of figures for call dates during the year.

<sup>h</sup> For all corporations, and for banks in 1938-39, based on data in *Statistics of Income*; for banks in 1934-37, based on data in the *Source Book* of the Bureau of Internal Revenue. The classifications for banks were, for 1930-37, "national banks" and "state banks and trust companies," and, for 1938-39, "banks and trust companies." Except for 1938-39 data on dividends pertain to all banks filing income tax returns—a slightly larger number than those filing net worth figures. Data on dividends include only dividends paid on common capital.

dividends may legally be, and generally are, as high as 6 percent of members' shares, three-quarters of the reporting federal credit unions at the beginning of the period, and one-quarter at the end, did not authorize dividends.

The dividend record of national banks over the forty years ending in 1929 reveals that during the last twenty-five years of that period the rate of return on total net worth had attained a degree of regularity reminiscent of contractual interest (Chart XV).<sup>23</sup> In each year from 1905 to 1929 dividends were paid at a rate of from 5.2 to 6.2 percent of total net worth. This high degree of regularity is explained by the fact that the amount of dividends paid from year to year increased at about the same rate as total net worth.

In 1932 and 1933 the dollar amount of dividends decreased sharply, as a result of the heavy charge-offs of the depression years, and by 1933 the rate on total net worth had declined to less than half its previous level. As the subsequent revival failed to restore the rate to its earlier level, it fluctuated from 1936 to 1941 within narrow limits—slightly below 4 percent of total net worth, or at about two-thirds of the average rate maintained over the earlier period.

In contrast to the regularity of rate of dividends on total net worth, the rate of dividends paid on capital stock exhibited a constant growth, with but minor fluctuations, from a low of 6.8 percent of capital stock in 1894 to a high of 13.7 percent in 1929 (Chart XV). The growth in rate of dividends paid on common capital, in contrast to the regularity in the rate on total net worth, may be attributed to the growing share of total net worth represented by surplus and undivided profits—or, conversely, to the diminution in the share represented by the par value of capital stock outstanding.

<sup>23</sup> Cash dividends averaged 5.5 percent of total net worth over the forty years. In eleven of the earlier years the rate was less than 5 percent but during the balance of the period 1890-1929 it showed little variation from year to year, as is evident from the following tabulation of the number of years in which rates were at various stipulated levels:

	1890-99	1900-09	1910-19	1920-29	1930-39	1940-47
Under 4½%	1	..	..	..	8	2
4½-5	7	3	..	..	..	..
5-5½	2	2	1	5	2	..
5½-6	..	4	8	3	..	..
6 or over	..	1	1	2	..	..

From 1910 through 1931 the rate of dividends was never less than 10 percent of capital stock; it exceeded 11 percent in all but two of those years, and was more than 12 percent in seven years.<sup>24</sup> During the early thirties the average rate dropped sharply, but it exceeded 4.5 percent of stock even at the low in 1933; in subsequent years the rate of common dividends recovered quickly, and from 1937 to 1941 averaged over 9 percent of common stock.<sup>25</sup>

### *Net Profit Paid Out in Dividends*

In most years for which data are available, dividends of sales finance and personal finance companies amounted to between 50 and 100 percent of net profit, averaging about 80 percent; in only a few of the years did dividends exceed net profit.

Although industrial banking companies in 1929 and 1933 paid out the highest proportion of net profit in dividends, the dividends paid by insured industrial banks since 1934 have generally been less than half of net profit, probably reflecting the conservatism attendant upon the acquisition by these institutions of the status of banks.

The proportion of net profit authorized by federal credit unions to be paid out in dividends increased steadily throughout the period for which data are available, rising from 40 percent in 1935 to 61 percent in 1941. The latter level was still comparatively low, however, largely because of the relative youth of these enterprises. There is, besides, a stipulation in federal credit union law which requires the retention of 20 percent of net profit. In a new institution the added incentive to build up a backlog of reserves serves to curtail the authorization of dividends.

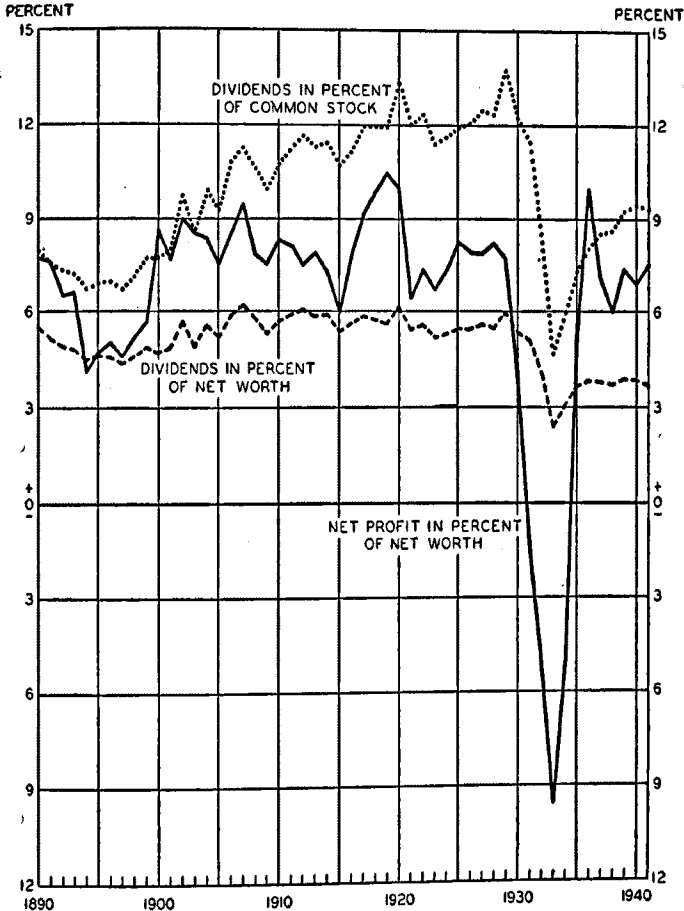
<sup>24</sup> Dividends averaged 10.7 percent of capital stock for the period 1890-1929, and 10.1 percent for the entire fifty-two years. The pattern of rates clearly elucidates the growth trend, as is evident from the following tabulation of the number of years in which rates were at various stipulated levels:

	1890-99	1900-09	1910-19	1920-29	1930-39	1940-41
Under 7%	4	..	..	..	2	..
7-8	6	1	..	..	1	..
8-9	..	2	..	..	4	..
9-10	..	4	..	..	1	2
10-11	..	2	2	..	..	..
11-12	..	1	8	4	1	..
12-13	..	..	..	4	1	..
13 or over	..	..	..	2	..	..

<sup>25</sup> Beginning in 1933, the rate of dividends on total net worth includes declarations on both preferred and common shares. The rate on common capital stock represents common dividends throughout.

CHART XV

RATES OF CASH DIVIDENDS AND NET PROFIT OF NATIONAL BANKS,  
1890-1941<sup>a</sup>



<sup>a</sup> Based on Annual Reports of the Comptroller of the Currency. For 1890-1915 the numerator (dividends or net profit) pertains to the years ending August 31, 1890-1906, the ten months from September 1, 1906 to June 30, 1907, and the years ending June 30, 1907-15; and the denominator (common stock or net worth) pertains to June 30 or approximately that date. For 1916 the numerator pertains to the eighteen months ending December 31, 1916, adjusted to an annual basis; and the denominator is the average of figures for June 30, 1915, June 30, 1916, and December 31, 1916. For 1917-41 the numerator pertains to the years ending December 31, 1917-41; and the denominator is the average of figures for call dates during the respective years. Common stock represents par value.

For the forty-year period prior to 1930, dividends of national banks averaged about 70 percent of net profit; thus, on the average, about 30 percent of net profit was retained and added to net worth. Reference to Chart XV reveals that the relation of dividends to total net worth was much more regular than that of net profit to total net worth, and it is therefore not surprising to find that the proportion of net profit paid out in dividends fluctuated considerably from year to year.

Nevertheless, dividends exceeded 80 percent of net profit in only ten of the forty years prior to 1930, stood between 60 and 80 percent in twenty-six years, and were less than 60 percent in four years. Heavy net charge-offs resulted in a sharp drop in net profit in 1930, and in net losses in 1931-34, yet the payment of dividends was curtailed much less drastically.<sup>26</sup> Thus, although a reasonable average margin of net profit above dividends had been maintained from year to year, the heavy charge-offs of five bad years, combined with the continuance of dividend payments, wiped out a large percentage of the retained net profit accumulated over the preceding forty years.

Dividends paid by national banks over the entire period, 1890-1941, amounted to 82 percent of net profit. Over the years 1929-41, slightly more than the total net profit earned during that period was paid out in dividends.

#### *Variation Among Individual Companies*

The dividend record of individual consumer instalment financing companies included in the income tax sample is characteristic of an industry growing to maturity. In 1929, when practically all the companies reported profitable operations, one-third of the personal finance companies, and about one-fourth of the sales finance and non-investment type industrial banking companies retained

<sup>26</sup> The computation of rates of dividends on net profit is meaningless for the years 1931-34, when there were net losses. For the rest of the period 1890-1941 the number of years in which rates were at various stipulated levels is as follows:

	1890-99	1900-09	1910-19	1920-29	1930-39	1940-41
Under 50%	..	..	..	..	1	1
50-60	..	2	2	..	2	1
60-70	1	5	2	4	1	..
70-80	3	3	3	5	1	..
80-90	2	..	3	1	..	..
90-100	3	..	..	..	..	..
100 or over	1	..	..	..	1	..

all of their net profit to retire borrowings or to provide additional funds for working capital. Only among investment type industrial banking companies did an exception occur: in that group less than 10 percent of the companies with profitable operations retained all net profits.

In 1936 practically all the companies that showed profitable operations, and a few that sustained net losses, paid dividends.<sup>27</sup> In the interim their worth as potential borrowers had become more generally recognized, the rates of interest paid on borrowed funds had been reduced, and they were therefore no longer so dependent upon retained funds for expansion.

In addition, there was a pronounced tendency for the companies that did pay dividends to pay out higher proportions of net profit in 1936 than in 1929.<sup>28</sup> This, too, indicates less urge to provide for the possibility of expansion, temporary or permanent, through the retention of net profit. In 1936 fewer of the insured industrial banks than of any other type of company paid out a relatively large proportion of net profit in dividends—an indication that these banks had become more conservative with respect to the retention of net profit, at a time when other types of companies had become less conservative.

Also, companies that paid dividends paid higher rates on net worth in 1936 than in 1929.<sup>29</sup> In each type of company the proportion paying dividends of more than 8 percent of net worth increased between those two years, while the proportion paying dividends of 4 to 6 percent decreased materially. In almost all cases this rate represented a somewhat higher percentage on the par, or stated, value of the outstanding stock.

Companies paying a rate of more than 8 percent in 1936 accounted for nearly half of the sales finance group, one-third of the personal finance, and one-fifth of the industrial banking companies, except the insured industrial banks (where they constituted scarcely more than one-twentieth).

In each of the types, the smaller the company, the greater the

<sup>27</sup> This may have been in part the result of the surtax on undistributed profits in 1936 and 1937 upon the dividend payments of these companies. Since, however, the proportion of net profits paid out in dividends by the companies included in the National Credit Office sample was not out of line in those years, it is believed that the tax was not a major factor.

<sup>28</sup> See Appendix Table B-15.

<sup>29</sup> See Appendix Table B-16.



likelihood that it will retain all of its net profit in the business and not pay dividends, a tendency particularly noticeable among institutions showing profitable operations. In larger companies, especially those in which stock is widely held, there is considerable reluctance to withhold payment of a dividend, for fear of the effect of such action upon the marketability of the stock; in a small company, in which stock is generally closely held, this factor is not operative.

Among the specialized companies that did pay dividends, it appears from the income tax data that there was no marked relationship between size of company and either rate of dividends on net worth or proportion of net profit paid out in dividends. However, national and regional sales finance and personal finance companies, on the average, showed a higher rate of dividends than the locals, and a higher proportion of net profit paid out in dividends;<sup>30</sup> and the six largest insured industrial banks showed higher averages than the smaller institutions.

National sales finance companies consistently paid higher rates of dividends than the regionals or locals, and paid out the highest proportion of net profit of any of the consumer instalment financing agencies over the period. Their dividend rates were particularly high during the years 1935-37, when their level of profit was correspondingly high.

During the last few years a substantial, but decreasing, proportion of banks have refrained from paying dividends.<sup>31</sup> Among all the various measurable factors affecting payment or nonpayment of dividends size of bank was most important. It is true that the higher the rate of net profit (on net worth) the higher was the proportion of banks paying dividends, but the differences were much more striking when banks were arranged according to size. This greater influence of size persisted even when the influence of other factors, such as rate of net profit, rate of net earnings, and proportion of net worth (to total assets), was held constant.

These size differences reflect the greater willingness of the man-

<sup>30</sup> These averages are based on the net worth or net profit of all companies, whether or not they paid dividends. Very few, however, of the larger companies included in the National Credit Office sample reported nonpayment of dividends—among the sales finance companies, no nationals; 1 regional, in 1933; 4 locals in 1932-33, 3 in 1935, and 1 each in 1934, 1936 and 1938; among the personal finance companies, only 1 regional, in 1929.

<sup>31</sup> See Appendix Table B-17.

agement in a small bank, where the stock is usually closely held, to withhold dividend payments; and, conversely, the reluctance of the management in a large bank, where the stock is widely held, to withhold a dividend and thereby adversely influence the market value of the stock. With but one exception in 1939 and one in 1941 every bank with average deposits in excess of 50 million dollars reported that it had declared a dividend in the years 1939-41.

TABLE 30

RATES OF CASH DIVIDENDS PAID BY INSURED COMMERCIAL BANKS, 1939, BY NET WORTH PROPORTIONS AND RATES OF NET PROFIT\*

<i>Net Profit in Percent of Net Worth</i>	<i>All Banks</i>	<i>Net Worth in Percent of Total Assets</i>				
		<i>Under 5%</i>	<i>5-10%</i>	<i>10-15%</i>	<i>15-20%</i>	<i>20% or Over</i>
Minus (net loss)	1.9%	..	2.0%	2.0%	1.8%	1.9%
Under 5%	2.3	(1.7)%	2.3	2.3	2.2	2.3
5-10	3.2	(2.7)	3.0	3.1	3.3	3.4
10-15	4.1	(5.7)	4.0	4.1	4.3	4.4
15-20	5.2	..	4.8	5.2	6.1	6.6
20 or over	7.9	(8.8)	6.9	8.7	7.4	(6.9)
ALL BANKS	3.4%	5.0%	3.6%	3.5%	3.2%	3.0%

\* Based on data from Federal Deposit Insurance Corporation. Rates of cash dividends represent cash dividend payments in percent of net worth of banks paying dividends; figures are averages of rates of individual banks. In regard to banks that were members of the Federal Reserve System net worth and total assets are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of year. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Net-worth and net-profit rate groups are inclusive of the lower limit and exclusive of the upper. Parentheses indicate groups containing 10 banks or fewer.

Although there was a greater likelihood that a dividend payment would be made among larger than among smaller banks, there was no regular difference in the *rate* of dividends paid by the large banks as compared with the small.<sup>32</sup> The rate was highest for the largest banks, but it was almost as high for smaller banks, and much lower for medium-sized banks. In fact, the rate of dividend payments on net worth appears to have been most closely

<sup>32</sup> See Appendix Table B-18.

related to the rate of net profit on net worth, as can be seen from Table 30.

Irrespective of the net worth ratio, the higher the rate of net profit the higher was the dividend rate, and this tendency was both consistent and marked. Also, as can be deduced from Table 30, the proportion of net profit paid out in dividends was larger, on the average, among banks with a low than among those with a high rate of net profit.

Among banks with approximately the same rate of net profit the larger the net worth ratio the higher, in general, was the rate of dividends paid, but the relationship was not marked. Among banks with losses or with low rates of net profit the institutions with a low capital cushion paid as high a rate of dividends (representing a higher proportion of net current operating earnings) as those with adequate or high capital cushions. This tendency may well give the supervisory authorities cause for concern, when they recall how rapidly the retained net profits of the banking system—accumulated slowly over decades—were wiped out by the unusual charge-offs of a few years of depression.

APPENDIX A

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Notes on the Character  
of the Data

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## Notes on the Character of the Data

THIS study was originated to utilize the large amount of data on consumer instalment financing agencies prepared by the Income Tax Study<sup>1</sup> and the unpublished data on bank operations in the files of the Federal Deposit Insurance Corporation, but it also makes use of a variety of other data, heterogeneous in character. The combined samples are believed to be sufficiently comprehensive and representative, and the data sufficiently uniform and accurate, to permit valid generalizations on the questions examined.

### COMPOSITION AND REPRESENTATIVENESS OF THE SAMPLES

In general, the study is based chiefly on the following data: for sales finance and personal finance companies, the income tax and National Credit Office samples; for industrial banking companies, the income tax sample and FDIC figures on all insured industrial banks; for credit unions, figures on federal credit unions reported to the United States Farm Credit Administration; and for commercial banks, data on all national banks for historical material, and data on either all insured commercial banks or all insured commercial banks not members of the Federal Reserve System for developments of recent years.

The derivation of the data was such that no problems arose with respect to classification, except in the income tax sample. Very few of the companies were exclusively engaged, however, in the activities considered characteristic of their type. Some personal finance companies in the National Credit Office samples bordered, either directly or through subsidiaries, on industrial banks, and, similarly, some of the sales finance companies made small loans. Insured industrial banks were increasingly engaged in commercial banking to the extent permitted by statutory limitations; and, conversely, a large portion of the business of some commercial banks bordered on industrial lending.<sup>2</sup>

<sup>1</sup>The income tax tabulations, comprising tables of aggregates and frequency distributions, totaling 344 typewritten pages, are on file in the U. S. Department of the Treasury, Bureau of Internal Revenue, as the *Base Book* covering Proposal No. 22, Income Tax Study.

<sup>2</sup>In its publications the FDIC usually includes among commercial banks the banks designated in this study as industrial banks. Where a distinction is made, it is based on legal status, affiliations and operating characteristics. The institutions designated as industrial banks are: banks operating under state codes of law specifically appli-

The 612 companies included in the income tax sample—229 sales finance companies, 179 personal finance companies, 112 investment type industrial banks, and 92 non-investment type industrial banking companies—were selected on the basis of positive identification, and consist of reasonably homogeneous groups representative of the types described.<sup>3</sup> In a great many cases, where the taxpayer failed to designate the character of the business in detail, it was necessary to classify on the basis of supplementary data.

Often the editing of the balance sheet in the income tax form provided positive identification, such as the existence of hypothecated deposits or of pledged investment certificates in the case of industrial banking companies, or the existence of substantial dealers' reserves in the case of sales finance companies.

Other useful, though not conclusive, evidence consisted of lists of companies existing during the period of the income tax data: for sales finance companies, membership lists of the American Finance Conference and of the National Association of Sales Finance Companies;<sup>4</sup> for personal finance companies, lists in reports of state supervisors, and the *Roster of Personal Finance Companies*, which includes all small loan licensees, most of whom are members either of the American Association of Personal Finance Companies<sup>5</sup> or of the various state associations; and for industrial banking companies, membership lists of the American Industrial Bankers Association and the Morris Plan Bankers Association.<sup>6</sup> In addition, almost half of the industrial banks included were identified by membership in the FDIC. Where these means of identification provided conflicting evidence, which could not be resolved by the

<sup>3</sup> The group of 92 non-investment type industrial banking companies was separated from the investment type industrial banks in order to improve the latter's homogeneity.

<sup>4</sup> In the winter of 1940-41 these trade associations were combined under the name American Finance Conference. See National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by Wilbur C. Plummer and Ralph A. Young (New York 1940) pp. 37-38, for a description of the membership of the associations.

<sup>5</sup> See National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (New York 1940) pp. 151 ff.

<sup>6</sup> See National Bureau of Economic Research (Financial Research Program), *Industrial Banking Companies and Their Credit Practices*, by Raymond J. Saulnier (New York 1940) pp. 180-83.

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cable to industrial banks; other banks associated with the Morris Plan group; and banks reported by examiners or by the bank as primarily engaged in "industrial" banking, that is, having more than 50 percent of total assets in the form of consumer instalment loans and more than 75 percent of deposits in the form of time deposits. In this connection it is pertinent to point out that although large numbers of commercial banks had the characteristics of industrial banks on one side of the balance sheet, there were only three that approached industrial characteristics on both sides of the balance sheet.

advice of experts, the companies affected were excluded from the sample.

In some of the samples certain companies were excluded from the analysis of income and expenses, either because their operating results were unrepresentative or because income and expense data were not available for them in satisfactory form. Their asset figures were included, however—except for the National Credit Office samples<sup>7</sup>—because the very changes that made them unrepresentative for the income and expense analysis were significant in showing changes in asset distributions.

In the income tax sample the companies thus excluded were those that filed on a consolidated basis<sup>8</sup> and those that held an unusually large proportion of securities, or of real estate, or of miscellaneous assets in one or more of the years studied. For the income and expense analysis this sample was thus reduced to 202 sales finance companies, 153 personal finance companies, 79 non-investment type industrial banking companies, and 93 investment type industrial banks.

Operating ratios of individual insured banks do not include the relatively small number whose operations commenced during the year; whose reports of earnings and dividends did not, because of changes in class or insured status, cover the full year's operations; or whose operations were materially affected by mergers during the year.

For sales finance companies, personal finance companies, investment type industrial banks and commercial banks the data used provide a coverage of half or more of total outstanding loans; for non-investment type industrial banking companies and credit unions the coverage is less satisfactory. Estimated total loans of consumer instalment financing agencies and commercial banks on December 31, 1936, and of selected samples are presented in Table A-1.

The income tax sample of 112 investment type industrial banks for which asset distributions are included covers a very high proportion of this field. The sample of 93 for which income and expense data are included covers about half the loans of companies of this type. The data for insured industrial banks (some of which are included in the income tax sample) cover all except a few insured institutions; their loans amounted to approximately half the loans of all industrial banking companies.

Sales finance companies included in the income tax sample held

<sup>7</sup> Since companies from these samples whose figures for income and expenses were not available in satisfactory form were excluded from figures covering assets, the data regarding them differ from those shown in other publications of the National Bureau of Economic Research.

<sup>8</sup> For these companies income consisted entirely or largely of dividends from subsidiaries, and expenses reflected only the operations of the parent holding company. The use of consolidated returns was optional in 1929 and 1933; in 1936 it was not permitted. The Revenue Acts of 1934 through 1941 denied to all corporations except railroads the privilege of filing consolidated normal tax returns.

TABLE A-1

OUTSTANDING LOANS OF CONSUMER INSTALMENT FINANCING AGENCIES AND COMMERCIAL BANKS, YEAR-END 1936<sup>a</sup>

Agency	U.S. Total, Estimated	Income Tax Sample <sup>b</sup>		Other Samples Used
		612 Cos.	527 Cos.	
Sales finance companies	\$1,900.0 <sup>c</sup>	\$170.9	\$164.8	\$1,315.0 <sup>d</sup>
Personal finance companies	301.0 <sup>e</sup>	38.1	23.0	138.6 <sup>d</sup>
Ind. bkg. cos.—total	191.3 <sup>e</sup>	168.2	97.3	†
Non-investment type	"	13.5	9.8	†
Investment type—total	"	154.7	87.5	†
Noninsured	"	"	(37.7)	..
Insured	90.5 <sup>b</sup>	"	(49.8)	89.7 <sup>i</sup>
Credit unions	66.0 <sup>e</sup>	..	..	7.3 <sup>j</sup>
Commercial banks	16,415.0 <sup>b</sup>	..	..	8,271.2 <sup>k</sup>
Insured	15,964.9 <sup>b</sup>	..	..	2,605.0 <sup>b</sup>
Noninsured	450.1 <sup>b</sup>	..	..	..

<sup>a</sup> All figures in millions of dollars. Loans consist of *all* loans held by the respective agencies, and wherever data are available loan figures are net, after reserves for bad debts.

<sup>b</sup> The 612 companies are those whose balance sheets were analyzed; the 527 are those whose income and expenses were analyzed.

<sup>c</sup> Estimated by inflating the amount of retail instalment paper held by sales finance companies, using the average ratio of such companies' retail instalment paper to total loans.

<sup>d</sup> Based on data from the National Credit Office, Inc. Some of the smaller companies in this group are included in the income tax sample.

<sup>e</sup> Based on National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38*, by Duncan McC. Holthausen, et al. (New York 1940) pp. 82, 83, 87.

<sup>f</sup> Some use was made of other samples, for which total assets are given in the respective tables.

<sup>g</sup> Not available.

<sup>h</sup> Based on data from Federal Deposit Insurance Corporation. For insured investment type industrial banking companies outstanding loans are averages of figures for the beginning, middle and end of the year, adjusted for deposits accumulated for the repayment of instalment loans. In "other samples used" insured commercial banks consist only of those that were not members of the Federal Reserve System.

<sup>i</sup> See footnote h above. Includes only banks operating throughout the year. Some of these companies are included in the income tax sample.

<sup>j</sup> Federal credit unions only. Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts.

<sup>k</sup> National banks only. Based on data from Annual Report of the Comptroller of the Currency, 1937.

roughly 10 percent of the loans of all sales finance companies; personal finance companies represented, for asset data, something under 15 percent of the total and for income data about 8 percent. This small coverage for these two types of agencies results from the fact that the use of any company whose size would permit its identification in subgroups of the tabulated data would violate the confidential character of the



income tax returns. Furthermore, the operations of all the larger personal finance companies—two of which accounted for over a third of all loans in the field—are carried on through subsidiaries, and therefore data from income tax returns would not be suitable for use in this sample.

The National Credit Office samples, however, covered almost three-fourths of sales finance company loans and about half of personal finance company loans in 1936 and later years. Therefore, in spite of the small number of companies they contain, the inclusion of these samples provides satisfactory coverage, and makes it possible to avoid any serious errors that might arise from the use of a sample containing a high concentration of small companies.

Since the formation of the FDIC insured commercial banks have represented from 92 to 94 percent of all commercial banks and have held more than 97 percent of the loans. Although national banks held only about half the loans of all commercial banks in 1936, their distribution with respect to size (and geographic location) makes them the most representative sample available for the years prior to 1934.

Non-national banks that were not included were primarily of two opposite types: state banks members of the Federal Reserve System, which were predominantly large banks in large centers; and state banks not members of the Federal Reserve System, which were small banks in small centers or in rural areas. Wherever data have been limited to insured commercial banks not members of the Federal Reserve System—holding only 15 percent of the loans, but numbering about half of all commercial banks—it is believed that satisfactory cognizance has been taken of the bias involved.

Federal credit unions held 11 percent of the loans of all credit unions at the end of 1936, 17 percent at the end of 1937 and 33 percent at the end of 1941. Accordingly, from 1936 or 1937 on, the federal group probably constituted a satisfactorily representative sample.<sup>9</sup>

In the National Credit Office samples, personal finance companies designated as national were those operating more than 200 offices in 1941; the regionals were those operating 50 to 200 offices; and the locals were those operating fewer than 50 offices. The designation of sales finance companies as national, regional, or local was based on knowledge of the scope of their operations. No attempt was made to determine the exact geographic distribution of the sales finance and personal finance company offices; the representativeness probably varied from year to year, being poorest for the local companies. These National Credit Office samples, used in conjunction with the income tax samples, offer probably a quite complete geographic coverage.

<sup>9</sup> But since there was such a rapid increase in the number and in the assets of federal credit unions, all ratios of income and expenses during a year to assets and liabilities outstanding at the end of the year consistently understate the results shown by individual unions that operated throughout the period.

The income tax sample of personal finance companies included representatives from all but three of the states in which laws similar to the Uniform Small Loan Law were in effect during the period covered.<sup>10</sup> The nine states, industrial and semi-industrial, which accounted for more than three-fourths of the total small loans outstanding on December 31, 1937, were satisfactorily represented.<sup>11</sup> Pennsylvania, with the largest number of licensees of any state, 15 percent of the total, also had the largest representation in the income tax sample.

Sales finance companies in the income tax sample represented forty states and the District of Columbia, including all states that in 1941 had regulatory legislation for the financing of retail instalment paper.<sup>12</sup>

The income tax sample of industrial banking companies represented every state that had specific legislation authorizing industrial lending during the period 1929-36, except Arizona and Washington.<sup>13</sup> North Carolina, however, which has legislation favorable to the organization of industrial banks, accounted for 16 of the 37 insured banks in the income tax sample,<sup>14</sup> and for 25 of the 84 insured industrial banks in

<sup>10</sup> See Young and Associates, *op. cit.*, pp. 27-35. The states not represented in the income tax sample were New Hampshire, Tennessee and Utah; the amount of small loans outstanding in these states was not significant in proportion to the national total. Included in the sample were three companies that reported income tax returns from Kentucky, New Mexico and Washington, which did not have small loan legislation throughout the period; these companies held total loans of less than 1 percent of the sample on December 31, 1936, and are not believed to impair the sample's validity.

<sup>11</sup> These states, in order of amount of small loans outstanding, were New York, Ohio, Pennsylvania, Illinois, Michigan, Massachusetts, Indiana, New Jersey and Missouri.

<sup>12</sup> The Indiana Retail Instalment Sales Act, which became effective July 1, 1935, provides for the licensing of all financial institutions buying retail instalment paper, and for the regulation of finance charges. On June 30, 1936, there were 328 retail instalment licensees operating in Indiana.

Maine has provided since 1939 for the licensing of anyone, except a supervised bank, engaged in the financing of time sales on motor vehicles.

Maryland has provided for the licensing and regulation, effective June 1, 1941, of sales finance companies, limiting charges on "extensions" to an effective interest rate of not more than 15 percent.

Michigan has regulated, effective 1939, motor vehicle retail instalment contracts, providing penalties for inadequate disclosure in the instruments, and for improper repossession of the goods sold.

Wisconsin has provided (originally, 1935; amended, 1937, 1939) for the licensing of anyone engaged in motor vehicle instalment financing, and for the regulation of fees and charges by the State Banking Commission.

<sup>13</sup> Saulnier, *op. cit.*, pp. 184-86, cites laws in existence as of the end of 1939; and digests of laws in existence in 1939, with dates of enactment in some cases, are presented in Consumer Credit Institute of America, *Industrial Banking*, by Margaret Grobren (New York 1940) Ch. 11.

<sup>14</sup> On December 31, 1936, industrial banking companies in New York and North Carolina held 12.8 percent and 8.9 percent, respectively, of the loans of the 37 insured investment type banks for which income and expenses were analyzed, and

existence on December 31, 1941. Industrial banks admitted to deposit insurance operate in twenty states and the District of Columbia.

Federal credit unions are organized in every state except Wisconsin, and in the District of Columbia and Hawaii, with a good representation in all but a few of the states. In six states and Hawaii there are no state-chartered credit unions. For the most part, federal credit unions predominate in states where there was no state law until recently, and are in the minority in states where there is a long-established state law. The geographic representation of federal credit unions has widened in each year since their establishment.

Insured commercial banks and national banks provide complete geographic coverage. The national banks constitute varying but satisfactory proportions in the different states.

Data in the income tax sample cover the operations of the same group of companies in each of the years, 1929, 1933 and 1936; the other samples consist of a changing number of enterprises.<sup>15</sup>

In the National Credit Office sales finance and personal finance company samples, the number of companies included varies widely. There were so few in certain years that some of the apparent variation may be due to the number in the sample; for this reason too much emphasis should not be placed upon the changes between any two years.

The historical data on national banks, insured commercial banks and federal credit unions pertain to all available reporting institutions, but for the historical data on insured industrial banks (and for the data pertaining to ratios of individual insured commercial banks), some reports were purposely excluded. Although the number of banks is not constant from year to year, the numerical change affected assets, liabilities, income and expenses so slightly as to introduce no noticeable error. Federal credit union activities, however, grew so rapidly during this period that new, recently established institutions were continually being added to the group of reporting companies; the resultant error is most serious in 1935 and 1936.

The unchanging character of the income tax samples introduces other types of bias, since the method of selection required that the companies have a continuous existence without change in name or corporate identity over the period.<sup>16</sup> But since the data exclude companies that showed

<sup>15</sup> The number and total assets of the companies in the various samples are presented in Appendix Tables B-1 and B-2.

<sup>16</sup> More than half of each type included had had a continued corporate existence for over a decade. In addition, it is probable that the operating life of some of the companies was longer than that shown by the date of incorporation on the tax form. This indicates a relatively high degree of continuity of existence in the consumer instalment financing business. The inherent quality of the instalment paper constituting its principal asset is reflected in the fact that a substantial proportion of the companies had enjoyed only a few years of corporate existence prior to the 1930's and nevertheless withstood the depression.

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7.3 percent and 6.0 percent, respectively, of the loans of the 93 insured and non-insured banks.

extremely good operating results (and absorbed other companies) as well as those that showed extremely poor operating results (and failed), there is no reason to believe, on balance, that the sample is seriously unrepresentative of the operations of all companies engaged in consumer instalment financing. This assumption is supported by comparison of the income tax data with collateral data obtained from other sources.

#### LIMITATIONS OF THE DATA

In general, relationships between income and expense items, and among asset, liability and net worth items, are based on aggregate figures, except that some figures covering insured banks are based on ratios of individual banks.

The data for insured industrial banks, on which the discussion of asset, liability and net worth items is based, are averages of figures for the beginning, middle and end of the year, except for 1934 and 1935. With this exception, the aggregate data on asset, liability and net worth items are, for all the samples, averages of figures for a single date at the end of the calendar year (fiscal year for some companies). These are not entirely representative of the average of values obtaining throughout the year. But since consumer instalment financing operations are relatively stable seasonally, the use of figures for a single date is not likely to distort the broad changes in asset distributions and in sources of funds which accompanied the cyclical change in volume of business, and the growing maturity of the industry.

Year-end balance sheet values were used as bases for the computation of ratios of income and expense in the income tax and credit union samples; this introduces an erratic error, caused by the severity of the cyclical fluctuations that characterized the period. Too much emphasis must not be placed, therefore, upon year-to-year fluctuations in ratios, particularly when these are severe and irregular.

An indication of the degree and direction of the bias resulting from the use of year-end figures is shown in Table A-2. In each type of consumer instalment financing agency year-end loans exceeded average loans for the industry as a whole in 1929 and 1936; in 1933 year-end loans exceeded average loans in the retail instalment credit field, but were below the average for the cash-lending agencies. For those years in which year-end loans exceeded average loans, the ratios of income and expenses to year-end loans or total assets understate the situation to a varying degree.<sup>17</sup>

In the National Credit Office samples the average of balance sheet values at the beginning and end of the year was used in the computation

<sup>17</sup> In the income tax sample about 10 percent of each type of company reported in each year on a fiscal year basis instead of a calendar year basis. To the extent that year-end figures are not lumped on December 31, but are distributed throughout the year, the bias just described is counteracted.

TABLE A-2

ESTIMATED YEAR-END CONSUMER INSTALMENT OUTSTANDINGS  
IN PERCENT OF ESTIMATED AVERAGE FOR THE YEAR,  
1929-41, BY TYPE OF LOAN<sup>a</sup>

Year	Automobile Retail Instalment Paper <sup>b</sup>	Instalment Cash Loans		
		Personal Finance Companies	Industrial Banking Companies	Federal Credit Unions
1929	103.7%	115.5%	108.1%	..
1930	84.7	104.5	99.0	..
1931	83.6	100.8	90.9	..
1932	72.8	95.1	87.0	..
1933	119.2	98.2	95.8	..
1934	106.2	104.6	103.8	°
1935	119.0	106.3	113.6	°
1936	110.7	107.1	109.9	154.1%
1937	98.2	107.9	105.9	136.4
1938	89.2	100.8	103.2	123.5
1939	112.0	116.9	105.6	127.1
1940	113.9	107.5	104.9	118.4
1941	94.5	102.6	99.5	107.6

<sup>a</sup> Except for credit unions based on data in *Survey of Current Business* (November 1942) pp. 9-25, which revises and brings up to date the National Bureau of Economic Research (Financial Research Program) estimates published in *The Volume of Consumer Instalment Credit, 1929-38*, by Duncan McC. Holthausen, et al. (New York 1940); averages are based on estimated end-of-month outstandings, January through December. For credit unions based on data from U. S. Farm Credit Administration, Division of Finance and Accounts; averages are based on figures for three to five dates during the year.

<sup>b</sup> Automobile retail instalment paper may be considered representative of total holdings of sales finance companies, even though the latter hold a small proportion of other types of retail instalment paper, and even though a small proportion of the total retail instalment paper is held by industrial banking companies and commercial banks.

<sup>c</sup> Not available.

of income and expense ratios; this appeared to reduce the error materially.<sup>18</sup> For insured industrial and commercial banks (except industrial banks in 1934 and 1935) averages of asset and liability items at the beginning, middle and end of the year were used as bases for computation of the income and expense ratios. National banks' ratios were based on averages of asset and liability items for call dates (at least four) during the year. For banks, therefore, both the seasonal and the cyclical biases were practically eliminated.

<sup>18</sup> In these samples an increasing proportion of the companies reported on a fiscal year basis toward the end of the period.

Another problem in interpretation arises from the limitations inherent in the use of data prepared from income tax returns. Since the balance sheets and income statements in these returns are general purpose forms, the accuracy of the data tabulated from them depends on the relevance to the consumer instalment financing industry of the common categories used, which affects the ability of the taxpayer to classify correctly the amounts to be entered against the printed items on the form; it depends also on the descriptiveness of the captions interlineated by the taxpayer, which in turn affects the ability of the tabulating agency to classify such amounts correctly.

Because of the heterogeneous character of the samples used, and because the danger of error increases in relation to the increase in detail of account categories, it has been considered advisable to utilize only a few broad account classifications for the principal samples of data. The asset, liability and net worth items that have been used conform, in general, to a satisfactory condensed balance sheet presentation of a consumer instalment financing agency; income and expense items have been severely limited. Descriptions of the principal account items used, and comments regarding their comparability in the data, in addition to those appearing in the text and footnotes, are given below. Where supplementary data have been utilized to provide greater detail, the main classifications conform with those used for the principal samples. Captions describing supplementary detail are sufficiently clear to provide accurate interpretation.

*Loans.* By far the most important asset in a consumer instalment financing agency is the instalment paper acquired. Every attempt has been made to tabulate assets of this character, however acquired, as "receivables," herein referred to as loans. In the income tax and insured bank data, the figures for loans represent values after deducting reserves for bad debts or for repossession losses; data in the National Credit Office sample conform reasonably well in this respect. In the income tax sample, hypothecated deposits were not deducted from the loans of industrial banking companies, but in the FDIC data on insured industrial banks, loans are shown after deduction of hypothecated deposits, unless otherwise indicated.

*Cash* is used consistently to include all items generally considered as cash equivalents, including bank deposits and, in the case of commercial banks, balances with correspondents and the Federal Reserve banks.

*Investments* include, in the income tax sample, investments in subsidiaries. This necessitated the exclusion of some companies from the income-expense analysis. In the National Credit Office data consolidated statements have been utilized wherever available.

*Miscellaneous assets* include all types of assets not separately tabulated.

*Net worth*, or owners' equity, has been divided, in the income tax sample, into preferred stock and common equity. *Preferred stock* includes capital advances made by the Reconstruction Finance Corporation, and

*common equity* includes all items of net worth except preferred stock. The amounts shown in the income tax and National Credit Office samples are probably not seriously affected by the lack of uniform treatment of reserves for contingencies, or by the lack of careful definition of other reserve accounts.

The figure reported on the income tax returns as preferred stock may consist either of the par amount of the preferred stock outstanding or of the stated value of no-par preferred stock. In either case some of the common equity, as reported, may actually consist of capital surplus paid in by the preferred stockholders. In some cases the real ownership equity is represented by the preferred investment; in other words, the major cash investment at the origin of the corporation was made by the preferred stockholders, and the common stock represented promotional hopes. Where this is true the common equity may consist almost entirely of surplus built up by retention of earnings during a period of successful operation.

*Borrowed funds* are treated under long-term debt and short-term debt. Except in the income tax sample *long-term debt* includes bonds and other evidences of funded debt; in the income tax data evidences of debt—both secured and unsecured—with a maturity of more than one year are treated as long-term. *Short-term debt* includes deposits and investment certificates, as well as other obligations; in the income tax data it includes also accounts payable, even in the analysis of interest payments, because the amount of this item may be expected to be nominal, and because of the difficulty of accurately excluding it.

*Deposits and investment certificates* include in the income tax data, dealers' deposits, dealers' credits and dealers' reserves.<sup>19</sup> Deposits constitute the most important source of funds of commercial banks and of investment type industrial banks. Where statutory limitations on the latter resulted in the use of investment certificates instead of deposits, these have been tabulated, in the income tax sample, as deposits; they include, besides unrestricted funds, credits to hypothecated accounts, representing debtors' payments that are not applied to reduce the debt until the completion of the entire transaction. In FDIC data on insured industrial banks, however, deposits are shown net, after deduction of hypothecated deposits; these include a small amount of demand deposits.

*Total income.* Because of lack of uniformity in reporting methods, it was not deemed advisable, in the income tax and National Credit Office samples, to attempt a segregation of income by sources. In the income tax sample total income corresponds in content and in scope to gross earnings from current operations as reported by insured banks; that is,

<sup>19</sup> Since none of these items, not even deposits, appears on the printed balance sheet on the income tax form, some taxpayers may have reported such items against other liability captions, such as notes payable or accounts payable, rather than writing them in; therefore it is probable that deposits are slightly understated in the income tax data.

bad-debt recoveries were excluded.<sup>20</sup> In the National Credit Office sample bad-debt recoveries were excluded where possible, but are presumably included for some companies.

*Cost of loan operations*, or total cost, includes all expenses except payments for borrowed money.<sup>21</sup> Net charge-offs or net bad-debt expense, are included,<sup>22</sup> and in the income tax data an excess of recoveries over net bad-debt expense in an individual company is treated as a deduction from total cost.<sup>23</sup> The details of operating costs are not uniformly presented in the principal bodies of data. In neither the income tax nor the National Credit Office sample would there have been any assurance that arbitrarily determined categories were on a uniform basis. The supplementary data showing additional details are believed to be reasonably uniform.

*Net charge-offs* were available on a satisfactory basis only for the income tax sample and for commercial banks. In the income tax sample they represent bad-debt losses incident to business operations—including some repossession losses—minus recoveries of bad debts previously charged off.<sup>24</sup> Worthless bonds charged off were not included with bad debts, because their inclusion would have made the latter less representative of the bad-debt losses incident to the financing of consumer loans.<sup>25</sup>

It may be presumed that the National Credit Office samples (at least in some cases) and the data on personal finance company operations based on state supervisory reports, include gross losses or charge-offs as a part of cost of operations, and recoveries as a part of total income.<sup>26</sup> In the former samples, covering the larger companies, the reserve basis is

<sup>20</sup> In this sample income items and deductions for income tax purposes were both adjusted by the amount of non-taxable income and non-deductible expenses, in order to obtain the amount of *book* income and costs.

<sup>21</sup> Total expense as derived from the income tax data corresponds essentially with the deductions made from total income for the purpose of determining net profit available for dividends or for addition to net worth; from this the amount of interest paid has been deducted.

<sup>22</sup> In the National Credit Office sample gross charge-offs are sometimes included in total cost, with recoveries reported as a part of income; in these cases net charge-offs are not available separately.

<sup>23</sup> See footnote 24, below.

<sup>24</sup> For companies using the reserve method, net bad debts were derived by adding the current year's credits to the reserve for bad debts reported as of the beginning of the year and subtracting the reserve reported as of the end of the year. When recoveries exceeded net bad debts charged off, the excess was tabulated as a negative expense item; this procedure made possible a uniform treatment of recoveries in the aggregates.

<sup>25</sup> As a result of this exclusion of the amount of worthless securities, the total costs of some of the companies were smaller, and their net profit greater, than the amounts actually reported on the income tax form. But in view of the small proportion of securities held by these companies the effect of this distortion is negligible.

<sup>26</sup> This practice seems to be followed also by other research workers in the field.



probably most generally used;<sup>27</sup> in the latter, actual charge-offs. For commercial banks net charge-offs or net losses represent the amounts reported as losses or charge-offs, minus the amounts reported as recoveries; the basis of reporting—that is, the use of a reserve or of an “actual realization” basis—varied from bank to bank. Profits on securities sold were excluded, by estimation when necessary, even though these probably include some recoveries.

*Operating profit* represents the difference between total income and cost of loan operations, and is subject to the limitations of those two items, already described. See also interest payments, below.

*Interest payments* include all payments made for the use of borrowed funds, including deposits. It is general accounting practice, and also the practice of the federal bank supervisory agencies, to include interest in total expenses. In the field of personal finance statistics, however, the usual practice is to exclude interest from expenses of operation, since the commonly employed concept of profit is that of net profit *before* interest payments.<sup>28</sup> This procedure has been followed in the present study, in order to facilitate comparison with material available from sources other than the income tax and insured bank data. However, operating profit provides an excellent basis for showing how the rate of net profit is influenced by interest cost, and by the degree of trading on equity.

*Net profit (or loss)* is the amount available for dividends or for addition to net worth. In the income tax sample this item is book profit or loss, obtained by adjusting the amount of statutory net income (or deficit) for tax-exempt income and for non-allowable deductions.<sup>29</sup> Net profit is slightly overstated, however, by the exclusion of worthless securities charged off from bad-debt losses.<sup>30</sup>

*Cash dividends* paid include all cash distributions to common or preferred stockholders. Payments to the Reconstruction Finance Corporation are included with preferred dividends, in accordance with the practice of federal bank supervisory agencies. Stock dividends are not included.

<sup>27</sup> In the published statements of industrial banks, and to a lesser extent in those of personal finance companies, it is customary to include in reserves for charge-offs the payments made to a second party for insuring against the risk of certain types of losses. The most common payment of this kind represents the expense of group insurance on the life of borrowers, the cost of which is frequently transferred to the borrower but is sometimes absorbed by the lender.

<sup>28</sup> This may be attributed to the preoccupation of the chief workers in the personal finance field with the question of the proper rate of return and the necessary rate of charge, which has resulted in a trend of analysis comparable to that found in the regulated public utilities. Here the concept of rate of return has been related, predominantly, to the value of the entire amount of necessary assets devoted to the business, with only secondary attention to the rate of return on equity capital.

<sup>29</sup> In 1929 losses for prior years were allowed as statutory deductions, but such deductions are excluded from these data.

<sup>30</sup> See above, under “net charge-offs.”

## Supplementary Tabulations

TABLE B-1

## NUMBER OF COMPANIES IN SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES AND COMMERCIAL BANKS, YEAR-END 1929-41

<i>Sample</i>	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>a</sup>	2	3	3	3	3	3	3	3	3	3	3	3	3
2 to 4 regional <sup>a</sup>	2	2	2	2	4	4	4	4	4	4	4	4	3
9 to 32 local <sup>a</sup>	9	11	10	15	19	24	28	32	32	32	29	29	30
202 local <sup>b</sup>	202	..	..	..	202	..	..	202	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>a</sup>	..	2	2	2	2	2	2	2	2	2	2	2	2
2 to 5 regional <sup>a</sup>	2	2	3	3	3	3	4	4	5	5	5	5	5
5 to 7 local <sup>a</sup>	..	..	..	..	..	5	5	7	7	7	7	7	7
153 local <sup>b</sup>	153	..	..	..	153	..	..	153	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>b</sup>	79	..	..	..	79	..	..	79	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>b</sup>	56	..	..	..	56	..	..	56	..	..	..	..	..
6 largest insured <sup>a</sup>	..	..	..	..	..	6	6	6	6	6	6	6	6
All other insured <sup>a</sup>	..	..	..	..	..	54	56	57	60	64	67	69	74
37 insured <sup>b</sup>	37	..	..	..	37	..	..	37	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>d</sup>	..	..	..	..	..	..	762	1,701	2,276	2,753	3,172	3,715	4,144
<i>Commercial banks</i>													
All national banks <sup>e</sup>	7,408	7,038	6,373	6,016	5,159	5,467	5,392	5,331	5,266	5,230	5,193	5,150	5,123
All insured banks <sup>e</sup>	..	..	..	..	..	14,137	14,123	13,969	13,795	13,657	13,534	13,438	13,427

(footnotes on page 197)

TABLE B-2  
 TOTAL ASSETS OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING  
 AGENCIES AND COMMERCIAL BANKS, YEAR-END 1929-41 (in millions)

Sample	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>a</sup>	\$625	\$703	\$596	\$372	\$456	\$615	\$839	\$1,204	\$1,416	\$956	\$1,089	\$1,478	\$1,720
2 to 4 regional <sup>a</sup>	41	34	34	22	58	69	110	169	195	132	176	236	192
9 to 32 local <sup>a</sup>	27	30	19	23	37	53	82	114	138	102	122	146	175
202 local <sup>b</sup>	114	..	..	..	88	..	..	189	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>a</sup>	..	89	101	90	89	97	101	122	144	135	148	163	179
2 to 5 regional <sup>a</sup>	5	7	17	10	10	13	20	24	41	48	62	72	84
5 to 7 local <sup>a</sup>	..	..	..	..	..	4	5	11	15	13	15	18	19
153 local <sup>b</sup>	21	..	..	..	21	..	..	26	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>b</sup>	13	..	..	..	10	..	..	11	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>b</sup>	40	..	..	..	32	..	..	42	..	..	..	..	..
6 largest insured <sup>a</sup>	..	..	..	..	..	55	66	72	84	93	103	116	132
All other insured <sup>a</sup>	..	..	..	..	..	29	36	45	54	62	72	86	102
37 insured <sup>b</sup>	49	..	..	..	34	..	..	58	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>a</sup>	..	..	..	..	..	..	2	9	19	30	48	72	106
<i>Commercial banks</i>													
All national banks <sup>a</sup>	28,882	28,800	24,662	23,311	21,747	25,630	28,225	31,070	30,124	31,666	35,319	39,734	43,538
All insured banks <sup>a</sup>	..	..	..	..	..	46,448	50,927	56,211	54,212	56,800	63,147	70,720	76,827

(footnotes on opposite page)

## FOOTNOTES TO TABLES B-1 AND B-2

\* Data from the National Credit Office, Inc. Some of the local companies are included in the respective income tax sample.

<sup>b</sup> Data from the Income Tax Study.

<sup>c</sup> Data from Federal Deposit Insurance Corporation. For industrial banks, total assets are averages of figures for beginning, middle and end of year, except in 1934 and 1935; deposits accumulated for the repayment of loans have been deducted from total assets; and banks that operated less than the full year or whose operations were materially affected by mergers during the year are not included. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

<sup>d</sup> Data from U. S. Farm Credit Administration, Division of Finance and Accounts.

<sup>e</sup> Data from Annual Reports of the Comptroller of the Currency.

TABLE B-3

DISTRIBUTION OF CONSUMER INSTALMENT FINANCING AGENCIES IN THE INCOME TAX SAMPLE, 1929, 1933, 1936, BY YEAR-END TOTAL ASSETS<sup>a</sup>

Agency	Total Assets (in thousands)					
	Under \$100	\$100-250	\$250-500	\$500-1,000	\$1,000-5,000	\$5,000-50,000
<i>229 Sales finance companies</i>						
1929	63 cos.	63 cos.	47 cos.	31 cos.	20 cos.	5 cos.
1933	81	67	38	29	11	3
1936	59	52	45	31	36	6
<i>179 Personal finance companies</i>						
1929	98	55	20	1	5	..
1933	99	60	12	4	4	..
1936	91	58	18	7	3	2
<i>92 non-invest. type indust. bkg. cos.</i>						
1929	26	43	18	4	1	..
1933	42	38	10	1	1	..
1936	39	40	9	2	2	..
<i>112 Invest. type indust. banks</i>						
1929	2	23	27	27	26	7
1933	4	27	27	32	18	4
1936	3	18	23	34	27	7

<sup>a</sup> Data from the Income Tax Study.

TABLE B-4

CONSUMER INSTALMENT LOANS IN PERCENT OF TOTAL LOANS OUTSTANDING OF INSURED COMMERCIAL BANKS, 1940, BY AMOUNT OF DEPOSITS AND POPULATION OF CENTER\*

Deposits (in thousands)	All Banking Centers	Population of Banking Center									
		Under 250	250- 500	500- 1,000	1,000- 2,500	2,500- 5,000	5,000- 10,000	10,000- 25,000	25,000- 50,000	50,000- 100,000	100,000 or Over
\$100 or less	6.8%	6.4%	6.4%	9.1%	3.7%	..	..	..	..	..	..
100—250	8.5	7.6	7.7	8.0	11.2	17.8%	(23.7)%	(20.2)%	..	(14.0)%	(18.0)%
250—500	9.3	8.3	8.0	8.2	9.6	12.0	19.9	18.9	(22.7)%	(15.6)	23.4
500—1,000	9.3	4.8	6.3	7.8	8.3	10.4	11.7	11.0	15.4	14.9	24.1
1,000—2,000	8.8	(8.4)	9.8	5.4	7.3	7.6	8.8	10.7	8.3	10.1	17.4
2,000—5,000	8.0	(10.1)	(.7)	(3.9)	5.2	6.4	6.8	7.6	7.8	10.8	12.9
5,000—10,000	7.5	..	..	..	..	(3.1)	6.8	6.6	6.3	6.7	10.7
10,000—50,000	6.4	..	..	..	(8.4)	(3.6)	(1.3)	6.5	7.5	6.2	6.2
Over 50,000	5.0	..	..	..	..	..	..	..	..	(8.2)	5.0
<b>ALL BANKS</b>	<b>8.7%</b>	<b>7.4%</b>	<b>7.6%</b>	<b>8.0%</b>	<b>8.9%</b>	<b>9.4%</b>	<b>9.6%</b>	<b>8.8%</b>	<b>7.9%</b>	<b>8.4%</b>	<b>10.5%</b>

\* Based on data from Federal Deposit Insurance Corporation. Figures are averages of ratios of individual banks. In regard to banks that were members of the Federal Reserve System loans outstanding and deposits are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Parentheses indicate groups containing 10 banks or fewer.

TABLE B-5

TOTAL INCOME OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES  
AND COMMERCIAL BANKS IN PERCENT OF TOTAL ASSETS, 1929-41<sup>a</sup>

<i>Sample</i>	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance companies</i>													
2 to 3 national <sup>b</sup>	14.6%	12.9%	12.0%	11.4%	13.2%	14.6%	12.8%	11.8%	10.8%	9.4%	9.6%	8.7%	9.1%
2 to 4 regional <sup>b</sup>	14.9	14.5	14.3	13.5	14.0	16.7	16.6	15.2	13.4	10.7	12.0	10.9	10.2
9 to 32 local <sup>b</sup>	19.4	16.6	17.6	15.5	16.6	17.6	17.6	16.0	15.5	13.0	14.2	13.8	13.6
202 local <sup>c</sup>	16.9	..	..	..	15.4	..	..	14.3	..	..	..	..	..
<i>Personal finance companies</i>													
2 national <sup>d</sup>	..	28.7	28.4	28.3	29.6	30.2	30.0	29.5	29.9	27.7	27.8	27.8	27.8
2 to 5 regional <sup>d</sup>	31.7	30.3	26.5	31.8	28.3	30.2	29.9	30.5	30.2	28.1	27.2	27.7	28.1
5 to 7 local <sup>d</sup>	..	..	..	..	..	27.9	29.3	29.8	28.7	26.2	26.8	28.2	27.1
153 local <sup>e</sup>	23.7	..	..	..	22.9	..	..	23.8	..	..	..	..	..
79 non-invest. type indust. bkg. cos. <sup>e</sup>	14.4	..	..	..	12.1	..	..	14.0	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured <sup>e</sup>	9.7	..	..	..	8.9	..	..	9.2	..	..	..	..	..
6 largest insured <sup>e</sup>	..	..	..	..	..	8.8	8.6	9.2	9.3	9.3	9.0	8.6	8.2
All other insured <sup>e</sup>	..	..	..	..	..	10.5	10.0	10.9	11.0	10.3	10.0	9.8	9.2
37 insured <sup>e</sup>	9.1	..	..	..	8.3	..	..	8.0	..	..	..	..	..
<i>Credit unions</i>													
All reporting federal credit unions <sup>f</sup>	..	..	..	..	..	..	4.7	6.1	7.3	7.6	7.5	7.5	6.9
<i>Commercial banks</i>													
All national banks <sup>g</sup>	4.9	4.7	4.3	4.3	3.7	3.4	3.0	2.8	2.8	2.7	2.5	2.3	2.2
All insured banks <sup>g</sup>	..	..	..	..	..	3.4	3.1	2.9	3.0	2.9	2.7	2.5	2.4

(footnotes on following page)

## FOOTNOTES TO TABLE B-5

<sup>a</sup> The number of companies for each year may be found in Appendix Table B-1.

<sup>b</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income. Here the denominator is the average of total assets at beginning and end of year.

<sup>c</sup> Based on tabulations prepared by the Income Tax Study. The figures represent total income in percent of year-end total assets.

<sup>d</sup> Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. In the majority of cases recoveries are probably included in total income. Here the denominator is the average of total assets at beginning and end of year.

<sup>e</sup> Based on data from Federal Deposit Insurance Corporation. Total assets are averages of figures for beginning, middle and end of year, except for industrial banks in 1934 and 1935, when year-end figures are used; deposits accumulated for the repayment of loans have been deducted from total assets of industrial banks. Cash depositors and banks designated in this study as insured industrial banks are included with all insured commercial banks.

<sup>f</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts. The figures represent total income in percent of year-end total assets.

<sup>g</sup> Based on data in Annual Reports of the Comptroller of the Currency. Total assets are averages of figures for call dates during the year.



TABLE B-6

## OPERATING COST ITEMS OF PERSONAL FINANCE COMPANIES IN PERCENT OF AVERAGE LOANS OUTSTANDING, FISCAL YEARS 1929-39\*

<i>Item</i>	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939
Salaries	8.58%	8.15%	7.68%	7.82%	8.53%	8.67%	8.53%	8.11%	7.74%	7.59%	7.46%
Traveling expenses	.44	.52	.51	.51	.58	.55	.62	.69	.64	.63	.61
Legal fees	.23	.39	.36	.36	.49	.47	.48	.43	.41	.41	.37
Auditing	.72	.76	.52	.41	.44	.37	.30	.26	.24	.23	.23
Total	9.97	9.82	9.07	9.10	10.04	10.06	9.93	9.49	9.03	8.86	8.67
Taxes and license fees	1.64	1.48	1.32	1.48	1.87	1.81	2.02	2.38	2.55	2.43	2.45
Recording and acknowledging fees	.10	.06	.06	.05	.07	.08	.06	.06	.10	.14	.14
Total	1.74	1.54	1.38	1.53	1.94	1.89	2.08	2.44	2.65	2.57	2.59
Rent	1.20	1.22	1.22	1.32	1.40	1.30	1.28	1.16	1.16	1.13	1.13
Depreciation on furn. and fixtures	.22	.23	.22	.25	.26	.25	.23	.21	.21	.20	.19
Total	1.42	1.45	1.44	1.57	1.66	1.55	1.51	1.37	1.37	1.33	1.32
Advertising	2.05	1.74	1.94	1.52	1.79	2.29	2.31	2.52	2.07	1.81	2.29
Printing, stationery, etc.	.79	.84	.85	.86	.95	.99	1.01	1.06	1.06	1.05	1.08
Insurance and bonding	.16	.17	.14	.20	.24	.24	.26	.24	.22	.22	.20
Sundry other expenses	1.93	1.61	1.99	1.94	1.63	1.76	1.84	2.00	1.99	1.96	2.08
Total	4.93	4.36	4.92	4.52	4.61	5.28	5.42	5.82	5.34	5.04	5.65
Total "other" operating costs	18.06	17.17	16.81	16.72	18.25	18.78	18.94	19.12	18.39	17.80	18.23
Bad debts and insurance against loss	2.08	2.25	2.81	4.91	4.44	3.55	2.77	2.12	1.90	2.36	1.99
TOTAL OPERATING COSTS	20.14%	19.42%	19.62%	21.63%	22.69%	22.33%	21.71%	21.24%	20.29%	20.16%	20.22%

\* For 1929-33 based on Russell Sage Foundation, *Expenses of Small Loan Licensees, 1929-33*, ed. by Rolf Nugent. For 1934-39 based on annual reports of state banking departments or on accountants' reports made available by the Russell Sage Foundation. The arrangement of the items has been made comparable to the presentation of the data for industrial and commercial banks. Average loans outstanding have been estimated at 1.15 times average employed assets. Total operating costs include all expenses other than interest payments.

TABLE B-7

OPERATING COST ITEMS OF INSURED INDUSTRIAL BANKS IN PERCENT OF LOANS OUTSTANDING,  
1934-41\* (dollar figures in thousands)

Item	1934	1935	1936	1937	1938	1939	1940	1941
Salaries, wages and fees	4.19%	3.40%	3.57%	3.47%	3.63%	3.67%	3.52%	3.50%
Taxes (other than on income)	.40	.41	.50	.43	.54	.47	.52	.43
Income taxes	..	..	.32	.48	.52	.47	.50	.69
Other costs of occupancy, including recurring depreciation	.18 <sup>b</sup>	.18 <sup>b</sup>	.81	.74	.63	.62	.62	.57
Other current operating costs	3.57	2.86	2.17	2.11	2.16	2.40	2.33	2.19
Total "other" operating costs	8.34	6.85	7.37	7.23	7.48	7.63	7.49	7.38
Net losses on loans <sup>c</sup>	1.34	.60	.09	.21	.45	.31	.64	.43
Net losses on other assets <sup>d</sup>	.60	.40	.61	.77	.28	.14	.07	-.01
<b>TOTAL OPERATING COSTS</b>	<b>10.28%</b>	<b>7.85%</b>	<b>8.07%</b>	<b>8.21%</b>	<b>8.21%</b>	<b>8.08%</b>	<b>8.20%</b>	<b>7.80%</b>
	\$5,746	\$6,134	\$7,235	\$8,795	\$9,480	\$10,444	\$12,575	\$13,848
Total loans outstanding	\$55,898	\$78,122	\$89,681	\$107,071	\$115,406	\$129,191	\$153,368	\$177,242
Number of banks	60	62	63	66	70	73	75	80

\* Based on data from Federal Deposit Insurance Corporation. Banks that submitted reports covering less than the full year's operations are not included. Loans outstanding are averages of figures for beginning, middle and end of year, except in 1934 and 1935, when year-end figures are used. Total operating costs include all expenses other than interest payments.

<sup>b</sup> Represents only depreciation on banking house, furniture and fixtures.

<sup>c</sup> Losses and charge-offs on loans, minus recoveries on loans.

<sup>d</sup> Losses and charge-offs on securities and other assets, minus recoveries on securities, profits on securities sold, and recoveries and profits on all other assets.

TABLE B-8  
 OPERATING COST ITEMS OF ALL REPORTING FEDERAL CREDIT UNIONS  
 IN PERCENT OF YEAR-END LOANS OUTSTANDING, 1935-41<sup>a</sup>

<i>Item</i>	<i>1935</i>	<i>1936</i>	<i>1937</i>	<i>1938</i>	<i>1939</i>	<i>1940</i>	<i>1941</i>
Salaries	.29%	.80%	1.43%	1.92%	1.93%	1.97%	2.40%
Stationery and supplies	1.32	.57	.30	.24	.21	.22	<sup>b</sup>
Cost of space occupied	} 1.16	.88	.96	1.10	.04	.04	<sup>b</sup>
Educational expense					.02	.05	<sup>b</sup>
Surety bond premiums					.07	.08	.09
Other operating costs					.99	.99	1.48
<b>TOTAL OPERATING COSTS</b>	<b>2.77%</b>	<b>2.25%</b>	<b>2.69%</b>	<b>3.26%</b>	<b>3.26%</b>	<b>3.35%</b>	<b>3.97%</b>
Total year-end loans outstanding	\$1,830,000	\$7,330,000	\$15,684,000	\$23,915,000	\$38,020,000	\$56,098,000	\$69,250,000

<sup>a</sup> Based on data from U. S. Farm Credit Administration, Division of Finance and Accounts. In 1938-40 year-end loans outstanding include loans to other credit unions. Total operating costs include all expenses other than interest payments and charge-offs.

<sup>b</sup> Included in "other operating costs."

TABLE B-9

OPERATING COST ITEMS OF ALL NATIONAL BANKS IN PERCENT OF AVERAGE LOANS AND INVESTMENTS OUTSTANDING, 1929-41<sup>a</sup> (dollar figures in millions)

Item	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
Salaries and wages	1.24%	1.29%	1.25%	1.26%	1.20%	1.21%	1.16%	1.12%	1.13%	1.18%	1.16%	1.14%	1.06%
Fees (directors and committees)	b	b	b	b	b	b	b	.02	.02	.02	.03	.02	.02
Real estate taxes	.30	.32	.26	.25	.25	.25	.23	.11	.11	.11	.10	.10	.08
Other taxes													
Losses and depreciation on banking house, furniture, fixtures	.11	.12	.09	.08	.13	.17	.13	.13	.12	.13	.13	.13	.13
Other current operating costs	.76	.78	.72	.90	.74	.78	.78	.79	.77	.76	.76	.75	.70
Total "other" operating costs	2.41	2.51	2.32	2.49	2.32	2.41	2.30	2.31	2.31	2.35	2.33	2.34	2.24
Net losses on loans <sup>b</sup>	.35	.55	.95	1.37	1.76	1.57	.61	.43	.11	.23	.13	.10	.03
Net losses on other assets <sup>d</sup>	.12	.15	.70	.87	1.34	.63	-.27	-.83	-.01	-.06	-.19	-.12	.11
<b>TOTAL OPERATING COSTS</b>	<b>2.88%</b>	<b>3.21%</b>	<b>3.97%</b>	<b>4.73%</b>	<b>5.42%</b>	<b>4.61%</b>	<b>2.64%</b>	<b>1.91%</b>	<b>2.41%</b>	<b>2.52%</b>	<b>2.27%</b>	<b>2.32%</b>	<b>2.16%</b>
	\$626	\$692	\$818	\$845	\$877	\$786	\$484	\$378	\$501	\$517	\$482	\$518	\$557
Total loans and invest. outstanding	\$21,772	\$21,574	\$20,600	\$17,853	\$16,164	\$17,053	\$18,322	\$19,827	\$20,821	\$20,500	\$21,218	\$22,359	\$25,741
Number of banks	7,408	7,038	6,373	6,016	5,159	5,467	5,392	5,331	5,266	5,230	5,193	5,150	5,123

<sup>a</sup> Based on data in Annual Reports of the Comptroller of the Currency. Loans and investments outstanding are averages of figures for call dates during the year. Total operating costs include all expenses other than interest payments.

<sup>b</sup> Reported as part of "other current operating costs."

<sup>c</sup> Losses and charge-offs on loans, minus recoveries on loans.

<sup>d</sup> Losses and charge-offs on securities and other assets, minus recoveries on securities, profits on securities sold, and recoveries and profits on all other assets.

TABLE B-10

NET CHARGE-OFFS ON LOANS OF CONSUMER INSTALLMENT FINANCING AGENCIES IN PERCENT OF YEAR-END LOANS OUTSTANDING, 1929, 1933, 1936, BY LOAN-INCOME RATES<sup>a</sup>

Agency	Loan-Income Rates									
	All Cos.	Under 8%	8-12%	12-16%	16-20%	20-24%	24-28%	28-32%	32-36%	36% or Over
<i>202 sales finance cos.</i>										
1929	1.51%	(.49)%	.44%	.65%	.91%	2.76%	1.69%	2.32%	(1.04)%	3.87%
1933	2.33	(2.13)	2.59	2.37	1.43	2.30	3.40	4.78	(2.94)	3.91
1936	1.24	(2.80)	.55	1.07	1.11	1.36	2.67	(.72)	(.94)	(4.77)
<i>153 personal finance cos.</i>										
1929	1.53	..	(.01)	.54	1.72	1.51	.93	1.25	2.14	3.37
1933	3.61	(.40)	2.19	1.96	2.72	2.87	4.79	2.59	5.49	8.04
1936	3.04	(2.30)	(1.93)	.70	1.09	1.24	2.21	5.20	4.15	4.40
<i>79 non-invest. type indust. bkg. cos.</i>										
1929	1.36	..	.20	1.37	1.58	2.57	(2.57)	..	..	..
1933	3.11	(1.22)	1.73	4.43	4.62	(2.64)	(4.08)	..	..	..
1936	1.28	(2.15)	1.06	.94	1.96	1.17	(.66)	..	..	..
<i>93 invest. type indust. banks</i>										
<i>56 noninsured</i>										
1929	.50	(.03)	.48	1.05	(.51)	..	..	..	..	..
1933	1.71	.82	1.39	3.56	(2.74)	..	..	..	..	..
1936	.68	(.66)	.61	.77	(1.61)	..	..	..	..	..
<i>37 insured</i>										
1929	.80	(.27)	.88	(.51)	..	..	..	..	..	..
1933	1.21	(1.39)	1.26	(.64)	..	..	..	..	..	..
1936	.22	(.39)	.18	(.56)	(-.40)	..	..	..	..	..

<sup>a</sup> Based on tabulations prepared by the Income Tax Study. Loan-income rates represent total income (composed predominantly of loan income) in percent of total year-end loans outstanding. Loan-income rate groups are inclusive of the lower limit and exclusive of the upper. Parentheses indicate groups containing 10 companies or fewer.

TABLE B-11

RATES OF "OTHER" OPERATING COSTS OF INSURED COMMERCIAL BANKS WITH  
 LOAN-INCOME RATES OF 5 TO 6 PERCENT, AND NUMBER OF BANKS, 1940,  
 BY LOAN PROPORTIONS AND AMOUNT OF DEPOSITS<sup>a</sup>

Deposits	All Banks	Loan Proportions					
		Under 20%	20-30%	30-40%	40-50%	50-60%	60% or Over
		RATES OF COST					
\$100,000 or less	3.35%	..	(2.77)%	(5.70)%	(2.68)%	(3.42)%	(2.86)%
100,000—250,000	2.52	(1.84)%	2.25	2.28	2.43	2.64	2.84
250,000—500,000	2.19	1.72	1.96	2.04	2.17	2.27	2.53
500,000—1,000,000	2.00	1.66	1.90	1.91	1.99	2.11	2.34
1,000,000—2,000,000	1.87	1.61	1.74	1.83	1.97	2.04	2.29
2,000,000—5,000,000	1.82	1.54	1.67	1.81	2.04	2.10	2.18
5,000,000—10,000,000	1.85	1.55	1.70	1.88	2.21	2.24	(2.38)
10,000,000—50,000,000	1.78	1.48	1.64	1.91	2.05	(2.05)	..
Over 50,000,000	(1.68)	(1.33)	(1.55)	(1.96)	(1.56)	..	..
ALL BANKS	2.01%	1.60%	1.78%	1.93%	2.08%	2.24%	2.49%
		NUMBER OF BANKS					
\$100,000 or less	26	..	1	3	4	9	9
100,000—250,000	351	3	19	77	97	86	69
250,000—500,000	770	24	84	154	209	185	114
500,000—1,000,000	954	52	151	244	247	157	103
1,000,000—2,000,000	914	95	199	264	209	105	42
2,000,000—5,000,000	691	86	213	176	140	54	22
5,000,000—10,000,000	224	34	71	68	32	15	4
10,000,000—50,000,000	110	16	40	30	18	6	..
Over 50,000,000	9	1	3	3	2	..	..
ALL BANKS	4,049	311	781	1,019	958	617	363

(footnote on opposite page)

## FOOTNOTE TO TABLE B-11

\* Based on data from Federal Deposit Insurance Corporation, pertaining to banks whose income on loans amounted to 5 to 6 percent of loans outstanding. Rates of operating costs represent costs of operation, exclusive of net charge-offs and interest payments, in percent of total assets; figures are averages of rates of individual banks. Loan proportions represent loans outstanding in percent of total assets. In regard to banks that were members of the Federal Reserve System loans outstanding, total assets and deposits are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Cash depositories, banks designated in this study as insured industrial banks and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Loan-income groups and loan-proportion groups are inclusive of the lower limit and exclusive of the upper. Deposits are exclusive of the lower limit and inclusive of the upper. Parentheses indicate groups containing 10 banks or fewer.

TABLE B-12

OPERATING PROFIT IN PERCENT OF AVERAGE TOTAL  
ASSETS OF INSURED INDUSTRIAL BANKS, 1936-41,  
BY LOAN-INCOME RATES\*

<i>Loan-Income Rates</i>	<i>1936</i>	<i>1937</i>	<i>1938</i>	<i>1939</i>	<i>1940</i>	<i>1941</i>
Under 10%	(3.07)%	(3.34)%	(3.31)%	(3.39)%	(2.00)%	2.44%
10-12	3.61	3.13	3.64	3.45	3.19	2.95
12-14	3.92	4.27	3.62	3.48	2.94	2.98
14-16	4.50	4.24	(3.43)	3.87	4.14	2.86
16 or over	(4.93)	(4.32)	(5.14)	(3.72)	(3.15)	(4.81)
ALL BANKS	3.65%	3.60%	3.60%	3.46%	2.89%	2.72%

\* Based on data from Federal Deposit Insurance Corporation. Loan-income rates represent income on loans in percent of average loans outstanding. Loans outstanding and total assets are averages of figures for beginning, middle and end of year, net after deduction of hypothecated deposits. Banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Loan-income rate groups are inclusive of the lower limit and exclusive of the upper. Parentheses indicate groups containing 10 banks or fewer.

TABLE B-13

**RATIO OF LOAN-INCOME RATES OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES AND COMMERCIAL BANKS TO RATE OF INTEREST PAID ON BORROWINGS, 1929-41<sup>a</sup>**

<i>Sample</i>	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941
<i>Sales finance cos.</i>													
2 to 3 national	2.7	2.9	3.6	3.0	5.3	6.4	7.9	7.6	6.2	4.8	5.7	7.0	8.4
2 to 4 regional	2.3	2.7	3.3	3.1	3.4	5.1	8.2	10.0	8.2	8.1	8.9	8.5	7.3
9 to 32 local	2.9	3.1	2.9	2.8	3.3	3.4	4.7	5.3	5.5	5.3	6.0	6.4	6.7
202 local	3.1	..	..	..	3.9	..	..	6.0	..	..	..	..	..
<i>Personal finance cos.</i>													
2 national	..	4.6	5.0	5.8	6.9	8.5	7.1	16.6	16.1	17.7	16.0	14.8	13.9
2 to 5 regional	5.0	4.9	3.9	4.4	5.8	6.3	8.0	9.3	12.2	12.8	14.6	15.5	15.8
5 to 7 local	..	..	..	..	..	5.7	4.9	8.9	7.4	7.7	8.1	7.9	8.8
153 local	4.5	..	..	..	4.3	..	..	4.6	..	..	..	..	..
<i>79 non-invest. type indust. bkg. cos.</i>	2.5	..	..	..	2.1	..	..	3.2	..	..	..	..	..
<i>Invest. type indust. banks</i>													
56 noninsured	3.6	..	..	..	3.7	..	..	4.6	..	..	..	..	..
6 largest insured <sup>b</sup>	..	..	..	..	..	3.8	3.9	4.6	4.8	5.5	5.4	5.4	5.5
All other insured <sup>c</sup>	..	..	..	..	..	4.8	5.2	5.5	5.5	5.9	6.1	6.0	5.8
37 insured	3.8	..	..	..	4.7	..	..	6.2	..	..	..	..	..
<i>Credit unions</i>													
All reporting fed. cred. unions	..	..	..	..	..	..	3.0	2.8	2.3	2.1	2.3	2.2	1.8
<i>Commercial banks</i>													
All natl. banks (income on loans)	1.8	1.7	1.7	1.8	1.9	1.9	2.3	2.6	2.6	2.7	3.0	3.3	3.5
All insured banks (inc. on loans)	..	..	..	..	..	1.9	2.2	2.5	2.6	2.8	3.1	3.4	3.6
All natl. banks (inc. on securities)	1.3	1.4	1.3	1.4	1.4	1.4	1.4	1.6	1.6	1.6	1.6	1.6	1.7
All insured banks (inc. on securities)	..	..	..	..	..	1.3	1.4	1.6	1.6	1.6	1.7	1.7	1.7

<sup>a</sup> Based on Tables 13 (Chapter 4) and 24 (Chapter 7).

<sup>b</sup> Ratio of loan-income rates to rate of interest on average time and savings deposits.

<sup>c</sup> Ratio of rate of income on securities to rate of interest on average time and savings deposits.



TABLE B-14

PERCENTAGE DISTRIBUTION OF CONSUMER INSTALMENT  
FINANCING AGENCIES, 1929, 1933, 1936, AND INSURED  
COMMERCIAL BANKS, 1938, BY NET PROFIT IN  
PERCENT OF YEAR-END NET WORTH<sup>a</sup>

Agency	Net Profit in Percent of Net Worth						Total
	Under 0 (net loss)	0-5%	5-10%	10-15%	15-20%	20% or Over	
<i>202 sales finance cos.</i>							
1929	2.0%	10.4%	30.7%	31.2%	15.3%	10.4%	100.0%
1933	28.7	38.2	25.2	5.4	1.5	1.0	100.0
1936	5.9	17.3	33.2	26.7	11.9	5.0	100.0
<i>153 personal finance cos.</i>							
1929	3.9	11.1	37.3	26.8	11.1	9.8	100.0
1933	25.5	36.6	34.6	1.3	.7	1.3	100.0
1936	11.8	37.2	28.1	11.1	8.5	3.3	100.0
<i>79 non-invest. type indust. bkg. cos.</i>							
1929	3.8	11.4	59.5	21.5	2.5	1.3	100.0
1933	34.1	48.1	15.2	1.3	1.3	..	100.0
1936	10.1	29.1	46.8	7.6	5.1	1.3	100.0
<i>93 invest. type indust. banks</i>							
<i>56 noninsured</i>							
1929	1.8	14.2	37.5	41.1	3.6	1.8	100.0
1933	25.0	55.4	19.6	..	..	..	100.0
1936	5.4	30.4	28.5	25.0	7.1	3.6	100.0
<i>37 insured</i>							
1929	2.7	10.8	40.5	35.2	8.1	2.7	100.0
1933	27.0	40.6	29.7	2.7	..	..	100.0
1936	..	10.8	29.7	35.2	13.5	10.8	100.0
<i>13,487 insured commercial banks</i>							
1938	16.0	29.3	32.0	15.4	5.2	2.1	100.0

<sup>a</sup> For consumer instalment financing agencies based on tabulations prepared by the Income Tax Study. For commercial banks based on data from Federal Deposit Insurance Corporation (figures covering insured commercial banks, 1938-41, are presented in the *Annual Report of the FDIC for 1941*, p. 57); in regard to banks that were members of the Federal Reserve System net worth is the average of figures for call dates during the year, and in regard to non-member banks it is the average of figures for beginning, middle and end of year. Banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included; cash depositories and banks designated in this study as insured industrial banks are included. Net-profit rate groups are inclusive of the lower limit and exclusive of the upper.

TABLE B-15

PERCENTAGE DISTRIBUTION OF DIVIDEND-PAYING COMPANIES AMONG CONSUMER INSTALMENT FINANCING AGENCIES, 1929, 1933, 1936, BY PROPORTION OF NET PROFIT PAID OUT IN DIVIDENDS<sup>a</sup>

Agency	No. of Cos. Paying Dividends	Dividends in Percent of Net Profit <sup>b</sup>							Total
		Minus <sup>c</sup>	Under 20%	20-40%	40-60%	60-80%	80-100%	100% or Over	
<i>202 sales finance companies</i>									
1929	148	1.4%	6.8%	18.2%	26.4%	26.9%	9.5%	10.8%	100.0%
1933	119	13.4	4.2	8.4	13.4	16.8	10.9	32.9	100.0
1936	190	4.2	.5	3.2	19.5	18.4	22.7	31.5	100.0
<i>153 personal finance companies</i>									
1929	100	1.0	7.0	24.0	25.0	14.0	13.0	16.0	100.0
1933	113	16.8	3.5	4.4	12.4	14.2	11.5	37.2	100.0
1936	140	7.9	2.9	2.1	8.6	18.6	14.3	45.6	100.0
<i>79 non-invest. type indust. bkg. cos.</i>									
1929	56	3.6	3.6	1.8	23.2	23.2	21.4	23.2	100.0
1933	43	23.3	..	11.6	16.3	7.0	18.5	23.3	100.0
1936	73	5.5	1.4	..	9.6	20.5	27.4	35.6	100.0
<i>93 invest. type indust. banks</i>									
<i>56 noninsured</i>									
1929	51	..	3.9	17.6	35.4	19.6	7.8	15.7	100.0
1933	38	15.8	..	7.9	10.5	21.1	7.9	36.8	100.0
1936	54	3.7	1.9	11.1	13.0	29.5	27.8	13.0	100.0
<i>37 insured</i>									
1929	32	..	6.3	25.0	25.0	25.0	12.5	6.2	100.0
1933	21	14.3	9.5	9.5	14.3	28.6	4.8	19.0	100.0
1936	36	..	13.9	30.5	27.8	19.4	5.6	2.8	100.0

<sup>a</sup> Based on tabulations prepared by the Income Tax Study.

<sup>b</sup> Each level is inclusive of the lower limit and exclusive of the upper.

<sup>c</sup> Dividend-paying companies that had sustained a net loss before dividend payment.

TABLE B-16

PERCENTAGE DISTRIBUTION OF DIVIDEND-PAYING COMPANIES AMONG CONSUMER INSTALLMENT FINANCING AGENCIES, 1929, 1933, 1936, BY DIVIDENDS IN PERCENT OF NET WORTH<sup>a</sup>

Agency	No. of Cos. Paying Dividends	Dividends in Percent of Year-End Net Worth <sup>b</sup>							Total
		Under 2%	2-4%	4-6%	6-8%	8-10%	10-15%	15% or Over	
<i>202 sales finance companies</i>									
1929	148	6.8%	14.1%	27.7%	27.7%	12.2%	8.8%	2.7%	100.0%
1933	119	10.9	32.7	30.3	14.3	5.9	3.4	2.5	100.0
1936	190	3.2	13.2	22.6	15.8	16.8	17.9	10.5	100.0
<i>153 personal finance companies</i>									
1929	100	9.0	17.0	32.0	22.0	7.0	7.0	6.0	100.0
1933	113	13.3	27.4	30.1	15.0	6.2	6.2	1.8	100.0
1936	140	6.4	23.6	26.4	13.6	9.3	10.7	10.0	100.0
<i>79 non-invest. type indust. bkg. cos.</i>									
1929	56	5.4	5.4	37.5	39.2	8.9	3.6	..	100.0
1933	43	16.3	34.9	37.2	7.0	2.3	2.3	..	100.0
1936	73	8.2	19.2	31.5	20.5	11.0	5.5	4.1	100.0
<i>93 invest. type indust. banks</i>									
56 noninsured									
1929	51	5.9	15.7	43.1	29.4	2.0	3.9	..	100.0
1933	38	18.4	47.4	23.7	10.5	..	..	..	100.0
1936	54	7.4	31.5	25.9	14.8	9.3	7.4	3.7	100.0
37 insured									
1929	32	6.2	18.8	46.9	25.0	3.1	..	..	100.0
1933	21	33.3	42.8	14.3	4.8	4.8	..	..	100.0
1936	36	11.1	27.8	41.6	13.9	2.8	2.8	..	100.0

<sup>a</sup> Based on tabulations prepared by the Income Tax Study.

<sup>b</sup> Each level is inclusive of the lower limit and exclusive of the upper.

TABLE B-17  
PERCENT OF DIVIDEND-PAYING INSURED COMMERCIAL BANKS, 1936-41, BY AMOUNT OF DEPOSITS\*

Deposits	All Insured Commercial Banks			Insured Commercial Banks Not Members of Federal Reserve System					
	1939	1940	1941	1936	1937	1938	1939	1940	1941
\$100,000 or less	52.8%	58.1%	60.0%	45.4%	48.8%	48.1%	53.0%	58.0%	60.9%
100,000—250,000	69.7	75.9	77.8	64.0	67.3	65.9	68.8	75.2	78.1
250,000—500,000	80.1	84.0	85.5	72.1	74.0	74.6	78.5	82.0	84.8
500,000—1,000,000	84.7	87.6	88.6	76.6	78.8	77.4	81.5	84.1	86.0
1,000,000—2,000,000	88.3	89.6	90.3	81.0	82.1	81.3	81.9	84.3	88.0
2,000,000—5,000,000	90.0	91.7	92.6	86.4	85.0	82.1	85.4	86.0	87.6
5,000,000—10,000,000	92.2	93.3	92.5	90.5	89.9	85.7	87.1	87.7	90.4
10,000,000—50,000,000	93.3	95.2	94.8	90.2	94.2	90.2	90.0	91.1	92.7
Over 50,000,000	99.2	100.0	99.3	(75.0)	(80.0)	(80.0)	(100.0)	(100.0)	(83.3)
<b>ALL BANKS</b>	<b>81.6%</b>	<b>85.4%</b>	<b>87.2%</b>	<b>69.5%</b>	<b>72.7%</b>	<b>71.7%</b>	<b>75.8%</b>	<b>80.2%</b>	<b>83.6%</b>

\* Based on data from Federal Deposit Insurance Corporation. Cash depositories, banks designated in this study as insured industrial banks, and banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Parentheses indicate groups containing 10 banks or fewer.

TABLE B-18

NUMBER AND PERCENTAGE DISTRIBUTION OF DIVIDEND-PAYING INSURED COMMERCIAL BANKS, 1939,  
BY DIVIDEND RATE AND AMOUNT OF DEPOSITS\*

Deposits	NUMBER				PERCENTAGE DISTRIBUTION				Average Dividends in % of Net Worth <sup>b</sup>
	Dividends in % of Net Worth				Dividends in % of Net Worth				
	Under 3%	3-5%	5% or Over	Total	Under 3%	3-5%	5% or Over	Total	
\$100,000 or less	125	73	42	240	52.1%	30.4%	17.5%	100.0%	3.29%
100,000—250,000	797	535	359	1,691	47.1	31.7	21.2	100.0	3.62
250,000—500,000	1,150	729	577	2,456	46.8	29.8	23.4	100.0	3.78
500,000—1,000,000	1,297	674	466	2,437	53.2	27.7	19.1	100.0	3.47
1,000,000—2,000,000	1,103	520	231	1,854	59.4	28.1	12.5	100.0	3.07
2,000,000—5,000,000	798	376	106	1,280	62.3	29.4	8.3	100.0	2.83
5,000,000—10,000,000	306	118	25	449	68.1	26.3	5.6	100.0	2.55
10,000,000—25,000,000	147	87	23	257	57.2	33.8	9.0	100.0	2.94
25,000,000—50,000,000	45	41	11	97	46.4	42.3	11.3	100.0	3.35
Over 50,000,000	39	57	28	124	31.4	46.0	22.6	100.0	3.81
<b>ALL BANKS</b>	<b>5,807</b>	<b>3,210</b>	<b>1,868</b>	<b>10,885</b>	<b>53.4%</b>	<b>29.5%</b>	<b>17.1%</b>	<b>100.0%</b>	<b>3.37%</b>

\* Based on data from Federal Deposit Insurance Corporation. In regard to banks that were members of the Federal Reserve System net worth and deposits are averages of figures for call dates during the year, and in regard to non-member banks they are averages of figures for the beginning, middle and end of the year. Banks that submitted reports covering less than the full year's operations or whose operations were materially affected by mergers during the year are not included. Dividend rate groups are inclusive of the lower limit and exclusive of the upper. Deposits are exclusive of the lower limit and inclusive of the upper.

<sup>b</sup> Averages of rates of individual banks.

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## **Studies in Consumer Instalment Financing**

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These studies are part of a broad program of research in finance inaugurated by the National Bureau of Economic Research in 1938 under grants from the Association of Reserve City Bankers and the Rockefeller Foundation. They have been prepared with the cooperation of public agencies, private enterprises and university specialists.

In all, the Consumer Instalment Financing series includes eleven volumes. Seven were published during 1940. Five of these were studies of the institutions dealing in consumer credit: *Personal Finance Companies and Their Credit Practices*; *Sales Finance Companies and Their Credit Practices*; *Industrial Banking Companies and Their Credit Practices*; *Commercial Banks and Consumer Instalment Credit*; and *Government Agencies of Consumer Instalment Credit*. Two were special statistical studies: *The Volume of Consumer Instalment Credit, 1929-38*; and *The Pattern of Consumer Debt, 1935-36*.

During 1941 a third special statistical study was published, entitled *Risk Elements in Consumer Instalment Financing*. A fourth special statistical study, *Consumer Instalment Credit and Economic Fluctuations*, was published in 1942.

The present study, *Comparative Operating Experience of Consumer Instalment Financing Agencies and Commercial Banks, 1929-41*, is the tenth volume in the series, and belongs with the earlier studies of institutions dealing in consumer credit. The final volume will be a summary of the findings of the Consumer Instalment Financing research program as a whole.