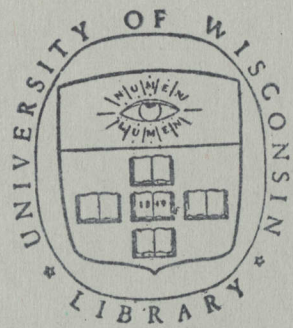


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COMMERCIAL BANK LENDING TO
SALES FINANCE COMPANIES

By
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A thesis submitted in partial fulfillment of
the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION
(Finance)

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CHAPTER I

INTRODUCTION

According to surveys of the Federal Reserve System, the finance industry represents the largest single industry customer of commercial banks in this country. On December 31, 1957, 4.4% of total bank loans, on a secured and unsecured basis, were outstanding to finance companies. Therefore, it is important for commercial banks, both large and small alike, to appreciate and understand the significance, functions and operations of finance companies.

When we refer to finance companies we have in mind three separate classifications, each with special and distinct characteristics. The three groupings are as follows:

1. Sales Finance - retail installment paper and related wholesale financing.
2. Small Loan - personal loans and installment loan credit.
3. Commercial Finance - accounts receivable financing, factoring, inventory financing and equipment financing.

In recent years there has been a pronounced overlapping trend in these three areas. Many sales finance companies have added small loan and direct loan departments; and, on the other hand, personal loan companies have branched into the sales finance field.

The reader should be aware of this overlapping process when analyzing any finance company. In the chapters that follow, the writer will concentrate on sales finance companies, which represent the largest user of bank credit in the finance industry.

Since their inception approximately forty-five years ago, sales finance companies have relied heavily on the short-term money market for the greater portion of their working funds. Commercial banks have supplied the majority of these short-term requirements; and, in general, credit experience in this type of bank lending has been excellent. Sales finance companies have experienced a rapid growth in the past forty years, and currently the philosophy of installment debt is accepted by the majority of Americans.

Today many bankers feel that an industrial manufacturing company should have a net worth to debt ratio of at least one to one before open bank credit becomes available. We will see, however, that many sales finance companies have unsubordinated debt of three or four times their effective capital base. Accordingly, the extension of open lines of credit to finance companies involves a different form of analysis for the banker.

This thesis will discuss some of the factors that influence the extension of bank credit to sales finance companies. Before we proceed, however, the reader should understand the historical background of this specialized industry, its place in our economy and its progress to date.

CHAPTER II

THE DEVELOPMENT AND ROLE OF SALES FINANCE COMPANIES

DEFINITION

A sales finance company is a specialized form of financial institution engaging primarily in "buying from automobile dealers and other retailers time-sales contracts arising out of installment sales to consumers".¹ Sales finance credit is invariably associated with the transfer of a commodity, which serves as security for the loan. In reality, a retail dealer lends the purchaser of a commodity the cost of the merchandise, less down payment, plus various charges. Then, in turn, the contract is sold to a sales finance company. This is in contrast to, and should not be confused with, small loan companies, consumer finance companies or personal finance companies, all of which engage principally in lending money directly to consumers under small loans laws of the various states.

ORIGIN-ASSOCIATED WITH THE ADVENT OF THE AUTOMOBILE INDUSTRY

Social scientists emphasize that human institutions arise in response to social and economic needs. This theory explains the origin of the first typical sales finance company in 1915.

In the early 1900's the automobile industry was in its infancy; and for many years after automobile production began,

¹ Phelps, Clyde William, The Role of the Sales Finance Company in the American Economy, (Baltimore, Commerical Credit Company, 1952), page 11.

cars were sold only for cash. Restricted by limited financial resources, car manufacturers were unable to offer credit terms to automobile dealers. In turn, the dealers' working capital funds were also limited, forcing them to operate solely on a "cash sale" basis. The result of this situation was obvious. The great majority of the population was unable to purchase cars; and, thus, mass production and mass distribution of automobiles appeared impossible.

Historically, commercial banks were the established institutions which financed the movement of goods from producer to consumer. After the turn of the century, however, the banking fraternity was unwilling to discard its prejudice against the use of installment consumer credit; and automobile dealers were looked upon as poor credit risks. Actually, bankers and many others regarded the automobile as a passing fad.

Since commercial banks failed to satisfy the needs of a changing economic society, a major problem arose. The solution to this problem was the formation of a new financial institution which provided inventory financing for the car dealers and retail financing, involving installment payments, for the consumers. The sales finance industry came into being in response to this emerging need, and the early companies pioneered in the development of new financing services which are vital to our economy today.

By 1920 a great number of sales finance companies had been formed, facilitating the rapid expansion of the automobile industry and the methods of mass production and distribution. It is often said that the rapid expansion of sales finance companies accelerated the development of automobile manufacturers to become the number one industry in the country. Although this assertion undoubtedly is accurate, it must be remembered that both industries grew and prospered together.

Once the theory of installment consumer credit and wholesale inventory financing had been applied successfully to the automobile industry, additional markets for this financing were established. Sales finance credit has been responsible for mass distribution of such consumer durables as refrigerators, washing machines, dryers, furniture, radios, T-V sets, etc.

RESPECTABILITY AND PUBLIC ACCEPTANCE

Throughout the 1920's the number of sales finance companies increased rapidly, approximating 1600-1700 by 1925. Since that time some concerns have liquidated, consolidated or branched into different areas. Currently, it is estimated that, exclusive of branch offices, approximately 2,500 sales finance companies are in operation.

The primary service of sales finance companies to society has been to enable the middle and low income groups to purchase automobiles and other durable goods which could be financed only

by means of installment payments from income. Grave misgivings, however, were expressed prior to 1929 regarding what would happen to finance companies when a depression occurred. The sharp recession periods of 1929-1933 and 1937-1938 proved to be a good test of the credit judgement and financial strength of sales finance companies. They made a gratifying showing during the 1930's and commercial banks which held their paper found it to be among the most liquid in their portfolios. Although consumer income declined sharply in these years, sales finance company customers established a good repayment record, much to the surprise of many bankers and other critics. Only a few small finance companies failed, and most creditors were paid in full.

The excellent record of sales finance companies during the 1930's firmly established the industry as a permanent financial institution. In fact, this experience undoubtedly accelerated the entry of commercial banks into the retail installment lending field in 1934. "In 1939, some 10,381 of the 13,493 insured commercial banks in the country reported that they handled retail installment paper. And for every 10 dollars of retail installment paper held by sales finance companies, the commercial banks held 4 dollars."²

During World War II, curtailed production, credit restrictions, etc., sharply depressed the volume and outstandings of sales finance companies. After the war and the removal of Regulation "W" in 1952,

2 Phelps, page 72.

installment credit expanded rapidly and, as of January 31, 1959, totaled \$34.1 billion. The increasing public acceptance of installment debt is documented by the following table:

Table 1
CONSUMER AND MORTGAGE DEBT COMPARISONS

In Millions of Dollars

	Instalment Credit						% of Dis- posable Income	³ Other Con- sumer Credit	Total Con- sumer Credit	% of Dis- posable Income	1-4 Family Mort- gage Debt	% of Dis- posable Income	Total Con- sumer & Mortgage Debt	% of Dis- posable Income
	Disposable Income (Billion \$)	Auto- motive	% of New Cars Sold on Credit	¹ Other	² Cash Loans	Total								
1957__	300.6	15,496	64	8,687	9,922	34,105	11.3	10,671	44,776	14.9	107,600	35.8	152,376	50.7
1956__	287.2	14,459	†67	8,510	8,858	31,827	11.1	10,270	42,097	14.7	99,000	34.5	141,097	49.1
1955__	270.2	13,472	62	7,634	7,852	28,958	10.7	9,712	38,670	14.3	88,200	32.6	126,870	47.0
1954__	254.5	9,809	57	6,751	7,008	23,568	9.3	8,724	32,292	12.7	75,700	29.8	107,992	42.4
1953__	250.2	9,835	58	6,779	6,391	23,005	9.2	8,238	31,243	12.5	66,100	26.4	97,343	38.9
1952__	237.4	7,733	66	6,174	5,496	19,403	8.2	7,998	27,401	11.5	58,500	24.6	85,901	36.2
1951__	226.1	5,972	49	4,880	4,442	15,294	6.8	7,323	22,617	10.0	51,700	22.9	74,317	32.9
1950__	206.1	6,074	45	4,799	3,830	14,703	7.1	6,692	21,395	10.4	45,200	21.9	66,595	32.3
1949__	188.2	4,555	46	3,706	3,329	11,590	6.2	5,715	17,305	9.2	37,600	20.0	54,905	29.2
1948__	187.6	3,018	42	2,901	3,077	8,996	4.8	5,402	14,398	7.7	33,300	17.8	47,698	25.4
1947__	169.0	1,924	45	2,143	2,628	6,695	4.0	4,875	11,570	6.8	28,200	17.7	39,770	23.5
1946__	159.2	981	---	1,290	1,901	4,172	2.6	4,212	8,384	5.3	23,100	14.5	31,484	19.8
1945__	150.4	455	---	816	1,191	2,462	1.6	3,203	5,665	3.8	18,600	12.4	24,265	16.1
1940__	76.1	2,071	---	1,827	1,616	5,514	7.2	2,824	8,338	11.0	17,300	22.7	25,638	33.7
1937__	71.0	1,384	---	1,368	1,208	*4,015	5.7	2,674	6,689	9.4	15,500	21.8	22,189	31.3
1932__	48.7	322	---	677	519	*1,521	3.1	2,046	3,567	7.3	16,700	34.3	20,267	41.6
1929__	83.1	1,318	---	1,197	643	*3,151	3.8	3,293	6,444	7.8	18,900	22.7	25,344	30.5

¹Includes time sales of department stores and mail-order houses, furniture, household appliance, jewelry and other retail stores.
²Personal instalment loans of commercial banks, small loan companies, industrial banks and loan companies, credit unions and miscellaneous lenders; also repair and modernization loans held by financial institutions. ³Includes single payment personal loans of banks and pawnbrokers, charge accounts, and service debt (to doctors, dentists, lawyers, etc.) *Total instalment credit from 1929-1933 was linked to new (revised) series, but major components were not revised—hence do not add up to totals. †Includes foreign cars, beginning 1956.

Sources: Federal Reserve Board and U. S. Department of Commerce.

INSTALLMENT CREDIT - A MATTER OF OPINION

Although installment selling has proven one of the most important factors in raising and maintaining our standard of living, criticism of the principle of installment sales has existed, and probably always will continue to do so. Critics argue that installment selling is unsound; that it causes overbuying; that it puts the consumer in continual debt; that it usurps purchasing power in one period at the expense of depression in another; and that it destroys the motive of thrift.

On the other hand, advocates of installment selling reply that it is one of the significant achievements of American capitalism, that it is the basis of mass production (and thus our high standard of living), and that it is also a stabilizing factor in our economy.

It is not the purpose of this paper to debate the wisdom of installment credit. Installment credit is widely used today by all income groups but usually is concentrated in families where the husband is under fifty years of age. Installment borrowing has been encouraged by the rise in real incomes, as increases in earnings in recent times have outstripped rising prices. For the past twenty years inflationary tendencies have dominated our economy; and the development of Social Security, medical insurance, pension funds, etc., has contributed to a declining regard for thrift. Automobiles and appliances are now regarded as necessities rather than luxuries.

Regardless of the reader's personal opinion, installment credit has grown to be a basic and integral part of our family and business life. Certainly, it has become well established in our economic order.

THE RETAIL FUNCTION

The principal source of business for sales finance companies originates from and with retail dealers. As previously mentioned, a typical sales finance company primarily handles "sales credit" which originates when an installment sales contract is negotiated between an installment purchaser and a retail dealer.

There are two principal steps to the usual installment retail transaction:

1. The buyer of a commodity normally makes a down-payment, in the form of cash, trade-in, or both, and then executes a note or other legal document in favor of the retailer. This note covers the remainder of the total time purchase price and usually is repaid in regular monthly installments. The dealer also obtains a title retention instrument, such as a conditional sales contract or a chattel mortgage.
2. Assuming the dealer lacks sufficient working capital to carry the installment paper to maturity, he sells the contract immediately after execution to a sales finance company (or commercial bank) at less than face value.

This is known as "discounting". After the sale of the contract, the buyer of the commodity repays the face amount of the original obligation to the sales finance company. Therefore, the income to the sales finance company is the difference between amount paid to the dealer for the contract and the face amount of the obligation repaid by the installment purchaser.³

The Supreme Court has held that a retail dealer may establish one price if his goods are purchased for cash or a higher price if installments are involved. Accordingly, when durable goods are sold on an installment basis, the "time price" (which is higher than the cash price) includes such factors as service charge, possible collection expense, discount, risk of loss, etc. The "time price differential" is not regarded by law as interest for the loan of money and is defined as part of the commodity's installment purchase price.

Under Section 218:01 of the Wisconsin statutes, which refers to retail installment paper acquired from a retail dealer, sales finance companies are without limitation regarding the time price differential (with the exemption of automobile paper where the maximum rate on new car loans is \$7.00 per \$100.00). In theory, they can charge "whatever the traffic will bear". Competition and the awareness of the public, however, has forced the sales finance industry to refrain from absurd "service charges".

³ Rogers, Thomas W., Development of the Sales Financing Industry in the United States, (April, 1955), page 6.

On a retail installment sales contract, the rate is always an "add-on" rate. Therefore, since the contract is amortized on a monthly basis, the effective cost of borrowing actually doubles. It appears, however, that a certain segment of the buying public does not appreciate the true significance of the add-on rate.

THE WHOLESALE FUNCTION

The other broad important service performed by sales finance companies is defined as wholesale financing or "floor-planning". For the most part, wholesale financing is an accommodation for the dealer and is performed for the purpose of acquiring a profitable volume of retail paper from the dealer. Rates for this financing are usually quite low and, for example, in the case of automobiles currently average between $4\frac{1}{2}$ - 5% simple interest, plus a nominal flat charge per car.

Wholesale financing originated from the insistence of automobile manufacturers for payment in cash upon delivery of cars to dealers. Sales finance companies reasoned that if automobile dealers were able to carry larger and more varied inventory lines, retail sales volume should increase correspondingly, thus generating more installment sales contracts. Accordingly, a new form of financing, commonly referred to as floor-planning, was developed to satisfy this need.

Operating procedures under floor-planning arrangements may vary in some respects but normally follow the same general approach.

When new cars are delivered from the manufacturing plant, the sales finance company remits payment to the manufacturer either by check or through a drafting arrangement. In the states where the Uniform Trust Receipts Act is recognized (including Wisconsin), a trust receipt is the instrument used to cover this transaction. The car dealer executes a note, either on a demand basis or with a stated maturity, in favor of the finance company. Therefore, possession of the cars is delivered to the dealer in trust for sale. Once a car is sold, the sales proceeds or an installment contract must be turned over to the sales finance company. In the states where trust receipts are not valid, conditional sales contracts or chattel mortgages are used.

A number of safeguards have been created to prevent the possibility of fraud in floor-planning. Proper supervision of the wholesale function is imperative, and most sales finance companies check the inventory being financed at least once or twice a month. This checking process involves a physical inspection of the units, at which time a representative of the finance company compares the serial and engines numbers of the cars with the recorded numbers on the trust receipt. A further factor that bears close observation in wholesale financing is the rate of turnover of the inventory as well as the percentage of retail installment sales contracts originated compared to the number of cars being floorplanned.

The hazards involved in wholesale financing are greater than in retail financing, where the risks are in smaller units and less concentrated. Some substantial losses have occurred in floor-planning despite the maintenance of safeguards. One of the contributing factors to these losses has been the sale of cars "out of trust" to "innocent" purchasers. When this occurs, the cars can not be recovered by the finance company. However, it should be stated here that when a dealer is intent on fraud, it is most difficult for the lender to prevent some loss. Therefore, the three "C's" of credit judgement, referred to as character, capacity, and capital, must be relied upon in wholesale financing, with major emphasis on the character factor.

CLASSIFICATIONS OF SALES FINANCE COMPANIES

Sales finance companies are classified as to type of paper handled, area of geographical operation, and relationship with industrial manufacturing concerns.

Some companies specialize in automobile paper and thus are classified in the industry as "automobile discount" companies. Conversely, a group of companies concentrate primarily on durable consumer goods other than automobiles and are referred to as "other retail" companies. In addition, as mentioned previously, there is an increasing trend in the sales finance industry toward establishment of small loan operations and direct consumer financing.

These latter companies are known as "diversified" finance companies, and two good examples of this classification are Commercial Credit Company and C. I. T. Financial Corporation.

A second basis of classification of finance companies regards area of geographical operation and includes "national", "regional" and "local" companies. G. M. A. C., Commercial Credit and C. I. T. are known as the national companies because they have offices throughout the country. General Finance Corporation, Associates Investment Company and Pacific Finance Corporation operate in large regional sections of the country and are examples of regional companies. Other companies, which operate in one community or small areas, are known as local companies.

There has been a decided trend in recent years for large manufacturing companies to form their own finance subsidiaries. General Electric Credit Corporation, Westinghouse Credit, Redisco, Inc. and Sears Roebuck Acceptance are examples of these finance subsidiaries which are known in the trade as "captive" companies. Of course, G. M. A. C. is the largest captive company and currently is involved in government anti-trust proceedings. While captive finance companies are usually profitable, the main purpose in their creation is to furnish their dealers an assured outlet for installment contracts arising from the time sales of their products.

The following schedule shows the 100 largest finance companies as of December 31, 1957, ranked on the basis of total capital funds. This roster includes sales finance, small loan and commercial finance companies:

ROSTER OF 100 LARGEST SPECIALIZED FINANCE COMPANIES

(Capital Funds are defined to be partnership funds in the case of unincorporated companies, and in the case of incorporated companies, as including Capital and Surplus Funds, together with non-current, Subordinated Debentures. Various thrift institutions which obtain funds by investment certificates as savings certificates are excluded.)—Copyright 1958—American Banker, Inc., New York, N. Y.

Rank	TOTAL Capital Funds	Capital and Surplus	Subordinated Debentures	TOTAL Capital Funds	Rank				
12/31/57	12/31/57	12/31/57	12/31/57	12/31/56	12/31/56				
1	General Motors Acceptance Corp., New York City	\$648,831,962	\$273,831,962	\$375,000,000	\$627,241,766	1			
2	C. I. F. Financial Corp., New York City	471,426,097	249,426,097	225,000,000	457,112,608	2			
3	Commercial Credit Co., Baltimore, Md.	340,621,675	215,621,675	125,000,000	282,823,258	3			
4	Associates Investment Co., South Bend, Ind.	218,321,672	138,287,672	80,034,000	189,413,523	4			
5	Household Finance Corp., Chicago, Ill.	161,491,450	161,491,450	.....	151,910,702	5		
6	Beneficial Finance Co., Wilmington, Del.	135,930,691	135,930,691	.....	126,718,778	6		
7	Pacific Finance Corp. of California, Los Angeles, Calif.	100,235,605	54,001,605	46,234,000	81,624,183	7			
8	General Electric Credit Corp., New York City	90,358,060	36,358,060	54,000,000	75,352,068	10			
9	American Investment Co. of Illinois, St. Louis, Mo.	83,705,712	47,620,712	36,085,000	75,357,236	9			
10	Seaboard Finance Co., Los Angeles, Calif.	80,917,503*	52,717,503	28,200,000	79,749,562*	8			
11	Sears Roebuck Acceptance Corp., Wilmington, Del.	76,024,669*	51,024,669	25,000,000	35,235,304*	16			
12	International Harvester Credit Corp., Chicago, Ill.	69,052,798*	49,052,798	20,000,000	62,357,197*	11			
13	Family Finance Corp., Wilmington, Del.	42,900,991*	31,650,991	11,250,000	39,889,366*	12			
14	General Finance Corp., Evanston, Ill.	42,160,139	23,304,639	18,855,500	35,559,354	15			
15	Walter E. Heller & Co., Chicago, Ill.	41,165,710	26,270,710	14,895,000	38,369,691	14			
16	General Acceptance Corp., Allentown, Pa.	38,816,014	18,816,014	20,000,000	39,380,240	13			
17	Yellow Mfg. Acceptance Corp., Detroit, Mich.	31,218,022	11,218,022	20,000,000	25,705,162	17			
18	State Loan & Finance Corp., Washington, D. C.	27,642,257	17,024,757	10,617,500	23,879,350	18			
19	James Talcott, Inc., New York City	25,637,008	16,287,008	9,350,000	21,561,049	20			
20	Liberty Loan Corp., Chicago, Ill.	23,480,833	13,028,133	10,452,700	15,702,955	27			
21	Securities Acceptance Corp., Omaha, Nebr.	21,854,007*	11,854,007	10,000,000	19,435,357	23			
22	Capital Finance Corp., Columbus, O.	21,764,830*	14,941,485	6,823,345	19,695,141*	21			
23	State Finance Co. (Dial Finance Co.), Des Moines, Ia.	20,454,196	11,153,196	9,301,000	19,638,772	22			
24	Refrigeration Discount Corp., Detroit, Mich.	19,040,947*	6,389,333	12,651,614	15,377,123*	28			
25	Thorp Finance Corp., Thorp, Wisc.	19,001,771*	9,942,871	9,058,900	13,755,604*	30			
26	Motor Finance Corp., Newark, N. J.	17,885,498	9,385,498	8,500,000	17,330,871	25			
27	Interstate Securities Co., Kansas City, Mo.	17,832,052*	11,037,052	6,795,000	17,394,041*	24			
28	Southwestern Investment Co., Amarillo, Tex.	17,476,623*	11,641,623	5,835,000	17,208,768*	26			
29	Securities Investment Co., St. Louis, Mo.	16,835,645	11,835,645	5,000,000	16,376,550	19			
30	Aetna Finance Co., Inc., St. Louis, Mo.	15,725,411*	11,482,411	4,243,000	15,112,043*	29			
31	American Discount Co., Charlotte, N. C.	14,165,209*	8,455,209	5,710,000	13,295,101*	31			
32	Equitable Discount Corp., Albany, N. Y.	13,796,427	5,887,577	7,908,850	10,202,335*	35			
33	Interstate Finance Corp., Evansville, Ind.	13,530,280*	8,816,580	4,713,700	12,216,137*	33			
34	Lincoln Service Corp., Washington, D. C.	13,241,369	7,190,969	6,050,400	12,691,437	32			
35	Bankers Commercial Corp., New York City	10,563,826	7,563,826	3,000,000	10,381,413	34			
36	Home Finance Group, Inc., Charlotte, N. C.	10,197,968*	6,737,968	3,460,000	8,539,010*	42			
37	Budget Finance Plan, Inc., Los Angeles, Calif.	10,068,536	6,568,536	3,500,000	9,424,513	36			
38	Colonial Finance Co., Lima, O.	10,067,983*	5,867,983	4,200,000	9,330,812*	37			
39	Mercantile Acceptance Corp. of California, San Francisco, Calif.	9,764,106*	5,950,106	3,814,000	9,400,970*	39			
40	Allied Finance Co., Dallas, Tex.	9,570,501*	5,668,501	3,902,000	8,153,368*	44			
41	Sun Finance & Loan Co., Cleveland, O.	9,494,371	5,894,371	3,600,000	8,806,580	40			
42	Provident Loan Society of New York, New York City	9,367,533	9,367,533	.....	9,337,984	38		
43	Standard Financial Corp., New York City	9,165,949	6,890,949	2,275,000	7,671,560	46			
44	Time Finance Co., Louisville, Ky.	9,114,309*	7,114,309	2,000,000	8,648,112*	41			
45	Industrial Finance & Thrift Corp., New Orleans, La.	8,757,346*	3,207,346	5,550,000	8,484,349*	43			
46	A. J. Armstrong Co., Inc., New York City	8,754,952	5,429,952	3,325,000	7,039,773	47			
47	Mossler Acceptance Co., Houston, Tex.	7,940,609*	6,220,609	1,720,000	7,873,574*	45			
48	Shapiro Bros. Factors Corp., New York City	7,569,510*	3,822,510	3,747,000	6,769,974	49			
49	Finance Co. of America, Baltimore, Md.	7,341,026	5,341,026	2,000,000	7,005,419	48			
50	Aid Investment & Discount, Inc., Akron, O.	7,066,166*	3,546,166	3,520,000	6,039,897*	55			
51	Local Finance Corp., Matjton, Ind.	7,054,770	3,094,505	3,960,265	.....	.....	
52	Mill Factors Corp., New York City	6,730,000	5,000,000	1,730,000	6,699,500	50			
53	Industrial Credit Co., St. Paul, Minn.	6,509,713	4,489,713	2,020,000	5,243,955	63			
54	Public Finance Service, Inc., Philadelphia, Pa.	6,470,597	2,570,597	3,900,000	6,091,153	53			
55	Guardian Consumer Finance Corp., Stamford, Conn.	6,429,918	5,279,918	1,150,000	5,766,059	59			
56	Federal Services Finance Corp., Washington, D. C.	6,355,983*	3,875,983	2,480,000	6,262,409	51			
57	Commercial Securities Co., Inc., Baton Rouge, La.	6,218,274*	3,774,974	2,443,300	5,345,422*	62			
58	Automobile Banking Corp., Philadelphia, Pa.	6,206,921*	3,569,421	2,637,500	5,999,428*	56			
59	Bankers Investment Co., Hutchinson, Kans.	6,145,874*	4,225,874	1,920,000	6,064,717*	54			
60	Union Investment Co., Detroit, Mich.	5,988,871	3,638,871	2,350,000	6,111,125	52			
61	Northern Illinois Corp., DeKalb, Ill.	5,980,762	4,600,762	1,380,000	5,804,965	58			
62	Approved Finance, Inc., Columbus, O.	5,854,350	954,350	4,900,000	5,852,183	57			
63	Pioneer Finance Co., Detroit, Mich.	5,788,762*	4,103,762	1,685,000	4,179,441	80			
64	Interstate Finance Corp., Dubuque, Ia.	5,734,679*	3,914,679	1,820,000	5,713,113*	60			
65	Ritter Finance Co., Inc., Wyncote, Pa.	5,603,770	3,343,770	2,260,000	4,428,189	71			
66	Securities Credit Corp., Denver, Colo.	5,489,986*	2,186,776	3,303,210	5,097,024*	64			
67	National Finance Co., Detroit, Mich.	5,447,911*	3,322,830	2,125,081	5,416,475*	61			
68	Federal Discount Corp., Dubuque, Ia.	5,296,639*	4,501,419	795,220	4,924,212*	66			
69	Merchants Acceptance Corp., Worcester, Mass.	5,286,101*	4,259,101	1,027,000	4,307,096*	79			
70	A. A. Murphy & Co., St. Paul, Minn.	5,276,231*	4,306,231	970,000	4,362,211*	76			
71	Maryland Credit Finance, Easton, Md.	5,105,389	2,855,389	2,250,000	5,043,044	65			
72	Hushman Factors Corp., New York City	5,100,445*	5,100,445	.....	4,721,292*	67		
73	First Acceptance Corp., Minneapolis, Minn.	5,046,203*	2,771,203	2,275,000	4,634,430*	68			
74	Strevell-Paterson Finance Corp., Salt Lake City, Utah	5,039,429*	3,324,429	1,715,000	4,539,119*	70			
75	A. S. C. Corp., Marion, Ind.	4,989,594*	4,136,260	853,334	4,404,436*	74			
76	Doty Discount Corp., Detroit, Mich.	4,811,222	3,011,222	1,800,000	3,882,487*	83			
77	Southwest Acceptance Co., Inc., San Antonio, Tex.	4,642,384	2,604,384	2,038,000	3,809,603	84			
78	Fidelity Acceptance Corp., Minneapolis, Minn.	4,632,214*	3,235,714	1,396,500	4,591,836*	69			
79	Colonial Acceptance Corp., Chicago, Ill.	4,624,596*	1,878,796	2,745,800	4,331,298*	78			
80	Commerce Acceptance Co., Atchison, Kans.	4,490,002*	3,080,002	1,410,000	4,400,348*	75			
81	Signature Loan Co., Inc., New York City	4,468,779*	2,723,779	1,745,000	2,915,490*	96			
82	Commercial Discount Corp., Chicago, Ill.	4,420,616	3,240,616	1,180,000	4,415,455	72			
83	Universal Finance Corp., Los Angeles, Calif.	4,336,218*	3,252,218	1,084,000	.....	.....	
84	Acceptance Finance Co., Inc., St. Louis, Mo.	4,035,034	2,510,509	1,524,525	4,077,227	81			
85	Local Finance Corp. of Rhode Island, Providence, R. I.	3,837,458*	1,932,958	1,904,500	3,667,735*	85			
86	Kentucky Finance Co., Inc., Lexington, Ky.	3,787,049*	2,054,049	1,733,000	3,613,581*	87			
87	Government Employees Corp., Washington, D. C.	3,681,861	2,646,121	1,035,740	2,745,302	99			
88	Ison Finance Corp., Atlanta, Ga.	3,652,823*	3,234,073	418,750	3,035,098*	95			
89	S. W. Coe & Co., Springfield, Ill.	3,623,697	2,673,697	950,000	3,532,286	93			
90	Personal Industrial Bankers, Inc., Washington, D. C.	3,604,961	2,604,961	1,000,000	3,319,967	71			
91	Mercantile Discount Corp., Chicago, Ill.	3,598,619	2,438,619	1,160,000	3,040,081	.....		
92	Franklin Finance Co., Inc., Hartford City, Ind.	3,574,000	1,219,000	2,355,000	3,655,282	86			
93	Stephenson Finance Co., Inc., Florence, S. C.	3,392,051*	1,580,051	1,812,000	3,153,641*	93			
94	Murdock Acceptance Corp., Memphis, Tenn.	3,364,133*	2,782,533	581,600	3,320,895*	90			
95	Continental Commercial Corp., Pittsburgh, Pa.	3,333,358*	3,173,358	160,000	3,551,606*	88			
96	Interstate Financial Corp., Syracuse, N. Y.	3,294,028*	1,914,028	1,380,000	2,547,424*	.....		
97	Girard Investment Co., Philadelphia, Pa.	3,222,192	2,020,355	1,201,837	2,803,235	98			
98	Southeastern Fund, Columbia, S. C.	3,103,702*	1,428,502	1,675,200	3,125,637*	94			
99	Certified Credit Corp., Columbus, O.	2,756,805	1,689,820	1,066,985	.....	.....	
100	Factors Corporation of America, Philadelphia, Pa.	2,754,964	1,217,464	1,537,500	3,386,457	89			
TOTALS					\$3,380,541,762	\$2,011,518,406	\$1,369,023,356	\$3,045,513,009

* Total capital funds as of end of year unless marked by asterisk, in which case they are as of the end of the nearest fiscal year.

CHAPTER III

RELATIONSHIP OF COMMERCIAL BANKS AND SALES FINANCE COMPANIES

Commercial banks and finance companies are lenders of money, and the existence of both institutions depends on the profitable employment of funds. The specialized finance industry has become the largest single industry customer of the banking system. On the other hand, bank credit has constituted the most important type of credit employed by sales finance companies. Therefore, the maintenance of a proper relationship between these two financial institutions is of substantial benefit to both parties.

THE IMPORTANCE OF A LONG AND MUTUALLY PROFITABLE ASSOCIATION

The monetary advantages of the establishment of a bank line of credit for a sales finance company customer are as follows:

1. ability of the company to use its line and employ the funds in the conduct of its business;
2. interest income to the bank;
3. maintenance of compensating deposit balances by the company which broadens the operations and earning power of the bank.

Apart from the monetary advantages, it is important that a commercial bank maintain a consistent attitude towards the finance industry. Unfortunately, there has been a tendency for some bankers

to cultivate finance company business during periods of easy money and then reverse their position when the money market becomes tight. This "fair weather" approach is not consistent with sound banking practice and credit judgement.

Prior to the establishment of a line of credit, the banker must satisfy himself regarding management, operating record, quality of receivables, etc. Once a line has been granted, however, the bank should stay in the credit picture unless confidence is lost in the integrity and ability of the management or unless other major adversities develop. The basic requirement regarding the relationship of a bank and a finance company is the maintenance of a sound working arrangement whereby the bank is prepared to help the finance company with its financial problems. Although a bank line is not a commitment in the true legal sense, it is a real obligation when the customer has performed according to the terms of the implicit agreement.

In establishing lines of credit for finance companies, a bank is influenced primarily by its own internal situation. No banker desires an over-concentration of lines in any one field, and many banks tend to limit aggregate finance company lines to approximately 10% of deposits or to a certain percentage of total bank lines of credit.

In theory, at least, sales finance companies represent an ideal bank credit. Most of their outstandings are secured; and

their risks are in small amounts, widely spread, on a monthly amortization basis. In addition, many finance companies could, in the case of necessity, liquidate their payables as they mature.

INTERCHANGE OF INFORMATION

The establishment of lines of credit for finance companies having a wide geographical operating pattern should be of real value to a bank. Executive officers of finance companies normally visit with their principal banks more frequently than management of industrial manufacturing customers. As a result, the banker obtains current information on significant economic conditions in various sectors of the economy. Therefore, the banker is kept well posted as to the outlook for product sales and distribution, thus keeping his finger on the "pulse of the economy".

Finance companies understand the climate of the long-term money market, and this information is helpful to the banker in advising his manufacturing customers.

COMPLETE AVAILABILITY OF DETAILED FINANCIAL INFORMATION

For years bankers have required closer information regarding finance companies than from any other line of business. Detail reflecting the quality of receivables, the company's policy regarding terms, down-payment and many other factors are necessary to banks in appraising the soundness of a finance company.

Some of the smaller finance companies are required to furnish monthly statements to their banks. Others furnish quarterly reports, and the larger companies will supply semi-annual audits and questionnaires. The volume of detailed information available to the banker deserves close scrutiny to determine whether a possible weakness is developing.

THE IMPORTANCE OF THE AUDIT REPORT

It is of utmost importance for finance companies to be audited by prominent and reputable firms of national standing. As finance companies are specialized institutions, some audit firms have become skilled in this form of analysis; and, therefore, many banks require that an experienced firm prepare the audit. Naturally, the auditors must exercise independent and critical judgement regarding the quality of receivables and other pertinent factors.

THE SALES FINANCE QUESTIONNAIRE

The National Association of Finance Companies and the American Finance Conference in cooperation with the Robert Morris Associates developed a standard form of finance company questionnaire during the 1930's. This questionnaire supplements the usual audit report and provides further detailed information on a uniform basis for all banks. The form includes analysis of volume, reconciliation of reserves for losses, schedule of installment maturities, direct

cash loans, etc. Please refer to the appendix for a sample questionnaire.

When the questionnaire and audit report are studied and analyzed, it may be difficult for the banker to retain an overall concrete picture of the company's figures and to make comparison with previous statements for improvement or deterioration in assets. The composite ratio analysis developed by a large mid-western metropolitan bank is most helpful in solving this problem. We shall discuss composite ratios at a later point.

THE IMPORTANCE OF QUALIFIED AND RESPONSIBLE MANAGEMENT

In extending credit, bank loaning officers realize that there is no substitute for the factor of character. As mentioned previously, it is unwise to deal with an individual whose integrity is open to question, regardless of the safeguards that are established.

The element of character is probably more important in the finance company industry than in any other. A finance company reloans the funds advanced by banks and other lenders and, due to the nature of its operation, does not carry inventory or have valuable fixed assets which a creditor may look to for possible security. Therefore, the finance company must have management whose character is above reproach and whose philosophy is intelligent and constructive. This is one of the reasons why

many banks spend more time with their finance company customers than with almost any other.

THE COMPENSATING BALANCE REQUIREMENT

Banks are compensated for establishing finance company lines through the medium of demand deposit balances maintained by finance companies. The normal requirement today is 15% of the line of credit committed, rather than 15% of the amount of line in use. A number of years ago the popular formula was 10% of the line when not in use and 20% when any portion of the line was drawn down.

In many cases, compensating balances are dormant accounts with activity being confined to crediting and debiting the account for loan transactions. Banks closely watch the balances to ascertain that the proper funds are on deposit. Recently finance companies have been using accounts of their insurance subsidiaries to serve as partial compensating balances when this arrangement is acceptable to the banker.

If it is likely that a degree of account activity will occur, usually it is in the best interest of the bank to have two accounts, one "compensating" and the other a "free" balance. Under this arrangement, the bank receives the normal profit from the former and can either request additional balances on the free account, if activity analysis shows a loss, or can revert to service charges.

The true significance to finance companies of the compensating balance doctrine is indicated by the following computation of borrowing costs:

BORROWING COSTS

The effective cost of money borrowed after taking into consideration
Rate of Interest, Compensating Balances and Discount (360 day basis).

Bank Rate	30 Day Pay Out		60 Day Pay Out		90 Day Pay Out	
	15% Bal.	20% Bal.	15% Bal.	20% Bal.	15% Bal.	20% Bal.
3-1/2%	4.42	4.75	4.50	4.87	4.61	5.05
3-3/4	4.75	5.10	4.83	5.23	4.95	5.42
4	5.08	5.45	5.17	5.61	5.30	5.80
4-1/4	5.41	5.81	5.51	5.97	5.64	6.18
4-1/2	5.75	6.17	5.85	6.34	5.99	6.56
4-3/4	6.03	6.50	6.15	6.66	6.33	6.94
5	6.43	6.87	6.57	7.08	6.68	7.33
5-1/4	6.77	7.27	6.88	7.46	7.04	7.71
5-1/2	7.11	7.64	7.23	7.84	7.39	8.10
5-3/4	7.46	8.01	7.58	8.22	7.75	8.50
6	7.80	8.39	7.93	8.60	8.10	8.89

CUSTOMER AND COMPETITOR

Commercial banks entered the sales financing field in 1934 and, since that time, have expanded to be a real source of competition for sales finance companies. This competition undoubtedly has forced finance companies to improve their services and reduce profit margins. On December 31, 1958, 54% of automobile paper and 37% of other consumer durable goods paper were held by finance companies. These statistics show that finance companies continue to control the majority of automobile paper despite the expansion of installment lending by banks.

In general, many banks offer lower rates than sales finance companies, although the rate structure varies in different localities. Also, costs are influenced to an important degree by various services and allowances given to dealers and customers.

Some reference should be made regarding the significance of a dealer's reserve. A dealer's reserve, often referred to as a "holdback", is set up as a credit to the dealer's account (about $\frac{1}{4}$ of the financing charge on new cars, or approximately $1\frac{1}{2}\%$ of the contract balance) for the purpose of absorbing such losses as may develop. When losses are small, the reserve increases to a point where quarterly payments are made to the dealer, representing excess reserve balances.

Since World War II, leading sales finance companies have been active in forming insurance subsidiaries. Some subsidiaries under-

write comprehensive and collision automobile insurance, while others underwrite credit life insurance. During the past three years, losses on collision coverage have been heavy. On the other hand, only the net investment income of the life insurance subsidiaries has been taxable. However, it is expected that taxation of underwriting income will be in effect in the near future, which will have an adverse effect on consolidated earnings of sales finance companies.

CHAPTER IV

SOURCES OF WORKING CAPITAL

Volume of the sales finance business fluctuates with the season of the year and the cyclical swings inherent in our economy. Therefore, these companies have relied heavily on the short-term money market for the majority of their working fund requirements. Also, they have needed funds that could be either expanded or contracted rapidly to realize the maximum efficiency of operation. Our commercial banking system has supplied the majority of the current credit requirements of the sales finance industry.¹

The rapid growth of sales finance companies has been fostered by highly developed credit and capital markets; markets which have been willing and able to underwrite the requirements of these companies. At the outset, it was difficult for this industry to secure bank lines of credit, to place their paper in the open market and to interest term investors and equity money. Due to the gratifying record of sales finance companies during the 1930's, as well as surplus money conditions in that period, banks and other lenders began to solicit the credit requirements of the finance industry. Bankers soon realized that sales finance companies represented excellent customers, and the relationship has expanded since that time.

¹ Schmus, Elmer E., former Vice President and Cashier, The First National Bank of Chicago, "The Banker's Viewpoint", Bulletin of the Robert Morris Associates, (December, 1954), Vol. 37, page 104.

THE COMPOSITE CAPITAL STRUCTURE PATTERN

The ratio of borrowings to total capital structure varies according to the type of receivables carried by the finance company. In consumer finance companies, for example, the receivables represent direct cash loans which are frequently unsecured. For such companies, between 70 - 75% of the total capital structure consists of borrowed funds. Conversely, sales finance company receivables represent retail installment sales contracts secured by liens on automobiles and other consumer durables. Also, many of these contracts are subject to repurchase by the dealer. Thus, these latter companies are able to operate with a borrowed fund ratio approximating 85%, which creates a high leverage capital structure. In addition, as previously mentioned, the low capital ratios of sales finance companies are accompanied by a relatively high ratio of short-term debt.

The following schedule² shows the sources of funds for the four largest sales finance companies:

	<u>DECEMBER 31</u>			
	<u>1953</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>
Short-term Notes	50%	42%	37.7%	38.8%
Long-term Debt	22	39	43.7	43.3
Other Sources	16	10	9.0	8.3
Equity Capital	<u>12</u>	<u>9</u>	<u>9.6</u>	<u>9.6</u>
	100%	100%	100.0%	100.0%

² Silbert, Theodore H., President, Standard Financial Corporation, "\$1 Billion Specialized Finance Industry Growth Accelerated by Mergers", American Banker, (December 1, 1958), Vol. CXXIII, No. 230, page 8.

Computations show that long-term debt has been relied on more heavily by the national companies than by either the regional or local companies. In addition, in the latter two classifications, the equity cushion has been consistently greater percentage-wise than that of the national companies. Undoubtedly, this reflects the factor of size as an index of the ability to tap the large central money market. This greater use of term capital has resulted in a smaller proportion of equity funds, rather than a lesser dependence on short-term money.³

Several factors explain the greater emphasis on term debt. After the close of World War II, interest rates began to stiffen; and, because money costs are a vital consideration in finance company operations, long-term funds were sought to take advantage of the favorable rates prevailing at the time. "The short term rate structure stabilized rather quickly, but in the meantime some banks, already heavily committed to the finance industry and with high demands from other commercial sources, curtailed their commitments to the finance field. Other banks were engaging more actively in the consumer credit field themselves, and for that reason were obliged to limit their advances to the finance industry".⁴

In the postwar period, the requirements of sales finance companies were also greater due to the increased unit costs of durable goods being financed. The result of these various factors

³ Schmus, Elmer E., former Vice President and Cashier, The First National Bank of Chicago, "The Function of Commercial Bankers", Special Bulletin #59, American Finance Conference, (December, 1952), page 36.

⁴ Ibid, page 36.

forced many finance companies to seek equity capital and term money to underwrite their expanded operations.

The change in the pattern of sales finance company borrowings is emphasized by the following comparative analysis based on the composite ratio statistics of the First National Bank of Chicago:

	<u>DECEMBER 31</u>			
	<u>1935</u>	<u>1941</u>	<u>1949</u>	<u>1958</u>
Current Debt to Total Resources	63.58%	65.57%	65.80%	51.09%
Long-term Debt to Total Resources (includes subordinated debt)	.39	4.71	11.41	25.68
Reserves to Total Resources	6.74	6.45	7.04	7.82
Net Worth to Total Resources	<u>29.29</u>	<u>23.27</u>	<u>15.75</u>	<u>15.41</u>
	100.00%	100.00%	100.00%	100.00%

Variations in the ratio of capital to debt and of short-term debt to long-term debt are the result of many factors. Some companies prefer a large leverage position which permits more revenue and profit per dollar of owners' capital investment. Risk increases, however, with the debt-equity ratio; and it is likely that lenders will tend to restrict continued expansion of debt ratios.

COMMON AND PREFERRED STOCK

Sufficient equity capital in the form of common and preferred stock is necessary for a sales finance company to support additional borrowings. Periods of tight money squeeze the undercapitalized company to a much greater extent than the firm whose capital structure has kept pace with its growth. Therefore, it is imperative that a proper balance be maintained between debt and stockholders' equity.

The sale of common stock normally represents the initial step in the formation of a sales finance company. In many small and medium size firms, the common stock is closely held, especially when the company's net worth is less than \$1,000,000. When common stock and surplus are in excess of \$5,000,000, national markets are available to the company.

Although preferred stocks are an important device for increasing the leverage on common stock earnings, this form of equity financing for sales finance companies has not been too popular. According to the composite figures, preferred stock averages 10% of the typical sales finance company's net worth. The preferred usually carries a fixed dividend rate and a sinking fund arrangement. Undoubtedly, the increasing trend of subordinated debenture financing has limited the offerings of preferred issues.

BANK LINES OF CREDIT

The important role played by commercial banks in supplying short-term funds to sales finance companies has been mentioned several times. Perhaps the following computation prepared from the composite ratio figures will highlight this fact:

	<u>DECEMBER 31</u>					
	<u>1935</u>	<u>1941</u>	<u>1947</u>	<u>1951</u>	<u>1955</u>	<u>1958</u>
Bank borrowings as a % of total unsubordinated debt	66.53%	69.60%	84.20%	73.44%	67.68%	52.48%
Open market borrowings as a % of total unsubordinated debt	25.54	21.36	9.61	11.41	10.06	17.48%

In the early days of bank lending to sales finance companies, a uniform basis for borrowing had not been established. A few advances were on an unsecured basis, but the majority were secured by collateral trust notes or a direct pledge of receivables, trade acceptances and other forms of collateral. In 1928, unsecured credit was made available to the larger firms, and in the past thirty years open lines of credit have been the typical medium of lending to the industry. The cooperation of finance companies in furnishing detailed operating information to their creditors hastened the advent of unsecured credit arrangements. Some of the smaller local independent firms, however, continue to borrow on a collateral trust basis.

Commercial bankers usually require that their finance company customers have the ability to rotate their lines of credit so that each bank line can be rested for 60 - 90 days during the calendar year. This rotating capacity is important to banks, because their loans and investments must be liquid. In addition, bank lines of credit not in use at any given time must be adequate to cover open market paper. This is essential as holders of the commercial paper may demand payment at maturity.

The character of the list of line banks which a sales finance company has is deemed most important by a banker who is considering establishing a line for the company. Before extending a line, a bank should check with the firm's principal lenders to determine their experience, the amount of line granted and their opinion of the management. In addition, the recommendation of a correspondent bank should not be accepted uncritically. Where a bank must rely upon such recommendation, the correspondent itself must unquestionably be in a position to render a reliable one.

Banks desire their finance company customers to employ their lines on a regular pattern of use, whether the money market is tight or easy. Earlier we mentioned the necessity of banks maintaining a consistent attitude towards the finance company industry. This principle should be a "two way street" to foster an effective bank-customer relationship.

During the majority of 1958, money conditions were relatively easy, and the use of commercial paper by the national and large regional companies increased substantially. On December 31, 1958, bank borrowings as a percentage of total unsubordinated debt were 52.48%, the lowest ratio ever recorded in the composite statistics. The proportion of commercial paper increased to 17.48% from 11.24% on December 31, 1957. This increase in open market paper has been accompanied by an increase in senior long-term borrowing. Therefore, at the present time some banks feel that their sales finance company customers are not recognizing their obligations. In reality, a strong list of line banks makes it possible for a firm's open market paper to be acceptable.

Finance company notes which banks accept under their lines of credit usually have 60 - 120 day maturities. Almost without exception, these notes are discounted which, as indicated in an earlier chapter, increases the effective cost of borrowing. Lines of credit to sales finance companies are subject to review annually after the receipt and analysis of the audit report and questionnaire. After the line has been renewed, a letter of confirmation is written to the company by the bank officer responsible for the account.

The cost of borrowing under its lines of credit is one of the principal expenses of doing business for the sales finance company. National and most regional companies pay the prime rate, currently 4%, for the use of short-term bank money. Interest rates for the local and smaller independents range upwards according to the risk element, size of capital funds and other factors.

COMMERCIAL PAPER - OPEN MARKET OPERATIONS

Since 1936, when the open market paper of sales finance companies gained acceptance in financial circles, there has not been a loss sustained nor an extension required. In general, commercial paper rates follow the pattern of the 91 day treasury bill rate and government agency short-term obligations.

The commercial paper market is available to the national and large regional sales finance companies. Customers for this paper include business corporations, banks, trust companies, investment funds, endowment funds, insurance companies and other investors desiring short-term holdings with a higher yield than government securities. In many instances, business corporations purchase this type of paper for tax accrual reserves.

Some of the large sales finance companies place their commercial paper directly. The majority of this paper, however, is offered through commercial paper brokers. There are some important advantages to the firm making proper use of the open market:

1. It is "cheaper" money than bank credit. Rates are normally at least $\frac{1}{2}\%$ or more below the prevailing bank prime rate. Also, no compensating balances are required.
2. Flexibility is added to financial planning. Bank lines are kept in reserve and borrowing position is strengthened.

3. Access is afforded to the broadest possible distribution of its paper. The value of this "advertising" medium is important for possible future establishment of new borrowing relations.

One of the unresolved problems for sales finance companies is how extensively should the open market be used. Naturally, it is tempting to use this market heavily when interest rates are depressed and paper is in strong demand. As previously mentioned, it is essential for a company to have unused bank lines to cover its paper outstanding. In addition, the company must realize that sale of commercial paper depends upon the day to day market; and, if money conditions suddenly tighten, the market can disappear rapidly. Thus, commercial paper can not be depended upon as a continual source for short-term funds. Accordingly, bank lines of credit are relied upon for the majority of the current requirements.

As of the date of this thesis, the prime rate of the commercial banking system is 4%. A schedule showing current commercial paper rates offered by a leading national sales finance company follows:

<u>PER ANNUM DISCOUNT RATE</u>	<u>YIELD TO MATURITY</u>
180 to 270 days - 3 5/8%	3.692% to 3.726%
90 to 179 days - 3 3/8%	3.404% to 3.433%
60 to 89 days - 3 1/4%	3.268% to 3.276%
30 to 59 days - 3%	3.008% to 3.015%

A number of commercial bankers have come to the conclusion that open market paper of their sales finance customers should be restricted to a maximum of 20% of short-term borrowing. This standard does not appear applicable to the national and a few of the large regional firms which used their line banks on a rather limited basis during 1958.

SUBORDINATED DEBT

The major source of funds for sales finance companies has been "superior" money, defined to include bank credit, commercial paper and senior term loans. During the past twenty years, one of the main problems of the sales finance industry has been the broadening of its borrowing base to underwrite the rapid expansion of its business. Offerings of common and/or preferred stock have proven to be relatively expensive media for increasing the equity capital base and have been used to a limited extent.

In 1936, General Finance Corporation of Chicago introduced a new financing medium, the "subordinated" term loan, as a means of increasing the borrowing base of its company. This new vehicle has been generally employed since 1944 to provide more working capital for sales finance companies.

A subordinated loan assumes a position of inferiority in creditor position to bank loans, commercial paper and senior term loans. Therefore, subordinated debt often is defined as "quasi-equity" capital, because its employment broadens the borrowing base

for short term funds in a manner similar to permanent additions to net worth. This broadening function is due to the fact that the larger sales finance companies usually borrow from three to four times their effective capital base, and bankers define "capital" of finance companies to include non-current portions of subordinated debt.

The use of subordinated debt by finance companies has a further advantage over other forms of "capital". Interest paid on this type of financing is deductible as an operating cost, which results in an income tax saving. Dividends on common and preferred stock are not deductible from taxable income. In addition, if the need for working capital diminishes, subordinated debt can be retired in a more flexible manner than true equity capital.

The majority of subordinated financing is done through insurance companies, and subordinated debt must be in the form of long-term debt to fulfill its purpose of increasing the borrowing base. The subordinated note itself, or an accompanying agreement, must clearly define the provisions of subordination and should include the following principles:

1. Superior debt must be defined to include current bank loans, senior term loans and commercial paper.
2. In the event of liquidation, dissolution, bankruptcy, reorganization, etc., all principal and interest outstanding on superior debt must be paid in full before any payment is made on the subordinated debt.

3. Without the written consent or the retirement of superior debt, under no conditions should subordinated debt be retired before the expressed dates of maturity.
4. Holders of superior debt should be notified immediately of any default in the subordinated debt.

Similar to other long-term obligations, the subordinated loan agreement contains various restrictive covenants. These covenants relate to the amount of superior debt that can be created, the maintenance of a specific amount of equity capital in relation to outstanding subordinated debt, etc.⁵ Before a commercial bank establishes a line of credit for a sales finance company, it is recommended that the subordinated loan agreements be thoroughly studied and reviewed by the bank's legal counsel.

LONG-TERM SENIOR DEBT

Senior term notes of sales finance companies usually are sold to insurance companies and are on the same parity with bank lines except as to maturity. These notes are issued with serial maturities over a number of years or are payable on a single date.

In general, commercial banks look favorably upon unsubordinated term borrowing when considering the extension of a line of credit to a sales finance company. Banks are lending on a short-term

⁵ Schmus, page 37.

basis and, therefore, have an opportunity to review the credit at least several times a year. Accordingly, a bank can withdraw its line if unfavorable factors develop. An insurance company, however, must maintain its creditor position until the maturity of its loan, unless it is otherwise accelerated.

Previously, we discussed some of the developments which have influenced the greater use of term money by sales finance companies in the postwar period. The following factors and principles also should be taken into consideration:

1. Prior to 1950, institutional lenders had difficulty locating satisfactory investment outlets at attractive rates and, accordingly, became increasingly interested in term commitments to the finance industry.
2. In recent years, sales finance companies have acquired retail installment contracts with maturities ranging between eighteen and thirty-six months. Therefore, term money has proven helpful in spreading maturities of unsubordinated borrowings over a longer period to compensate for the lengthening of receivables.
3. Finance companies, employing both short-term and long-term funds, can borrow more in the aggregate than in the short-term market alone.

4. The acquisition of term money does not involve the establishment of compensating deposit balances. Also, the "price" is on an interest to follow basis rather than discounted interest. Accordingly, the effective cost of long-term funds may not be greater than the cost of short-term credit.

Some bankers recommend that a finance company, when negotiating for senior term money, should consider an issue with a spread of maturities. In this way, interest costs are averaged out, and the risk of a heavy maturity at any given time is avoided.

THE SALE OF RECEIVABLES

Although the sale of receivables has not become a popular financing medium, some of the smaller firms have used this device to provide working capital. Usually banks acquire the installment paper on a non-recourse basis and advance approximately 85% of the value of the receivables, retaining 15% for a loss percentage reserve. If all of the receivables of the company are not sold to the bank, the problem of "selectivity" of paper that is sold arises. Generally, banks realize the inherent danger of "selectivity" and refrain from this practice.

CHAPTER V

RATIO ANALYSIS OF SALES FINANCE COMPANIES

A number of factors are evaluated when a commercial bank considers the extension of a line of credit to a sales finance company. Proper emphasis should be given to the history and size of the company; the method of operation; the diversification, geographical distribution and liquidity of the receivables; the quality, ability, integrity and character of the management; the trend in the economy; and, of course, the bank's own internal policy and operation. Consideration also should be centered on the company's ability to obtain credit or capital as needed.

In the introduction of this paper, it was mentioned that credit appraisal of finance companies requires a different form of financial statement analysis. The significant feature of this appraisal is known as ratio analysis.

THE PURPOSE, VALUE AND USE OF RATIOS

It is not the intent of ratio analysis to replace the credit judgement of the bank officer. Rather, it provides him with a helpful tool with which to improve his evaluation of a particular company. Ratio analysis also establishes a uniform basis for the comparison of individual companies which are similar in size and type of operation. Unless the loaning officer has a fundamental

knowledge of the operations of the industry, ratios will be of little value, because the trends portrayed cannot be interpreted intelligently.

The great majority of banks extending credit to the sales finance industry employ ratio analysis to some degree. Some banks apply this analysis to the most detailed phases of operations, while others place great significance on three or four ratios in exercising credit judgement. As ratios can be misleading, it is important that their use be intelligent and be interpreted to include all of the necessary factors. For example: if only the balance sheet ratios are considered, a satisfactory condition may be reflected. If on the other hand, only the volume or operational ratios are interpreted, a different impression may be gained.

THE COMPOSITE RATIO ANALYSIS

Since 1935, the First National Bank of Chicago has compiled statistics obtained from audit reports and questionnaires furnished by sales finance companies. This information is assembled in the form of composite ratios which present an analysis by percentages of the principal balance sheet items, volume statistics and operating data. The composite analysis is prepared from the ratios of approximately thirty individual companies, including national, regional and local names. In the aggregate, these companies control more than 50% of the sales finance industry volume. Therefore,

most bankers feel that the composite statistics portray the industry as a whole and, thus, serve as a good "yardstick" for credit judgement.

The composite figures are compiled twice a year, as of June 30th and December 31st, and are available to the majority of banks lending to finance companies. A copy of the most recent statistics, dated December 31, 1958, is inserted in the appendix and should be referred to at this point in order to appreciate the number of factors that are analyzed.

Because the composite figures serve as the "norm" for the industry, a banker can quickly compare the ratios of one of his customers with the composite statistics. An unfavorable trend or a danger sign will be highlighted by this comparison, thus alerting the officer. Also the composite statistics permit the banker to follow the general improvement or deterioration of the finance industry as a whole.

Sixty-three ratios are included in the composite figures, and each ratio is of significance. As mentioned earlier, perhaps some bankers base their opinions on a limited number of individual ratios and fail to realize the importance of an overall, critical approach.

In 1955, Mr. Elmer E. Schmus, former Vice President and Cashier of the First National Bank of Chicago, prepared a booklet entitled "Ratios of the Installment Sales Finance and Small Loan Companies",

which is included in the appendix of this thesis. Reference to this material is suggested, because the method used in compiling the various ratios comprising the composite figures is described in some detail. In the remainder of this chapter, the writer will discuss several principles which many bankers consider to be of special importance in the appraisal of a sales finance company.

DEBT PROPORTIONS

Many commercial banks consider a debt to net worth ratio of 1 to 1 to be the minimum standard for an industrial manufacturing company seeking the establishment of a line of credit. Conversely, a number of the larger sales finance companies commonly have total unsubordinated debt equivalent to 3 or 4 times their effective "capital" (capital defined to include subordinated debt). Perhaps this high debt ratio may seem unrealistic; but, upon further analysis of the operations of the sales finance industry, we realize that sound credit principles have not been abandoned by commercial banks.

First of all, approximately 95% of the assets of a typical sales finance company are current assets, represented primarily by receivables and lesser amounts of cash. According to the composite figures of December 31, 1958, only 4.16% of total resources consist of non-current assets. The outstanding receivables of the typical sales finance company are in relatively small amounts; are payable

in monthly installments; are usually secured; and, in many cases, are subject to a repurchase agreement by the respective dealer. Also, operations of the national and regional firms afford excellent geographical diversification, because these companies are not tied to economic fluctuations within a single industry or region.

A further factor explaining the acceptance by banks of the high debt to "capital" ratio among their finance company customers is due to the stability of the industry. Stability of earnings is the most significant example. When an economic recession depresses the volume of the industry, the outstanding receivables represent good existing earning assets to provide a satisfactory level of net income. In other words, this industry is not dependent upon current sales volume for current income. Therefore, a sales finance company has opportunity to make necessary operating adjustments during a recession. Short-term borrowings can be trimmed quickly, thus reducing debt expense. Due to the nature of their business, finance companies are not heavily burdened with inflexible charges. This factor of operating flexibility is significant to the banker.

A sales finance company that has one dollar of capital funds to every three dollars of unsubordinated debt has, in effect, four dollars worth of assets to pay every three dollars of unsubordinated debt. This means that the company could lose one-quarter of these assets before bank loans would be impaired. Perhaps some bankers

establish an arbitrary standard for the relationship between debt and capital of their sales finance customers. Unfortunately, this premise assumes the same degree of liquidity of assets for all the companies which is an erroneous theory.

LIQUIDITY PERIOD OF UNSUBORDINATED DEBT

A sales finance company must have a good liquidity position to establish and maintain a satisfactory borrowing relationship with its banks. The speed with which a company can pay its current liabilities reflects the quality of its assets, and this consideration has a direct bearing upon the aggregate amount of bank lines it can obtain.

When analyzing the statement of a finance company, the banker should anticipate the eventuality of a forced or voluntary liquidation. Obviously, the period of liquidation will be extended when the debt to capital ratio is high and the outstanding paper is of long maturity. The longer the period of liquidation, the greater the per cent of paper that will be absorbed by expense. Also, the poorer the quality of paper, the greater will be the repossessions and, thus, loss. Actually, the quality of paper handled by a finance company may be substandard for one of three principal reasons:

1. The character of the maker is indifferent. (The banker is not in a position to gauge this factor).

2. The downpayment, as a percentage of the purchase price, is inadequate.
3. The maturity of the paper is too long.

The latter two factors should be apparent from an analysis of the audit report and the sales finance questionnaire.

Primarily, the liquidity of a sales finance company is determined by the "run off" of its retail paper. There has been a strong tendency in recent years for companies to accept paper with longer maturities and lower downpayments. This is indicated in ratios #10, 11, 12, 37, 38, 41 and 42 of the composite statistics included in the appendix. With retail paper of longer maturity and lower downpayment, the liquidity period of the industry has lengthened from 6.73 months on December 31, 1940, to 11.28 months on December 31, 1958. Ratio #16 of the composite figures highlights this lengthening trend.

The quality and liquidity of the receivables held by a finance company must be analyzed carefully by the bank officer. In addition, the reserve for losses as a percentage of retail paper outstanding should be compared with the composite figures for the industry. Throughout the years, the loss experience of sales finance companies has been favorable, although 1958 proved to be a good test of their reserve policy. During this past year, repossessions increased sharply; and aggregate losses totaled 1.35% of retail paper liquidated, the highest ratio since 1953. In general, loss reserves for retail paper (ordinarily no loss reserves are maintained for wholesale paper) have proven adequate.

INTERPRETATION OF COMPOSITE AND INDIVIDUAL COMPANY RATIOS

In reality, there is no unconditional answer as to how high or how low the various ratios should be for any given sales finance company. The factor of size is an important consideration as far as diversification of operations is concerned. In the larger companies, the greater depth of management is significant. The ownership of the company is an additional factor to be considered. In the case of "captive" companies, the willingness of the parent company to supply additional capital is important.

In some respects, the ratios of an individual company may vary from the composite figures; this does not necessarily imply an unfavorable credit position. Several unfavorable variations may be compensated by other favorable proportions. A company may show a rather high unsubordinated debt position; but, upon further analysis, this may be due to a higher than average amount of new car wholesale paper. Because good quality wholesale paper represents a highly liquid asset, in this instance the company should not be criticized, assuming that proper control measures against fraud are maintained. Also, the geographical area of operation of the company is a contributing factor.

The interpretation of a single ratio of a company reflects a single factor and should be considered as such. When all the ratios of a company are analyzed and compared with the composite

figures, the bank officer is provided with an important basis for evaluating his customer. It should be remembered, however, that ratio analysis is but one factor taken into consideration when bank credit is extended to a sales finance company.

CHAPTER VI

SUMMARY AND CONCLUSION

Sales finance companies have satisfied a fundamental need in our economy by providing credit to many people to whom it previously had been denied. The industry has made important contributions to the productive development of our country as well as to our present high standard of living. In general, sales finance credit has been well administered; and during adverse economic periods, the industry has established a favorable record.

Although the growth of the industry has been rapid, the basic principles of installment financing have remained unchanged. In theory, sales finance companies represent the ideal credit customer of banks; their receivables are in small amounts, are payable in monthly installments and, in many cases, furnish good geographical and occupational diversification. It is essential, however, that these companies continue to extend installment credit in accordance with sound principles and practices. Substandard paper, involving extended terms and minimum downpayments, should not be encouraged or accepted.

Undoubtedly, in the years to come, commercial banks will continue to supply the majority of the short-term requirements of sales finance companies. Bank officers can extend this type

of credit soundly if they understand the characteristics of the business and apply the proper analysis to financial statements, audit reports and questionnaires.

In this paper, some of the more important factors influencing the extension of bank credit to sales finance companies have been discussed. The writer wishes to reiterate the significance of responsible and well qualified management, whose character and integrity are beyond question, as one of the prime considerations. Also, because these companies borrow from three to four times their effective capital, the quality of their receivables is most important.

Although sales finance companies have established a good record, the operations of the industry are not foolproof. Competition has intensified in recent years and has contributed to a partial relaxation of credit standards. Commercial banks must not relinquish the safeguards they require as proper supervision has to be maintained at all times. The relationship between a commercial bank and a sales finance company can, and should, be beneficial to both parties.

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Statement Date		12/31 1952	12/31 1953	12/31 1954	12/31 1955	12/31 1956	12/31 1957	12/31 1958
% Cash to Debt	1	17.02	16.44	18.07	15.07	14.74	14.70	17.22
Ratio - Debt to Working Capital	2	3.81 to 1	3.57 to 1	3.34 to 1	3.96 to 1	3.89 to 1	3.90 to 1	3.27 to 1
% Retail Receivables to Total Receivables	3	66.66	70.66	70.68	71.68	71.69	68.02	63.48
% New Car Retail to Total Retail	4	28.08	37.00	50.35	60.85	62.23	58.27	52.96
% Used Car Retail to Total Retail	5	71.92	63.00	49.65	39.15	37.77	41.73	47.04
% Wholesale to Total Receivables	6	9.70	9.11	8.19	9.90	7.44	9.78	8.17
% New Car Wholesale to Total Wholesale	7	60.30	73.36	75.99	82.55	72.34	70.38	62.92
% Used Car Wholesale to Total Wholesale	8	39.70	26.64	24.01	17.45	27.66	29.62	37.08
% Other Receivables to Total Receivables	9	23.64	20.23	21.13	18.42	20.87	22.20	28.35
% Retail maturing in 6 mo.	10	47.54	47.08	45.05	39.42	38.57	37.70	37.09
% Retail maturing in 12 mo.	11	78.24	78.33	75.05	68.22	66.94	65.99	65.53
% Retail maturing over 12 mo.	12	21.76	21.67	24.95	31.78	33.06	34.01	34.47
Debt - In Dollars, including holdbacks rebates, tax reserves, etc.	13							
% Cash, wholesale, retail and other Receivables maturing in 6 mo. to debt	14	81.94	81.10	80.64	71.12	68.69	69.69	72.72
% Cash, wholesale, retail and other Receivables maturing in 12 mo. to debt	15	115.37	116.43	114.82	102.83	101.09	100.58	104.82
No. of months collections required to pay debt net of cash and Wholesale Paper	16	9.03	8.98	9.18	11.49	11.92	11.99	11.28
Bank lines	17							
% Bank borrowing to Debt	18	71.65	65.84	58.95	67.68	61.54	60.28	52.48
% Open market borrowings to Debt	19	14.35	14.13	17.34	10.06	11.18	11.24	17.48
% Unused Lines to open market notes	20	281.66	364.30	377.02	458.18	475.72	560.34	431.87
% Balances delinquent over 60 days to Total Retail	21	.37	.46	.24	.22	.27	.43	.51
% Capital loans to Net Worth	22	3.16	2.84	2.31	2.65	2.33	2.46	2.19
% Repossessions to Net Worth	23	1.20	1.43	.92	1.31	1.46	1.79	1.77
% Reserves for losses to Total Retail	24	2.33	2.22	2.13	2.15	2.15	2.18	2.11
% Deferred Income to Total Retail	25	7.97	7.77	7.96	8.22	8.73	9.39	9.59
% Loss to Retail liquidated	26	.76	1.40	1.18	.64	.72	.74	1.35

Statement Date	12/31 1954	12/31 1955	12/31 1956	6/30 1957	12/31 1957	6/30 1958	12/31 1958	
Volume of Business for the Period	\$							
% Automobile Paper - Retail	27							
% Automobile Paper - Wholesale	28							
% Industrial & Home Equipment-Retail	29							
% Industrial & Home Equipment-Wholesale	30							
% Personal Loans	31							
% Accounts Receivable	32							
% Rediscounts	33							
% Unclassified	34							
Analysis of Retail Automobile Paper								
% New Car Retail	35	47.05	56.18	55.42	50.91	52.44	47.62	47.15
% Used Car Retail	36	52.95	43.82	44.58	49.09	47.56	52.38	52.85
% New Car Paper maturing longer than 18 months	37	86.20	90.93	93.34	93.37	93.75	-	-
% New Car Paper with down payment of less than 33 $\frac{1}{3}$ %	38	40.34	52.05	57.18	60.32	60.38	-	-
% New Car Balloon, excluding Demonstrator paper	39	11.85	12.82	5.34	5.14	5.26	4.66	4.46
% Demonstrator paper	40	8.29	6.29	5.92	7.56	6.35	9.24	7.67
% Used car Paper maturing longer than 12 months	41	79.63	82.76	84.58	88.45	88.74	-	-
% Used Car Paper with down payment of less than 33 $\frac{1}{3}$ %	42	27.28	38.09	45.63	51.77	53.64	-	-
% Used Car Paper with final instalment larger than preceding ones	43	2.64	3.15	2.06	2.15	1.96	2.03	1.48

Name of Co. Composite Ratios - Installment Sales Finance Companies

Statement Date	12-31-52	12-31-53	12-31-54	12-31-55	12-31-56	12-31-57	12-31-58
	000 omitted	000 omitted	000 omitted	000 omitted	000 omitted	000 omitted	000 omitted
Preferred or Preference Stocks	44 \$ 26,409	\$ 26,676	\$ 34,126	\$ 99,462	\$ 104,449	\$ 104,155	\$ 104,247
Common Stock	45 186,974	210,900	215,082	268,831	269,437	272,350	272,081
Surplus-Earned and Capital	46 396,052	444,639	509,197	518,078	594,653	660,134	743,749
Net Worth	47 609,435	682,215	758,405	886,371	968,539	1,036,639	1,120,077
Debentures	48 987,769	2,004,587	2,128,779	3,006,358	3,487,049	3,678,970	4,242,475
Total Net Worth and Debentures	49 1,597,204	2,686,802	2,887,184	3,892,729	4,455,588	4,715,609	5,362,552
Volume for period	50 12,552,633	15,344,183	14,397,821	20,994,954	18,727,446	20,641,438	18,313,539
Total Outstandings	51 4,569,717	5,656,028	5,694,736	8,276,814	8,587,036	9,363,648	8,888,292
% Total expense including taxes to gross income	52 83.73	86.36	86.93	86.76	87.23	88.49	89.88
% Net profit to Retail purchased	53 1.48	1.37	1.46	1.23	1.37	1.31	1.24
% Net profit to Average Net Worth	54 14.37	12.54	12.33	12.17	11.50	11.48	10.84
% Dividends to Net Profit	55 44.80	51.85	50.47	47.11	49.12	47.61	50.00
% Current Debt to Total Resources	56 65.37	60.75	58.33	60.20	56.64	55.23	51.09
% Long Term Debt to Total Resources	57 12.43	17.37	18.40	18.86	21.54	22.56	25.68
% Unearned income, and loss reserves to Total Resources	58 7.42	7.11	7.06	7.36	7.82	7.97	7.82
% Net Worth to Total Resources	59 14.78	14.77	16.21	13.58	14.00	14.24	15.41
% Non-Current Assets to Total Resources	60 2.62	2.94	3.07	2.95	3.14	3.47	4.16
% Gross Income to Total Purchases	61 5.50	6.13	6.71	5.43	6.74	6.96	7.88
% Net Profit to Total Purchases	62 .88	.80	.83	.70	.83	.81	.77
% Expense to Total Purchases	63 4.62	5.33	5.88	4.73	5.91	6.15	7.11

SUPPLEMENTARY RATIOS

(RETAIL AUTOMOBILE VOLUME)

	12/31/55	12/31/56	12/31/57	12/31/58
% New Car Paper maturing longer than 24 months	67.91	78.10	79.66	82.82
% New Car Paper maturing longer than 30 months			43.92	63.89
% Used Car Paper (Current & two preceding yearly models) maturing longer than 18 mos.	83.68	85.97	88.13	90.77
% Used Car Paper (Current & two preceding yearly models) maturing longer than 24 mos.			34.69	49.99
% Used Car Paper (Older models) maturing longer than 12 months	71.54	73.72	77.49	80.86
% Used Car Paper (Older models) maturing longer than 18 months			37.71	48.44
% New car retail volume with advances over 100% of dealers cost			32.14	28.61
% New car retail volume with advances over 110% of dealers cost				5.67
% Used car retail volume with advances over 100% of wholesale value			* 59.05	34.77
% Used car retail volume with advances over 110% of wholesale value				18.81
% Used car retail volume with advances over 120% of wholesale value				9.94

* Related to low book value



SALES FINANCE COMPANY QUESTIONNAIRE

NOTE: In submitting this questionnaire with financial statements, please ascertain that identical terminology is used and that all figures in each are in agreement. Figures in schedules should be stated to the nearest dollar. If the information requested is already included in audit report, it need not be duplicated herein.

Name and Address of Company _____

Submitted as of _____ covering the period from _____ to _____

SECTION I—GENERAL QUESTIONNAIRE

- Does this report include operations of subsidiary or affiliated companies? _____. If so, please list below the names of any subsidiary or affiliate which has been financed other than by advances from the reporting company, the outstanding capital and percentage of ownership of each and the amount and description of outside financing.
- Is any financing done for concerns in which officers, stockholders, directors of company or their families have a direct or beneficial interest? If so, please give details.

SCHEDULE A

VOLUME OF BUSINESS FOR THE PERIOD AND OUTSTANDINGS AT END OF PERIOD:
(Use blank lines to detail classifications not specified below.)

DISCOUNTS (Note A)

Automobile—New.....
Automobile - Used (From Dealers)
Automobile - Used (Direct Loans)
Domestic appliances.....
House trailers.....
Modernization—F.H.A.....
Modernization—Own plan.....
Bulk purchases (Describe).....
Other (Describe).....
.....
Totals.....

	VOLUME			OUTSTANDINGS END OF PERIOD (Except Wholesale)
	RETAIL	WHOLESALE	TOTAL	
Automobile—New.....	\$ _____	\$ _____	\$ _____	\$ _____
Automobile - Used (From Dealers)				
Automobile - Used (Direct Loans)				
Domestic appliances.....				
House trailers.....				
Modernization—F.H.A.....				
Modernization—Own plan.....				
Bulk purchases (Describe).....				
Other (Describe).....				
.....				
.....				
Totals.....	\$ _____	\$ _____	\$ _____	\$ _____

DIRECT CASH LOANS—Under Small Loan Acts or Comparable Laws (Note B)

COMMERCIAL LENDING AND MISCELLANEOUS FINANCING (Note C)

Loans—Accounts receivable security.....
Loans—Inventory security.....
Machinery and equipment loans.....
Capital loans to automobile dealers.....
Rediscounts—Auto.....
Rediscounts—Other.....
.....

DIRECT CASH LOANS—Under Small Loan Acts or Comparable Laws (Note B)	\$ _____	\$ _____
Loans—Accounts receivable security.....	\$ _____	\$ _____
Loans—Inventory security.....		
Machinery and equipment loans.....		
Capital loans to automobile dealers.....		
Rediscounts—Auto.....		
Rediscounts—Other.....		
.....		
Total Commercial Loans and Miscellaneous Financing.....	\$ _____	\$ _____

TOTAL VOLUME—ALL CLASSIFICATIONS..... \$ _____

TOTAL OUTSTANDINGS ALL CLASSIFICATION, EXCEPT WHOLESALE..... \$ _____

- NOTE A: Please complete Discount Section II. NOTE B: Please complete Direct Cash Loan Section III.
NOTE C: If Commercial or Miscellaneous Financing operations are engaged in please complete the separate Commercial Financing Questionnaire.

Carried in Stock by Cadwallader & Johnson, Inc., 225 W. Huron St., Chicago 10, Ill.
Robert Morris Associates, Form No. C123R

SCHEDULE D

BORROWINGS:

NOTE: Please attach schedule of latest confirmed lines of credit from banks and names of brokers handling sale of open market paper.

	SECURED OR UNSECURED	MAXIMUM* AMOUNT	MINIMUM* AMOUNT	OWING AT STATEMENT DATE
Bank loans under lines of credit..		\$	\$	\$
Open market borrowings.....		\$	\$	\$
Other current loans.....		\$	\$	\$
Long term debt—Not subordinated.		\$	\$	\$
Long term debt—Subordinated.....		\$	\$	\$
Paper sold with recourse.....		\$	\$	\$
Paper sold without recourse.....		\$	\$	\$

*As determined by month-end balances.

SCHEDULE E

MONTHLY MATURITIES OF INSTALMENT RECEIVABLES (INCLUDING DIRECT CASH LOANS) OUTSTANDING AT STATEMENT DATE:

MONTH	DISCOUNTS	DIRECT CASH LOANS PRINCIPAL	DIRECT CASH LOANS INTEREST	TOTAL
Past Due.....	\$	\$	\$	\$
1st.....				
2nd.....				
3rd.....				
4th.....				
5th.....				
6th.....				
7th.....				
8th.....				
9th.....				
10th.....				
11th.....				
12th.....				
Over 12 months'.....				
Totals.....	\$	\$	\$	\$

NOTE: Totals in first two columns of above schedule should agree with respective totals in balance sheet. If non-installment receivables are included in the above schedule, state amount. \$

Robert Morris Associates, Form No. C123R
Carried in Stock by Cadwallader & Johnson, Inc., 225 W. Huron St., Chicago 10, Ill.

SECTION II—DISCOUNTS

**SCHEDULE A
ANALYSIS OF RETAIL INSTALMENT VOLUME FOR THE PERIOD:**

NEW UNITS

	AUTOMOBILE (From Dealers)
33-1/3% down or over, but not over 18 months.....	\$
33-1/3% down or over, over 18 but not over 24 months.....	\$
33-1/3% down or over, over 24 months but not over 30 months.....	\$
33-1/3% down or over, over 30 months.....	\$
Less than 33-1/3% down, not over 18 months.....	\$
Less than 33-1/3% down, over 18 but not over 24 months.....	\$
Less than 33-1/3% down, over 24 months but not over 30 months.....	\$
Less than 33-1/3% down, over 30 months.....	\$
Balloon paper, excluding demonstrator paper.....	\$
Balloon paper—demonstrator paper only.....	\$
TOTAL—(Should agree with line "Automobile—New" Schedule A page 1)	\$

**USED UNITS (Automobile [Direct Loans] to be classified only on basis of terms) ...
(CURRENT AND TWO PRECEDING YEARLY MODELS)**

	AUTOMOBILE (From Dealers)	AUTOMOBILE (Direct Loans)
33-1/3% down or over, not over 12 months.....	\$	
33-1/3% down or over, over 12 but not over 18 months.....	\$	
33-1/3% down or over, over 18 months but not over 24 months.....	\$	
33-1/3% down or over, over 24 months.....	\$	
Less than 33-1/3% down, not over 12 months.....	\$	\$
Less than 33-1/3% down, over 12 but not over 18 months.....	\$	\$
Less than 33-1/3% down, over 18 months but not over 24 months.....	\$	\$
Less than 33-1/3% down, over 24 months.....	\$	\$
Balloon paper.....	\$	\$
SUB-TOTALS.....	\$	\$

(MODELS OLDER THAN ABOVE)

33-1/3% down or over, not over 12 months.....	\$	
33-1/3% down or over, over 12 months but not over 18 months.....	\$	
33-1/3% down or over, over 18 months.....	\$	
Less than 33-1/3% down, not over 12 months.....	\$	\$
Less than 33-1/3% down, over 12 months but not over 18 months.....	\$	\$
Less than 33-1/3% down, over 18 months.....	\$	\$
Balloon paper.....	\$	\$
SUB-TOTALS.....	\$	\$

TOTAL—USED UNITS (Column totals should agree with respective lines in Schedule A page 1)..... \$

**SCHEDULE B
ANALYSIS OF FLOOR PLAN LOANS
TO DEALERS:**

CLASSIFICATION

CLASSIFICATION	WHOLESALE		
	MAXIMUM OUTSTANDING IN PERIOD	OWING AT STATEMENT DATE	AMOUNT OUTSTANDING 6 MONTHS OR OVER
Automobile—New.....	\$	\$	\$
Automobile—Used.....	\$	\$	\$
Other (Detail).....	\$	\$	\$
.....	\$	\$	\$
.....	\$	\$	\$
.....	\$	\$	\$
Totals.....	\$	\$	\$

Ten Largest Loans to Dealers Based on Used Car Collateral

OWING AT STATEMENT DATE	LOW BOOK VALUE USED CAR COLL.	MAXIMUM LOAN	AM'T OUTSTANDING 6 MONTHS OR OVER	NEW OR USED CAR DEALER
\$	\$	\$	\$	
\$	\$	\$	\$	
\$	\$	\$	\$	
\$	\$	\$	\$	
\$	\$	\$	\$	
\$	\$	\$	\$	
\$	\$	\$	\$	
\$	\$	\$	\$	
\$	\$	\$	\$	
\$	\$	\$	\$	

SCHEDULE D

ANALYSIS OF PAST DUE ACCOUNTS—DIRECT CASH LOANS:

"90 DAY" ACCOUNTS—No collections received for 90 days or more.....

"60-89 DAY" ACCOUNTS—No collections received for 60 to 89 days.....

"INTEREST ONLY" ACCOUNTS—Accounts on which interest and charges only were received in the last 60 days of the period.....

Totals.....

NUMBER	UNPAID BALANCES
	\$
	\$

NOTE: Any comments you may desire to make regarding your method of classification of past due accounts may be made on page 8.

SCHEDULE E

RATIO OF CHARGES COLLECTED ON INTEREST BEARING DIRECT CASH LOANS TO CHARGES EARNED:

(Submit data if available)

Charges earned in period covered.....

Charges collected in period covered.....

AMOUNT
\$
\$

SCHEDULE F

If 5% of your loan volume consisted of loans originally made for \$2,500 or more, give the following data on page eight on the ten loans having the largest loan balances at the end of the period: (a) Date made; (b) Original amount; (c) Repayment schedule; (d) Security; (e) Delinquency status.

PLEASE NOTE

If commercial or miscellaneous financing operations are engaged in please complete the separate commercial financing questionnaire.

The foregoing information, supplementing our financial statement of _____

prepared by _____ is submitted for the purpose of obtaining credit.

(Name of Company)

By _____
(Title)

NOTE: Any additional information you may wish to make available to your lending banks with respect to credit or operating policies and procedures not covered above may be submitted on page 8.

Robert Morris Associates, Form No. C123R
Carried in Stock by Cadwallader & Johnson, Inc., 225 W. Huron St., Chicago 10, Ill.



SUPPLEMENT TO FORM No. C123R

REPLACES SCHEDULES A AND G OF SECTION II

SECTION II — DISCOUNTS

SCHEDULE A
ANALYSIS OF RETAIL AUTO VOLUME FOR THE PERIOD

USE DOLLAR FIGURES ONLY
OMIT CENTS

NEW UNITS — Cash Advanced as a Percentage of DEALER COST*

	24 Mos. or less	25-30 Mos.	31-36 Mos.	Over 36 Mos.	Balloon Paper	Totals***
90% or less.....	\$	\$	\$	\$	\$	\$
91%—100%.....	\$	\$	\$	\$	\$	\$
101%—105%.....	\$	\$	\$	\$	\$	\$
106%—110%.....	\$	\$	\$	\$	\$	\$
Over—110%.....	\$	\$	\$	\$	\$	\$
Demonstrator Paper.....	-----	GIVE DOLLAR	TOTALS ONLY	-----	-----	\$
Totals.....	\$	\$	\$	\$	\$	\$
% Without Recourse****						%

USED UNITS (Late Model, Current and two preceding years) Cash Advanced as a Percentage of Used Car Guide WHOLESALE VALUE**

	18 Mos. or less	19-24 Mos.	25-30 Mos.	Over 30 Mos.	Balloon Paper	Totals***
90% or less.....	\$	\$	\$	\$	\$	\$
91%—100%.....	\$	\$	\$	\$	\$	\$
101%—110%.....	\$	\$	\$	\$	\$	\$
111%—120%.....	\$	\$	\$	\$	\$	\$
Over—120%.....	\$	\$	\$	\$	\$	\$
Totals.....	\$	\$	\$	\$	\$	\$
% Without Recourse****						%

USED UNITS (Older Models than above) Cash Advanced as a Percentage of Used Car Guide WHOLESALE VALUE**

	12 Mos. or less	13-18 Mos.	Over 18 Mos.	Balloon Paper	Totals***
90% or less.....	\$	\$	\$	\$	\$
91%—100%.....	\$	\$	\$	\$	\$
101%—110%.....	\$	\$	\$	\$	\$
111%—120%.....	\$	\$	\$	\$	\$
Over—120%.....	\$	\$	\$	\$	\$
Totals.....	\$	\$	\$	\$	\$
% Without Recourse****					%

DIRECT LOANS — Cash Advanced as a Percentage of Used Car Guide WHOLESALE VALUE**

	18 Mos. or less	19-24 Mos.	25-30 Mos.	Over 30 Mos.	Totals***
100% or less.....	\$	\$	\$	\$	\$
Over 100%.....	\$	\$	\$	\$	\$
Totals.....	\$	\$	\$	\$	\$

*Dealer Cost may include invoice plus applicable freight charges, taxes and license fees. Cash Advanced must exclude finance and insurance charges.

*Please state reference book or books used.

***Dollar totals in these columns should agree with respective totals in Schedule A — Page 1.

****Without Recourse means without dealer endorsement, repurchase, deferred credit, withheld reserve, or similar protective provisions.

RATIOS OF THE
INSTALLMENT SALES FINANCE
AND
SMALL LOAN COMPANIES



by

ELMER E. SCHMUS
VICE-PRESIDENT AND CASHIER
THE FIRST NATIONAL BANK
OF CHICAGO

JUNE—1955



The First National Bank of Chicago

FOR a number of years The First National Bank of Chicago has maintained statistics and compiled ratios obtained from the audit reports and supplemental information furnished in questionnaires by many of its installment sales finance company accounts. From the ratios of the individual companies we have prepared a composite analysis which shows the trend of the industry as we see it. The figures are those of the national companies, the so-called regional companies and certain of the independents, and since these companies enjoy a major portion of the total volume of the sales finance companies we believe the composite ratios reflect the industry as a whole. We hope the information contained in the booklet will be interesting and beneficial, not alone for the purpose of judging your finance company credits but also in connection with your own consumer credit operations.

The first section of the booklet describes the method of compiling the installment sales finance company ratios, while the remainder of the booklet has been developed since 1948 for the purpose of making ratio analyses of the personal loan companies. In the past it was not necessary to apply the customary yardstick to the personal loan companies since these companies even at the peak of loan outstandings did not generally borrow in excess of their capital investment. As consumer loan credits expanded, banks

generally liberalized their credits to the personal loan companies, which has resulted in the loan companies furnishing information which heretofore had not been required of them.

In our ratio analysis we place greater emphasis upon the liquidity of a finance company than upon the debt ratio. We, of course, consider the debt ratio of the company, but we feel that liquidity, reflecting the quality of the assets of the company, should be a relatively more important factor in appraising finance company credit than the inflexible "debt to net worth" or working capital formulae, which systems assume that all receivables have the same degree of liquidity.

On pages 16, 17, 18 and 19 are recorded composite ratios prepared from the reports of installment sales finance companies for the years ended December 31, 1935 to December 31, 1941, inclusive, and for the years ended December 31, 1947 to December 31, 1954, inclusive. We did not compile ratios for the years 1942 to 1946, inclusive, since installment sales credits were at such a low level during the war that any ratios developed would be of little value for comparative purposes.

A comparison of the more pertinent ratios of December 31, 1954 with those of December 31, 1941—the pre-war peak in outstandings—shows that finance companies have, since the close of World War II, followed quite closely the pattern of their 1941 operations. At December 31, 1941 the ratio of debt to working capital stood at 2.96 to 1 and although this ratio has increased in post-war years, the increase is not out of line, as indicated by the December 31, 1954 ratio of 3.34 to 1. Despite a steady increase in outstandings this ratio has remained almost constant since the war's end, the low point of 3.34 to 1 being recorded at December 31, 1954 and the high at the close of 1952. The number of months' collections required to pay debt, net of cash and wholesale paper, increased from 6.92 months at December 31, 1941 to 9.18 months at the end of 1954, but here again the increase is not excessive. Prior to the war, banks accepted as standard either a 3 to 1 debt ratio or a six months' liquidity,

depending upon which theory was more acceptable to the particular bank. In view of the demonstrated flexibility by the finance companies in the control of their purchases, banks generally now feel secure in their commitments to companies showing a nine months' liquidity, which would be the equivalent of approximately a 4 to 1 debt position based on the terms granted the consumer in 1941. The two ratios previously referred to show that on the average the companies maintained a position within the present accepted standard.

The companies on the average enjoyed an excellent credit experience during 1954. Balances delinquent over sixty days were equal to 24/100 of 1 per cent of total retail receivables as compared with 68/100 of 1 per cent at the end of 1941, while the percentage of loss to retail liquidated amounted to 1 and 18/100 per cent in 1954 as against 68/100 of 1 per cent in 1941. We believe it pertinent to point out the ratios show that since 1935 the per cent of loss to retail paper liquidated of the installment sales companies has exceeded 1 per cent in only four years, the high point being in 1938 when the loss was only 1.70 per cent of paper liquidated. The per cent of repossessions to net worth has not changed significantly in the years following the war, being equivalent to .92 per cent at December 31, 1954 as compared with 85/100 of 1 per cent at the close of 1941. The combined loss and deferred income reserves have consistently approximated 10 per cent of total retail outstandings, amounting to 9.34 per cent at December 31, 1941 and 10.09 per cent at the 1954 year end, certainly under present liquidating experience an adequate reserve. In addition to these reserves, the banks lending the finance companies enjoy a further protection against loss in the entire net worth of the companies plus whatever subordinated indebtedness that may be outstanding. The companies earned net profits in 1954 equivalent to 12.33 per cent to the average of net worth, an excellent return in light of present operating costs and tax rates. As has been the case in post-war years, dividends were conservative at 50.47 per cent of net profits.

The ratios of the personal loan companies also reflect a satis-

factory condition of affairs at the close of 1954. Debt shows a ratio to working capital of 1.89 to 1, and using the collection-debt factor, as explained under Ratio 8, the companies on the average could liquidate debt in approximately 8.04 months. The personal loan companies on the average carried individual loan balances averaging \$251.00, while the average amount of the individual loans made was \$305.00, reflecting a splendid diversification of their business. The per cent of loss to average notes outstanding at December 31, 1954 was 1.94, which is not excessive for small loan operations, and the loss reserves on the average were equivalent to 3.68 per cent to loan balances. The companies reported on the average net profits of 13.10 per cent to average net worth, and only slightly over 45.5 per cent of net profits were paid out in dividends.

INSTALLMENT SALES FINANCE COMPANY RATIOS

Ratio (1)

Adequate cash balances must be maintained by finance companies not alone for current operating purposes, but also for the maintenance of compensating balances fully commensurate with the lines of credit granted by banks. For many years, banks required the finance companies to maintain average balances equal to 20% of the line granted when all or a portion of the line was in use and 10% when the line was not in use. In recent years this requirement has been modified in most quarters to a constant average balance of 15% of the line granted. Banks generally have increased substantially their commitments to finance companies, which with greater demands by industry on commercial bank funds will cause the banks to examine more closely into balances maintained by borrowing accounts and probably result in more exacting balance requirements in order to help meet the increased demand for funds. In calculating the percentage of cash to debt, consider as cash all funds available for the retirement of current indebtedness and include in debt all current liabilities (not excepting hold-backs and dealers' reserves) and all long term debt which is not specifically subordinated to current notes payable.

(1a) As a supplementary ratio exclude the long term unsubordinated notes.

Ratio (2)

For many years the ratio of debt to working capital was the generally accepted ratio used in determining debt position, although it has the obvious fault of showing no discrimination as to the liquid character of the assets. It is, nevertheless, valuable in determining the over-all debt position. In the period of our analysis ended December 31, 1954, the composite debt ratios of a group of automobile finance companies handling the major portion of the national volume ranged from 1.50 to

1 on December 31, 1938 to 3.81 to 1 at the close of 1952. In calculating the ratio, include in debt all current liabilities and all long term debt which is not specifically subordinated to current notes payable. In computing working capital, include in current assets all currently available cash, all notes of customers taken in the regular course of business, repossessions, current accounts receivable, and cash value of life insurance (exclude all capital advances), deducting from the total thereof the reserves for bad debts, deferred income and any other reserves applicable to current assets. Some finance companies operate manufacturing, insurance or other subsidiaries which should not be consolidated with the parent company in developing this ratio, but should be treated as investments.

(2a) As a supplementary ratio, eliminate from total unsubordinated debt the long term portion thereof and relate this amount to working capital.

Ratios (3), (4) and (5)

Inasmuch as retail or discount paper is the principal source of income in the operation of a finance company, we are interested in determining the percentage of total receivables represented in this category. In calculating this ratio for an automobile finance company, only retail automobile paper should be included in retail receivables in ratio number 3, other retail paper being classified as "other receivables" in ratio number 9. Total receivables include only those receivables taken in the regular course of business. Credit experience on new car paper has been rather consistently better than on used car paper—hence, we are interested in determining the percentage in each category and in watching the trend of outstandings.

Ratios (6), (7) and (8)

Finance companies make wholesale advances to dealers as a means of obtaining the retail paper generated by them. Inasmuch as the income derived from wholesale paper does not generally cover the cost of rendering this service, particularly

at the low rates now prevalent, a well-managed finance company endeavors to keep wholesale advances at as low a level as is consistent with obtaining the desired amount of retail paper. In calculating this percentage for an automobile finance company, *use only wholesale automobile outstandings* in comparing with total receivables. Wholesale used car outstandings have in past years offered some problems in times of economic stress when the value of cars pledged to loans suffered marked declines and sizable losses were sustained. The wholesale financing of new cars has, on the other hand, offered comparatively few problems from the standpoint of losses. Because of the differences in the risks involved in the two types of wholesale financing, it is very desirable to determine the percentage of wholesale automobile outstandings in each category.

Ratio (9)

In calculating this percentage for an automobile finance company, "other receivables" should include all finance receivables except retail automobile paper and wholesale automobile paper. In view of the diversification which has taken place among automobile finance companies during recent years, the percentage of "other receivables" undoubtedly will continue at a substantial percentage of total outstandings.

Ratios (10), (11) and (12)

The liquidity position of a finance company is a most important criterion of its financial condition. Liquidity is determined, very largely, by the run off of retail paper; hence, the importance of determining the percentage of retail paper (including small loans) maturing in these three categories and the desirability of watching the trends from year to year. Composite figures for the group of companies referred to in ratio number 2, show that between 1935 and 1954, retail paper maturing in six months decreased from 62.09% to 45.05% of total retail paper while for twelve months the decrease was from 92.19% to 75.05%.

Ratio (13)

This figure represents the gross amount of unsubordinated debt—including holdbacks, rebates, tax reserves and all open accounts and accruals.

Ratios (14) and (15)

These ratios are preliminary to the determination of liquidity (ratio number 16) and serve as a yardstick for comparison between companies on a six months' and on a twelve months' liquidation basis. In calculating these ratios, include in debt all current liabilities and all long term debt which is not specifically subordinated to current notes payable.

Ratio (16)

Expressing as it does the theoretical period required to liquidate the indebtedness of a finance company other than subordinated debt, this ratio is of fundamental importance in the analysis of finance company statements. The old ratio basis of limiting debt to a certain number of times working capital or net worth assumed that the various companies had the same degree of liquidity, inferring that the terms and rate of collection of receivables were standard—which in an unrestricted economy obviously would not prevail. Under the old debt ratio yardstick, the careful operator who purchased only high grade paper was, in effect, penalized in that the ratio standard set up did not discriminate between him and the operator who purchased large quantities of sub-standard paper. In the years immediately preceding the war, a liquidity slightly in excess of six months was the average for well-managed companies, and this generally resulted in a ratio of debt to working capital of approximately 3 to 1. Reference to the composite ratios shows that at December 31, 1940 the companies previously referred to on the average had debt equivalent to 2.66 times working capital and a liquidity of 6.73 months. At December 31, 1941 the ratio of debt to working capital was 2.96 to 1 with a liquidity of 6.92 months. At December 31, 1954 the

ratio of debt to working capital was 3.34 to 1 with a liquidity of 9.18 months. In view of the excellent payment record of installment paper over the years, as reflected in ratio number 26 of the composite ratios, coupled with the desire of banks to assist the finance companies in handling the greatly increased volume of paper developed since the end of the war, a nine months' liquidity standard, under average economic conditions, is now regarded as reasonable. It is expected that this liquidity will, on the basis of average terms, result in a debt to working capital ratio of approximately 4 to 1. In calculating liquidity, include in debt all current liabilities and all long term debt which is not specifically subordinated to current notes payable. In addition to cash and wholesale paper, deduct from the debt, short term accounts receivable, which have been purchased. In calculating the number of months' collections required, take monthly maturities of all retail paper as well as small loan maturities (principal only) and relate these monthly totals to the net debt.

Ratios (18), (19) and (20)

The primary source of credit for a finance company is its banks. Without adequate lines from representative banks, a finance company would find it most difficult to borrow effectively on the open market and, of course, could not likely obtain long term funds with which to operate. Sometimes a company with a good list of banks, which grant ample credit lines, loses sight of the fact that open market borrowings are based on those lines and permits the use of the open market to take up too large a part of total debt. While a saving in interest costs can usually be effected, we believe that a company should limit the use of the open market to 15% or 20% of its borrowings and should at all times have unused credit lines available to cover the open market paper. This is essential because holders of this paper may expect payment at maturity.

Ratio (21)

An obvious criterion of the quality of installment paper is

the percentage of delinquent accounts. In view of the fact that a 30-day delinquent account frequently does not represent a serious condition, the standard has been set at over 60 days, and, on this basis, it is important to know the aggregate of the balances affected by the delinquent installments. Many finance companies operate small loan departments and delinquencies in this type of paper should be calculated as required under the small loan company ratio number 13.

Ratio (22)

In order to obtain new dealer connections as well as to service existing relationships, finance companies frequently find it necessary to make capital advances. These loans are made for a number of different purposes and usually are payable monthly or on the basis of automobile sales so that, if prudently made, they are liquidated within a reasonable period. The interest rate received usually is not fully compensating for the money advanced, but if it leads to a greater volume of good retail business, it is a proper function of a finance company. It is important, however, to ascertain that a finance company has limited its advances to a reasonable proportion of its resources; hence, it is desirable to calculate a ratio comparing the total of advances with the net worth of the company.

Ratio (23)

The handling of repossessions is a necessary part of the finance business and in a period of unsettled economic conditions, the repossessions of a finance company may mount quite substantially. Usually it is good business for the company to dispose of these assets as quickly as possible. The values assigned should be realistic, which may be considerably less than the total of balances on the underlying notes. In arriving at the total of repossessions, all repossessed items should be included, irrespective of whether they are in the hands of the finance company or in the hands of dealers on either a recourse or a non-recourse basis.

Ratio (24)

Many and various methods are employed in setting up bad debt reserves, one widely used method providing that a proportion of the discount on each note purchased be added to the reserve. The result aimed at should be a reserve which is adequate for losses which may be sustained—having in mind the grade of paper purchased, collection experience and the prevailing general economic conditions. The conservatism of a company's charge-off policy obviously has an important bearing on the amount of reserve required, but over a period of years we have found that well-managed companies have maintained reserves equal to $2\frac{1}{2}\%$ to 3% or better of total retail and small loan outstandings. Ordinarily, no reserves are set up for wholesale paper as this service function of a finance company, if properly set up, should not develop any losses.

Ratio (25)

Inasmuch as an installment obligation is payable over a period of months, although the discount or income thereon is obtained upon purchase, good accounting practice requires the deferment of a portion of that income until it is earned through the payment of monthly installments. Many methods are used in setting up deferred income, a common one being the so-called "sum of the digits" or 12/78 method in which for twelve months' paper 12/78 of the discount is taken up in the first month, 11/78 in the second month and so on through the year—this method very properly taking up a greater part of the discount as income in the early months as an offset to the acquisition costs. Some companies set up as deferred income an arbitrary percentage of the outstanding receivables at statement date, but this does not reflect swings in volume or rates and the percentage frequently chosen (6) is not quite adequate based on our composite percentages for the group of companies referred to previously which ranged from 6.48 to 8.03. In calculating the percentage, care must

be taken to exclude small loans and all other installment paper which is not on a discount basis.

Ratio (26)

The amount of net losses (receivables charged off, less recoveries) on retail and small loan paper is best expressed by relating this to the total of these classes of paper liquidated during the year. This ratio, together with the ratios pertaining to delinquent accounts and repossessions, gives a good picture of the collection record, the losses and the condition of the installment paper. The revised Sales Finance Company Questionnaire, on page 2, Schedule C, provides in complete detail for an exposition of liquidation and losses, by classes of paper, for the period covered. Well-managed finance companies, under reasonably good economic conditions, have not sustained net losses on retail paper much in excess of 1% of the paper liquidated, our composite ratios for the six years ended December 31, 1941, showing a range from .68% to .92% for five of the years; in 1938, when conditions were unsettled, it rose to 1.70%. In recent years the credit experience has generally been quite satisfactory, with the composite ratios since 1947 showing a range of net losses to retail paper liquidated of from .44 per cent to 1.57 per cent. In calculating the ratio only retail paper—that is, discount and small loans—should be included, eliminating such outstandings as assigned accounts, inventory loans, etc. Care should be exercised that only receivables charged to the reserve are used in the calculation and not the Profit and Loss provision.

Ratios (27) to (34) incl.

In order to understand properly the operations of a finance company, it is important to know the proportions of the various types of paper handled. This series of ratios breaks down into its component parts the volume of paper purchased during each year. Occasionally, finance companies change the general character of their operations and this is graphically portrayed in these calculations.

Ratios (35) and (36)

Over the years, installment credit based on new cars has had a materially better loss record than that based on used cars—hence, it is interesting to note the proportion of retail volume in each category as well as the trend over the years.

Ratios (37) to (43) incl.

Under previous restrictions of Regulation "W", it has not been necessary to calculate these percentages, which bring out the proportions of sub-standard paper—standard terms calling for a down payment of not less than 33-1/3%, with maturities of not longer than 18 months in the case of new car paper and 12 months for used car paper. Experience has proved that over the years, under free competitive conditions, those companies which purchased the more substantial proportions of sub-standard paper had the greater losses; the value of ascertaining company policies in this regard is therefore important.

Ratios (44) to (63) incl.

These ratios are statistical in character but they have considerable value in indicating trends in the business. For example, they show the types of invested capital, the volume figures and outstandings as well as the trends in operating income and expense totals in comparison with total volume, and the source of total resources. Probably one of the more significant ratios is concerned with the percentage of net profits shown for the year as compared with the average net worth, the average being computed by totaling net worth at the beginning and at the end of the year and dividing by two.

COMPOSITE RATIOS — INSTALLMENT SALES FINANCE COMPANIES

	Statement Date	12/31/35	12/31/36	12/31/37	12/31/38	12/31/39	12/31/40	12/31/41	12/31/47	12/31/48
% Cash to Debt.....	1*	16.33	19.27	18.24	28.26	21.77	16.57	16.23	17.33	18.82
		2.60	2.39	2.33	1.5	2.04	2.66	2.96	3.63	3.72
Ratio—Debt to Working Capital.....	2	to 1	to 1	to 1	to 1	to 1	to 1	to 1	to 1	to 1
% Retail Receivables to Total Receivables	3	72.33	78.15	73.69	64.43	62.89	64.59	69.19	54.20	65.54
% New Car Retail to Total Retail.....	4	65.56	—	56.59	46.02	45.76	49.39	50.28	25.72	24.91
% Used Car Retail to Total Retail.....	5	34.44	—	43.41	53.98	54.24	50.61	49.72	74.28	75.09
% Wholesale to Total Receivables.....	6	15.50	11.25	12.49	13.03	10.66	13.78	11.61	15.22	13.45
% New Car Wholesale to Total Wholesale	7	78.87	—	66.29	63.74	59.33	66.38	69.73	49.95	44.90
% Used Car Wholesale to Total Wholesale	8	21.13	—	33.71	36.26	40.67	33.62	30.27	50.05	55.10
% Other Receivables to Total Receivables	9	15.36	13.93	13.82	22.54	26.45	21.63	19.20	30.58	21.01
% Retail maturing in 6 mo.....	10	62.09	56.14	56.70	59.05	54.64	52.72	54.80	57.22	52.38
% Retail maturing in 12 mo.....	11	92.19	87.19	88.30	89.52	86.04	84.31	86.60	88.83	83.94
% Retail maturing over 12 mo.....	12	7.18	12.81	11.70	10.48	13.96	15.69	13.40	11.17	16.06
Debt—In Dollars, including holdbacks, rebates, tax reserves, etc.....	13	—	—	—	—	—	—	—	—	—
% Cash, wholesale, retail and other receivables maturing in 6 mo. to debt	14	108.78	103.48	103.13	130.40	104.40	95.23	92.81	93.07	89.49
% Cash, wholesale, retail and other receivables maturing in 12 mo. to debt	15	143.76	140.24	141.26	169.93	142.69	130.98	128.68	123.53	120.77
No. of months' collections required to pay debt net of cash and Wholesale Paper.....	16	5.5	5.79	5.82	3.87	5.62	6.73	6.92	6.56	7.65
Bank lines	17	—	—	—	—	—	—	—	—	—
% Bank borrowings to Debt.....	18	66.53	61.95	69.43	63.53	65.94	66.23	69.60	84.20	80.33
% Open market borrowings to Debt.....	19	25.54	28.36	19.40	22.25	25.01	24.59	21.36	9.61	10.06
% Unused Lines to open market notes....	20	—	—	—	723.5	262.52	154.49	161.54	378.26	385.67
% Balances delinquent over 60 days to Total Retail	21	.77	.50	.56	.90	.66	.53	.68	.63	.63
% Capital loans to Net Worth.....	22	2.40	.79	1.41	2.01	1.93	1.68	1.14	5.24	3.46
% Repossessions to Net Worth.....	23	1.57	1.44	2.84	1.42	.95	1.44	.85	.93	.86
% Reserves for losses to Total Retail....	24	2.87	2.66	2.61	2.94	2.61	2.52	2.86	2.05	2.56
% Deferred Income to Total Retail.....	25	7.46	6.96	7.08	6.97	7.29	7.05	6.48	7.26	8.03
% Loss to Retail liquidated.....	26	.75	.92	.89	1.70	.82	.92	.68	.48	.66
Volume of Business for the Period										
% Automobile Paper—Retail	27	—	—	—	—	—	—	—	—	—
% Automobile Paper—Wholesale	28	—	—	—	—	—	—	—	—	—
% Industrial & Home Equipment—Retail	29	—	—	—	—	—	—	—	—	—
% Industrial & Home Equipment— Wholesale	30	—	—	—	—	—	—	—	—	—
% Personal Loans	31	—	—	—	—	—	—	—	—	—
% Accounts Receivable	32	—	—	—	—	—	—	—	—	—
% Rediscounts	33	—	—	—	—	—	—	—	—	—
% Unclassified	34	—	—	—	—	—	—	—	—	—

Analysis of Retail Automobile Paper

% New Car Retail.....	35	58.85	60.10	54.00	39.94	46.49	49.94	48.14	—	—
% Used Car Retail.....	36	41.15	39.90	46.00	60.06	53.51	50.06	51.86	—	—
% New Car Paper maturing longer than 18 months.....	37	2.26	29.73	34.82	19.79	33.53	46.26	46.73	—	—
% New Car Paper with down payment of less than 33⅓%.....	38	20.95	38.57	22.26	17.54	25.18	32.39	33.01	—	—
% New Car Balloon, excluding demonstrator paper.....	39	7.55	9.58	5.57	6.56	8.51	10.47	11.03	—	—
% Demonstrator paper.....	40	10.98	8.09	8.49	13.36	9.51	9.70	8.89	—	—
% Used Car Paper maturing longer than 12 months.....	41	20.65	38.81	49.18	46.40	52.70	60.23	63.05	—	—
% Used Car Paper with down payment of less than 33⅓%.....	42	20.65	37.09	27.92	21.88	31.83	40.03	37.16	—	—
% Used Car Paper with final installment larger than preceding ones.....	43	4.18	7.13	5.71	4.90	5.53	6.52	5.69	—	—
		(000 omitted)								
Preferred or Preference Stocks.....	44	\$ 54,108	\$ 74,758	\$ 86,202	\$ 71,936	\$ 64,904	\$ 44,734	\$ 40,045	\$ 39,872	\$ 42,954
Common Stock.....	45	115,373	129,182	162,845	162,984	153,747	188,311	180,510	151,991	154,673
Surplus-Earned and Capital.....	46	73,117	92,410	105,599	110,286	109,713	116,016	117,530	144,302	197,318
Net Worth.....	47	242,598	296,350	354,646	345,206	328,364	349,061	338,085	336,165	394,945
Debentures.....	48	25,000	170,742	204,443	178,876	173,721	211,107	184,249	105,196	334,766
Total Net Worth and Debentures.....	49	267,598	467,092	559,089	524,082	502,085	560,168	522,334	441,361	729,711
Volume for period.....	50	2,695,385	3,526,548	3,903,241	2,213,464	3,058,688	4,059,779	4,541,411	5,546,144	7,479,587
Total Outstandings.....	51	876,343	1,279,772	1,515,856	979,164	1,166,106	1,605,419	1,777,986	1,571,235	2,144,802
% Total expense including taxes to gross income.....	52	69.23	70.82	71.23	77.41	76.13	77.20	78.85	81.41	80.91
% Net profit to Retail purchased.....	53	2.95	2.92	2.98	3.01	2.31	2.11	1.96	1.33	1.55
% Net profit to Average Net Worth.....	54	16.22	15.54	15.02	9.51	9.44	10.54	11.03	12.60	16.24
% Dividends to Net Profit.....	55	52.53	81.48	75.73	85.06	70.34	67.54	72.34	40.03	37.43
% Current Debt to Total Resources.....	56	63.58	62.27	63.35	51.01	59.24	63.19	65.57	70.55	68.66
% Long Term Debt to Total Resources.....	57	.39	3.60	2.56	3.55	3.69	4.86	4.71	7.15	9.22
% Unearned income, and loss reserves to Total Resources.....	58	6.74	6.99	6.41	6.66	6.56	6.44	6.45	5.93	6.35
% Net Worth to Total Resources.....	59	29.29	27.14	27.68	38.78	30.51	25.51	23.27	16.37	15.77
% Non-Current Assets to Total Resources...	60	2.52	2.05	1.71	2.57	2.41	2.03	2.07	2.83	3.68
% Gross Income to Total Purchases.....	61	5.83	6.29	6.38	8.32	5.98	5.71	5.40	3.44	4.22
% Net profit to Total Purchases.....	62	1.70	1.82	1.84	1.95	1.40	1.24	1.11	.64	.81
% Expense to Total Purchases.....	63	4.13	4.47	4.54	6.37	4.58	4.47	4.27	2.79	3.41

*Ratio numbers

COMPOSITE RATIOS — INSTALLMENT SALES FINANCE COMPANIES

Statement	Date	12/31/49	12/31/50	12/31/51	12/31/52	12/31/53	12/31/54
% Cash to Debt.....	1*	20.35	17.05	17.04	17.02	16.44	18.07
		3.41	3.68	3.79	3.81	3.57	3.34
Ratio—Debt to Working Capital.....	2	to 1	to 1	to 1	to 1	to 1	to 1
% Retail Receivables to Total Receivables	3	74.88	77.45	67.21	66.66	70.66	70.68
% New Car Retail to Total Retail.....	4	34.32	44.00	33.12	28.08	37.00	50.35
% Used Car Retail to Total Retail.....	5	65.68	56.00	66.88	71.92	63.00	49.65
% Wholesale to Total Receivables.....	6	11.10	9.91	12.92	9.70	9.11	8.19
% New Car Wholesale to Total Wholesale	7	73.40	70.47	63.78	60.30	73.36	75.99
% Used Car Wholesale to Total Wholesale	8	26.60	29.53	36.22	39.70	26.64	24.01
% Other Receivables to Total Receivables	9	14.02	12.64	19.87	23.64	20.23	21.13
% Retail maturing in 6 mo.....	10	51.87	47.20	56.64	47.54	47.08	45.05
% Retail maturing in 12 mo.....	11	82.00	79.23	88.53	78.24	78.33	75.05
% Retail maturing over 12 mo.....	12	18.00	20.77	11.47	21.76	21.67	24.95
Debt—In Dollars, including holdbacks, rebates, tax reserves, etc.....	13	—	—	—	—	—	—
% Cash, wholesale, retail and other receivables maturing in 6 mo. to debt	14	89.49	81.32	91.92	81.94	81.10	80.64
% Cash, wholesale, retail and other receivables maturing in 12 mo. to debt	15	121.48	116.62	125.22	115.37	116.43	114.82
No. of months' collections required to pay debt net of cash and Wholesale Paper.....	16	7.63	8.98	7.15	9.03	8.98	9.18
Bank lines	\$ 17	—	—	—	—	—	—
% Bank borrowings to Debt.....	18	75.89	76.92	73.44	71.65	65.84	58.95
% Open market borrowings to Debt.....	19	13.02	10.48	11.41	14.35	14.13	17.34
% Unused Lines to open market notes....	20	341.88	308.25	317.08	281.66	364.30	377.02
% Balances delinquent over 60 days to Total Retail.....	21	.72	.31	.41	.37	.46	.24
% Capital loans to Net Worth.....	22	2.54	2.25	2.77	3.16	2.84	2.31
% Repossessions to Net Worth.....	23	1.44	.72	1.04	1.20	1.43	.92
% Reserves for losses to Total Retail.....	24	2.65	2.61	2.39	2.33	2.22	2.13
% Deferred Income to Total Retail.....	25	7.99	7.88	7.26	7.97	7.77	7.96
% Loss to Retail liquidated.....	26	1.57	.58	.44	.76	1.40	1.18
Volume of Business for the Period							
% Automobile Paper—Retail	\$ 27	—	—	—	—	—	—
% Automobile Paper—Wholesale	28	—	—	—	—	—	—
% Industrial & Home Equipment—Retail	29	—	—	—	—	—	—
% Industrial & Home Equipment— Wholesale	30	—	—	—	—	—	—
% Personal Loans	31	—	—	—	—	—	—
% Accounts Receivable	32	—	—	—	—	—	—
% Rediscunts	33	—	—	—	—	—	—
% Unclassified	34	—	—	—	—	—	—

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Analysis of Retail Automobile Paper

% New Car Retail.....	35	—	—	—	—	35.48	47.05
% Used Car Retail.....	36	—	—	—	—	64.52	52.95
% New Car Paper maturing longer than 18 months.....	37	—	—	—	—	83.32	86.20
% New Car Paper with down payment of less than 33 $\frac{1}{3}$ %.....	38	—	—	—	—	29.89	40.34
% New Car Balloon, excluding demonstrated paper.....	39	—	—	—	—	10.83	11.85
% Demonstrator paper.....	40	—	—	—	—	8.00	8.29
% Used Car Paper maturing longer than 12 months.....	41	—	—	—	—	85.95	79.63
% Used Car Paper with down payment of less than 33 $\frac{1}{3}$ %.....	42	—	—	—	—	30.98	27.28
% Used Car Paper with final installment larger than preceding ones.....	43	—	—	—	—	2.78	2.64

(000 omitted)

Preferred or Preference Stocks.....	44	\$ 42,433	\$ 56,832	\$ 32,012	\$ 26,409	\$ 26,676	\$ 34,126
Common Stock.....	45	155,238	158,348	161,363	186,974	210,900	215,082
Surplus-Earned and Capital.....	46	250,420	316,460	359,015	396,052	444,639	509,197
Net Worth.....	47	448,091	531,640	552,390	609,435	682,215	758,405
Debentures.....	48	672,578	826,772	924,909	987,769	2,004,587	2,128,779
Total Net Worth and Debentures.....	49	1,120,669	1,358,412	1,477,299	1,597,204	2,686,802	2,887,184
Volume for period.....	50	8,947,135	10,818,794	11,394,128	12,552,633	15,344,183	14,397,821
Total Outstandings.....	51	2,804,844	3,673,373	3,722,546	4,569,717	5,656,028	5,694,736
% Total expense including taxes to gross income.....	52	80.73	79.50	82.08	83.73	86.36	86.93
% Net profit to Retail purchased.....	53	1.88	1.92	1.78	1.48	1.37	1.46
% Net profit to Average Net Worth.....	54	15.38	17.37	14.96	14.37	12.54	12.33
% Dividends to Net Profit.....	55	39.15	38.64	41.13	44.80	51.85	50.47
% Current Debt to Total Resources.....	56	65.80	66.68	65.98	65.37	60.75	58.33
% Long Term Debt to Total Resources.....	57	11.41	10.60	11.68	12.43	17.37	18.40
% Unearned income, and loss reserves to Total Resources.....	58	7.04	7.27	6.66	7.42	7.11	7.06
% Net Worth to Total Resources.....	59	15.75	15.45	15.68	14.78	14.77	16.21
% Non-Current Assets to Total Resources...	60	3.45	2.88	3.11	2.62	2.94	3.07
% Gross Income to Total Purchases.....	61	5.15	4.98	5.32	5.50	6.13	6.71
% Net Profit to Total Purchases.....	62	1.00	1.02	.94	.88	.80	.83
% Expense to Total Purchases.....	63	4.15	3.96	4.38	4.62	5.33	5.88

*Ratio Numbers

SMALL LOAN COMPANY RATIOS

Ratio (1)

Small loan operations require a reasonably strong cash position to meet loan demands and to maintain balances fully commensurate with bank borrowings. In the past, small loan borrowings have been quite moderate in relation to the net investment in the business and since banks generally are now willing to make larger commitments to these companies, it becomes increasingly important that an adequate cash position be maintained. All funds available for the retirement of current debt should be included in cash and in computing the ratio, include in debt all current liabilities and all long term debt which is not specifically subordinated to current notes payable.

(1a) In view of the close relationship between cash and short term indebtedness, it is important to calculate a ratio excluding the long term portion—provided, of course, that long term debt is unsubordinated.

Ratio (2)

For many years the ratio of debt to net worth was the customary yardstick in measuring the financial position of a small loan company. While we believe that liquidity is a more important criterion, this ratio continues to have value in showing the over-all debt position. In calculating the ratio, include in debt all current liabilities and all long term debt which is not specifically subordinated to current notes payable, and eliminate from net worth intangible items such as good will.

(2a) Here again it is important to calculate a ratio excluding the long term portion—provided of course that long term debt is unsubordinated.

Ratio (3)

Small loan companies often carry investments and other assets of a non-liquid character, thereby reducing the amount of working capital available for small loan operations. It becomes important, therefore, to know the relation of indebtedness to working capital. All current liabilities and all long

term debt, which is not specifically subordinated to current notes payable, should be included in indebtedness. In arriving at working capital, include in current assets such items as all currently available cash, all current notes of customers taken in the regular course of business, cash value of life insurance, deducting from the total thereof the reserve for bad debts and deferred income (if the company has some discount paper) and any other reserves applicable to current assets.

(3a) As a supplementary ratio, eliminate from total unsubordinated debt the long term portion thereof and relate this amount to working capital.

Ratio (4)

In addition to indicating the average amount of loan receivables outstanding, this calculation is a step preliminary to determining the collection-debt factor (ratio No. 8) which we regard as one of the more pertinent ratios in analyzing the statement of a small loan company. The average is calculated by totaling the monthly trial balance figures of outstandings for each of the twelve months and dividing by 12.

Ratio (5)

The determination of average monthly cash principal collections is the second step necessary to the calculation of the collection-debt factor. Inasmuch as this ratio has to do only with cash principal receipts, all renewal paper should be eliminated.

Ratio (6)

Having obtained the average of outstandings and the average monthly cash principal collections thereon, we can now determine the percentage relationship so as to arrive at the collection factor, that is, an over-all ratio of cash principal collections to outstandings. It is, of course, obvious that this ratio is a very general one, which averages out seasonal swings, but in view of the great amount of work involved in spreading out the actual monthly maturities, this ratio represents a practical and reasonably accurate solution for determining the rate of collection.

Ratio (7)

In developing debt and liquidity ratios, we are concerned only with unsubordinated indebtedness; for credit purposes, properly subordinated debt is similar to preferred stock.

Ratio (8)

The theoretical liquidity of a small loan company can be properly determined only by the procedures customarily used in the case of a discount company, but inasmuch as the work of spreading the principal maturities of a small loan company is quite cumbersome due to the very small size of the average note, this method is not always required. If a small loan company has its records set up so that the spread of monthly principal maturities is available, this information should be submitted, particularly where discount paper is also handled. An alternative method is the use of the collection-debt factor which, however, does not yield a result comparable with the liquidity determined by the spreading of maturities. In applying the collection-debt factor, the total of cash and U. S. Government bonds at statement date should first be applied against total unsubordinated indebtedness, arriving thereby at net debt. Then, using the percentage developed in ratio No. 6 (the collection factor which is the per cent of average monthly cash principal collections to average outstandings) and applying this to the small loans outstanding at statement date, we arrive at an estimate of the amount of principal collections for the following month. This estimated amount of principal collections for the month is then applied to the amount of net indebtedness. Although the resulting number of months does not state the liquidity of the company (actual principal collections following the statement date would be on a declining rather than a level basis), it does express the relationship of the collection rate to net indebtedness (the collection-debt factor) and thereby serves as a basis for a comparison of the relative debt paying position.

(8a) If the company has unsubordinated long term debt which has been included in debt in calculating ratio No. 8, it is

also interesting to know the comparable period when applied to only the current portion of the indebtedness.

Ratio (9)

In order to finance the increasing volume of business available to them, small loan companies have, in recent years, borrowed more heavily in relation to their net worth and working capital than was the practice some years ago. Hence, it is important to know that adequate bank credit lines are available to them from a good list of banks.

Ratios (10), (11) and (12)

These ratios show, as to total unsubordinated debt (including such items as accounts payable and accruals), the percentage representing loans from banks and the percentage obtained from open market borrowings. Inasmuch as borrowings on the open market should merely supplement borrowings on established lines of credit with banks, it is important that this form of advance be limited to between 15 per cent to 20 per cent of total bank borrowings. A well-managed company will, at all times, limit open market borrowings so that unused lines are available in an amount ample to cover outstanding open market notes.

Ratio (13)

Due to the nature of its business, wherein a substantial portion of its outstandings represents renewal paper (that is, paper renewed with increased balances) a small loan company's receivables cannot be analyzed as to delinquency by the same standards as a discount company's paper. The most practical approach in measuring delinquent accounts is on the basis of recency of payment as it shows up the extent to which the accounts are active. In making advances to wage earners, cash lenders not infrequently have to forego installments periodically when there is a transition in employment or financial problems develop in the family unit. A well-intentioned borrower with a good record is entitled to this consideration even though he may never catch up with the original terms.

In the light of these facts, it appears proper to classify past due accounts on the bases of (a) *90 day accounts*—those accounts on which no collections of any kind have been received for 90 days or more; (b) *60-89 day accounts*—those accounts on which no collections of any kind have been received for 60 to 89 days; and (c) *"interest only" accounts*—those accounts on which interest and charges only were received in the last 60 days of the period. Accounts in this classification obviously have more vigor than those in the other two classifications. They are, nevertheless, "problem" accounts and in the normal course of events a number of them will become current, while others whose paying capacity does not improve will fall into the two poorer classifications. For many years a number of the prominent small loan companies have classified their past due accounts in this manner for their internal operating purposes.

Ratios (14) and (15)

Small loan companies operating in different areas show quite a variation as to size of loans, but practically all of them in recent years have shown sizable increases as a result of larger average loans predicated on the greater income of borrowers. The average amount of individual loan balances is determined by dividing the total amount of small loan balances at the statement date with the number of individual loans outstanding at that date. The average amount of individual loans made is determined by dividing the dollar volume of loans made during the year, including renewals, with the number of individual loans made during the year, whether original or renewal loans.

Ratio (16)

It is important that an adequate loss reserve be maintained, the adequacy of the reserve depending on the condition of the receivables, the conservatism of the company's charge off policy, the company's experience on losses and recoveries and general economic conditions. In a study of the adequacy of the loss reserves, comparison of ratio No. 16 should be made with ratios No. 17, No. 18 and No. 20.

Ratio (17)

The percentage of loss to average notes outstanding points out the charge-off policy of the company, for loss refers to receivables charged to the bad debt reserve (not the profit and loss provision), and this total is related to the average amount of notes outstanding, which is calculated by taking the average of outstandings for the twelve months as determined by monthly closings.

Ratio (18)

The percentage of recovery on loans charged off reflects the company's charge-off policies, for if recoveries are meager it is apparent that loans are not charged off until they are practically hopeless. Recoveries refer to amounts collected during the year on accounts charged off whether in the current year or in preceding years, using as a basis of comparison the total of accounts charged to the bad debt reserve during the year.

Ratios (19) and (20)

When an additional advance is made in the renewal of a loan, it usually signifies that the company was satisfied with the credit risk of the borrower at the time of the renewal. On the contrary, when a renewal is made without an increase of the unpaid balance, it usually signifies that repayment of the loan was not being made according to the original terms, and that a readjustment of terms was found necessary. In view of the very substantial volume of renewal paper in the small loan business, these ratios carry special significance in determining the grade of renewal paper on the company's books. The calculation of these ratios is based on the total volume for the period, comparing therewith the volume of renewal loans which had increases (19) and the volume of renewal loans on which no increases were made at the time of renewal (20).

Ratios (21) to (38) inclusive

These ratios are statistical in character but they have considerable value in indicating trends in the business.

SMALL LOAN COMPANY RATIOS

Statement Date	12/31/48	12/31/49	12/31/50	12/31/51	12/31/52	12/31/53	12/31/54	
% Cash to Debt.....	1*	19.95	19.92	18.52	18.53	19.67	18.83	19.21
Ratio—Debt to Net Worth.....	2	2.02 to 1	1.95 to 1	2.35 to 1	2.60 to 1	2.77 to 1	2.58 to 1	2.40 to 1
Ratio—Debt to Working Capital.....	3	1.81 to 1	1.74 to 1	2.05 to 1	2.19 to 1	2.27 to 1	2.06 to 1	1.89 to 1
Aggregate Average Outstandings of Loan Receivables—in dollars—from monthly trial balances	4	281,422	334,480	393,061	441,383	551,019	609,997	659,336
Aggregate Average Monthly Cash Principal Collections (renewals excluded) (ooo omitted)	5	25,131	28,255	31,058	36,504	43,132	44,847	46,111
% Average Monthly Cash Principal Collections to Average Outstandings (Collection Factor)	6	8.93	8.45	7.90	8.27	7.83	7.35	6.99
Debt—Total Unsubordinated—in dollars (000 omitted)	7	301,604	351,313	456,052	564,319	653,789	706,545	745,359
No. of Months' Collections required to pay net debt—applying % in ratio No. 6 to fiscal date outstandings....	8	6.36	6.62	8.01	7.12	7.55	8.22	8.04
Bank lines	9	—	—	—	—	—	—	—
% Bank borrowings to Debt.....	10	70.23	65.09	68.53	66.34	64.64	62.05	61.94
% Open market borrowings to Debt....	11	9.37	9.34	7.87	6.26	7.61	6.03	9.09
% Unused lines to open market notes...	12	404.03	352.67	709.77	700.24	810.55	877.24	505.31
<i>Past Due Accounts</i>								
% "90 day" accounts—no collections received for 90 days or more....			1.07	1.26	1.63	1.45	1.61	2.12
% "60-89 day" accounts—no collections received for 60 to 89 days	13		1.39	1.32	1.37	1.29	1.38	1.37
% "Interest only" accounts (accounts on which interest and charges only were received in the last 60 days of the period).....			1.80	1.57	1.73	1.33	1.46	1.52
Average Amount—individual loan balances—in dollars	14	187.00	188.00	193.85	203.00	234.00	245.00	251.00

Average Amount—individual loans made —in dollars	15	236.00	227.00	233.77	250.00	282.00	296.00	305.00
% Loss Reserves to Notes Outstanding..	16	4.60	4.01	3.80	3.58	3.65	3.61	3.68
% Loss to Average Notes Outstanding..	17	1.59	1.78	1.64	1.65	1.63	1.90	1.94
% Recovery on loans charged off.....	18	30.07	21.71	24.00	26.55	23.84	21.90	18.71
% Loans renewed with increases of un- paid balances	19	56.47	66.07	66.07	71.32	71.18	70.32	70.95
% Loans renewed without increases of unpaid balances	20	1.15	1.05	.83	.69	.74	.57	.59

000 omitted

Preferred or Preference Stocks.....	21	45,476	45,249	\$ 41,514	\$ 36,857	\$ 47,463	\$ 44,547	\$ 40,655
Common Stock	22	61,685	74,470	75,491	81,794	81,174	98,225	111,864
Surplus—Earned and Capital.....	23	71,225	74,653	102,424	110,727	134,349	146,779	157,671
Net Worth	24	178,386	194,372	219,429	229,378	262,986	289,551	310,190
Debentures	25	130,597	156,377	186,225	269,031	337,521	424,466	445,048
Total Net Worth and Debentures.....	26	308,983	350,749	405,654	498,409	600,507	714,017	755,238
Volume for period.....	27	860,121	954,364	1,056,008	1,365,230	1,473,931	1,599,616	1,642,046
Total Outstandings	28	461,951	518,712	639,827	755,989	888,369	972,887	1,044,083
% Total expense including taxes to gross earned interest, etc.	29	76.49	79.60	81.45	85.38	86.29	86.31	85.08
% Gross Income to Total Loans and Purchases	30	13.50	14.23	14.82	13.92	14.38	15.31	16.44
% Net Profit to Total Loans and Pur- chases	31	3.16	2.89	2.73	2.02	1.92	2.15	2.40
% Expense to Total Loans and Purchases	32	10.34	11.34	12.09	11.90	12.46	13.16	14.04
% Net Profit to Average Net Worth...	33	20.15	16.92	16.30	13.43	12.69	13.39	13.10
% Dividends to Net Profit.....	34	50.56	52.08	49.33	52.31	48.09	47.76	45.66
% Current and Long Term Debt to Total Resources	35	64.10	63.27	66.77	69.65	70.49	70.37	69.71
% Loss and Contingent Reserves to Total Resources	36	5.42	5.09	5.02	4.70	5.20	4.89	5.04
% Net Worth to Total Resources.....	37	30.48	31.64	28.21	25.65	24.31	24.74	25.25
% Non-Current Assets to Total Resources	38	3.00	3.30	3.40	3.34	3.30	3.32	3.15

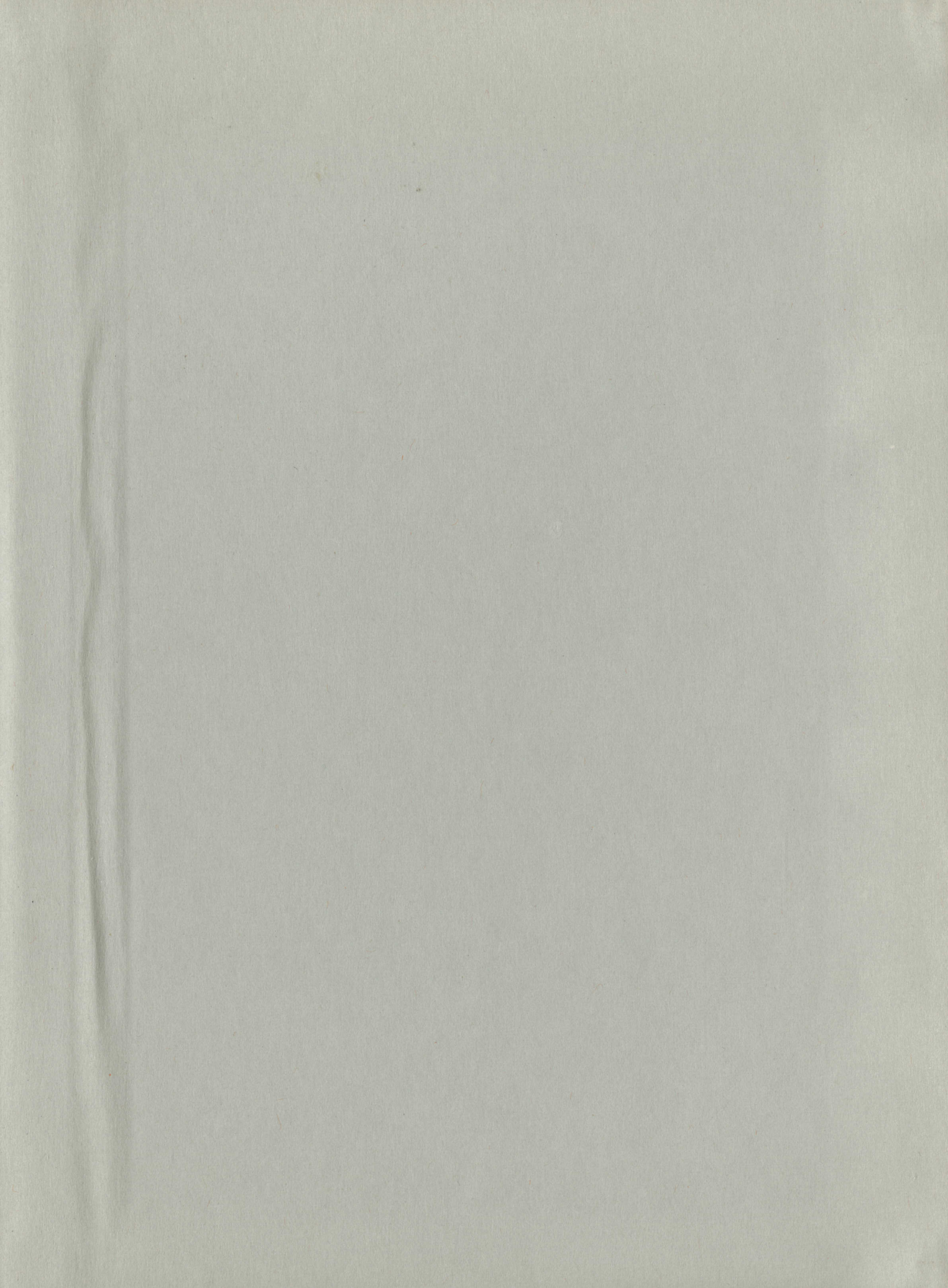
February 10, 1960

John Dickens Master's Thesis

Approved:

Frank M. Graner

Frank M. Graner
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