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CREDITS AND COLLECTIONS IN THEORY AND PRACTICE

CREDITS AND COLLECTIONS

IN

THEORY AND PRACTICE

BY

THEODORE N. BECKMAN, PH.D.

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FOURTH EDITION
SIXTH IMPRESSION

McGRAW-HILL BOOK COMPANY, INC.
NEW YORK AND LONDON
1939

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To My Daughters

GLORIA JUNE, MARILYN ADELE, *and* JOANNE

PREFACE TO THE FOURTH EDITION

Since the publication of the completely revised third edition of this book, early in 1938, a new bankruptcy law has been enacted by Congress. This law, known as the Chandler Act or the Bankruptcy Law of 1938, became effective Sept. 22, 1938. It has almost revolutionized the old law and the procedure under it, and many new phases have been added to it. It was therefore deemed advisable to revise thoroughly and completely the chapter on Bankruptcy, in conformity with the new law. This is primarily the reason for the new fourth edition of this volume.

The author has taken advantage of the opportunity and effected many other changes, most of which were necessarily of a minor character. Thus this edition represents an up-to-date treatment of the subject matter it contains.

THEODORE N. BECKMAN.

COLUMBUS, OHIO,
December, 1938.

PREFACE TO THE THIRD EDITION

Prior to the twenties, men and women had come into the credit field without previous preparation. Their entrance into this line of work was frequently not a matter of deliberate choice or planning. The special knowledge of the problems that presented themselves for solution had to be acquired largely through experience, and the attendant waste of time and money was appalling. As the credit system became more complex and its operation more intricate, progressive credit managers attempted to approach the subject scientifically. They have discovered that, although some of the special knowledge and skill can be secured only from experience, a fundamental background can be acquired through diligent study. Accordingly, many of the colleges and universities are at present offering courses in credits and collections, and classes in this and allied subjects are being conducted under the direction of the Institute of Credit of the National Association of Credit Men, in order to introduce those entering the profession to this tremendously important subject and to aid those already in the field in the acquisition of additional knowledge and a broader perspective.

To accelerate the movement in this direction, the author has felt that there was need for a book covering the general field of credit and collections which would serve both the college student and the man in business —a book which would not only present all the essential information on the subject, but which would also obviate the necessity of resorting to several volumes dealing with the various phases of it. This resulted in the first edition of this book, published in 1924. In it an attempt was made to cover the entire field of credit and collections, both foreign and domestic. Although special attention was given to mercantile credit, an effort was made throughout to maintain a proper balance between the different classes of private credit and to set forth in a logical and concise manner the theory underlying credit work and the lessons learned as a result of the experiences of practitioners in the field.

To keep abreast of the times and to reflect the author's added knowledge of the subject and more mature judgment, the book was thoroughly revised and a second edition was published in 1930. In this edition the contents were improved and strengthened at many points. Facts were brought up to date. Statistical evidence was presented as a means of measuring quantitatively the significance of the items to which they applied. The entire field of credit and collections was covered in a

more comprehensive manner and the book was better balanced, partly as a result of more extensive discussions of retail credit.

Among the entirely new features of the book were two chapters on instalment credit, a chapter on credit limits, a chapter on methods of controlling credit and collections, and a list of questions and problems at the end of each chapter. It was believed that these new features would make the book more valuable and flexible as a textbook in our colleges and universities, and more useful to the practical credit executive.

Since 1930, many important changes have taken place in the credit and collection field; much information bearing on the subject has been gathered by various agencies; and through constant study, experience, and observation the author has gained additional knowledge. To reflect all these is the purpose of this new, third edition of the book.

For this edition every chapter was thoroughly revised and the contents were brought up to date, statistically and qualitatively. The treatment is believed to be more critical and analytical and the discussions more rounded and penetrating. Some of the old chapters were completely rewritten, three new chapters were added, many new developments in the field were incorporated, and new and improved illustrative material was included. Among the new chapters are one which presents a general picture of consumer credit and one dealing with the operations of finance companies—sales and personal.

Greater emphasis throughout the book has been placed on consumer credit, in line with its increased importance in our credit structure. To enhance the teachability of the book, new questions and problems were included at the end of each chapter, many of the older ones were dropped or modified, the selected references at the end of each chapter were brought up to date and made more comprehensive, and at many points the material was improved in organization.

The sources of inspiration and direct material assistance in the preparation of this book, including the third edition, are too numerous to list. Much help has been received from university professors who have used the older editions as a textbook, from many credit men, from the managers of a number of interchange and adjustment bureaus, from trade and credit associations, and from recognized authorities on various phases of the subject. To all these the author acknowledges his indebtedness and expresses his appreciation for their unstinted cooperation.

THEODORE N. BECKMAN.

COLUMBUS, OHIO,
January, 1938.

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PART I

FUNDAMENTAL PRINCIPLES OF CREDITS AND COLLECTIONS

CREDITS AND COLLECTIONS IN THEORY AND PRACTICE

CHAPTER I

NATURE AND FUNCTIONS OF CREDIT

Essential Characteristics of Credit.—Definitions of credit are legion. The elements stressed in them are equally numerous and varied. Nevertheless, despite slight differences in the wording, practically all definitions of credit include, directly or by implication, two essential features: futurity and confidence.

Every credit relationship necessarily involves the deferring of one of the two exchanges in a business transaction. The buyer of goods on time or the borrower of money at the bank obtains the goods or money, as the case may be, without offering in return anything but a promise, sometimes secured in one of several ways, to pay an equivalent sum at a future time. Dealing in the future is always somewhat hazardous and, at best, uncertain; it, therefore, requires some degree of confidence on the part of the one who accepts a promise to pay in lieu of goods or services.

Credit Defined.—With but few exceptions, all definitions of credit may be divided into two groups, depending upon whether credit is viewed as an executed act, resulting in a right of the creditor to receive and demand payment, or as a power, both realized and potential. The former is largely a legalistic conception. It stresses the creditor's point of view. On that basis, credit is conceived as the other side of debt. It is a right to receive and demand payment, while a debt constitutes an obligation to make payment.

When thus viewed, the truth about credit and its position in our economic life is but partially revealed. According to such definitions which stress the legal aspects of the subject, credit does not exist until goods have been transferred or until services have been rendered and the debt actually created. It follows, therefore, that the credit of an individual or firm would always equal the amount of indebtedness actually incurred and that it would be improper to say that a "person's credit is good" or that a given firm "has unlimited credit," when, as a matter of

fact, no, or very little, credit has been utilized. Such restriction in the usage of the term would be contrary to established business parlance.

Obviously, it appears more reasonable to think of credit as a *power*, at least from the standpoint of borrowers, to obtain goods or services on the basis of the seller's belief that payment will be made as agreed. Thus, in its commonly understood business use, credit may be defined as the power to secure economic goods or services in return for a promised equivalent payable at a future time. The equivalent may consist of commodities or services. Usually, however, credit obligations are discharged by money payments or credits of more or less general acceptability, which ordinarily pass as money, as will be shown in the following pages. Thus, credit may be something potential or realized, that part which has been used becoming a debt, while the unutilized portion constitutes the residue of power up to the limit which is placed upon it by creditors or would-be creditors.

From the foregoing it would appear incorrect for a seller of goods to state "we do not give credit." Instead, he should have said "we do not accept credit," for it is the prospective buyer who gives or offers his credit in exchange for the merchandise purchased or services obtained. The seller may accept or reject this intangible commodity, depending upon whether or not, in his opinion, the buyer possesses the willingness and ability to redeem his promise at maturity. It is said that, in practice, credit is stood on its head when sellers on time are referred to as credit grantors; but, since it is difficult to inaugurate changes of this nature successfully, the practical application of the term is generally adopted. It seems, however, that it is possible to reconcile the practical usage with the definition laid down, by thinking of the seller as granting the buyer permission to use his purchasing power as represented by his ability and willingness to pay at a future time. It is probably because of this conception that John Stuart Mill defined credit as "the permission to use another's capital."

Various Conceptions of Credit.—In addition to the conceptions mentioned in preceding paragraphs, the term credit has many different shades of meaning. Few of the attempts at defining it otherwise than in the manner in which it is employed in the previous paragraphs are at once clear and comprehensive. Prendergast, for example, states that "credit is the confidence that is reposed in the ability and purpose of men to meet their obligations,"[1] while Laughlin defines credit as "the machinery invented to accomplish the purposes of capital."[2] Although the word "credit" is derived from the Latin "credo" (I believe), it is by no means synonymous with confidence, but simply indicates that con-

[1] PRENDERGAST, W. A., "Credit and Its Uses," p. 8.

[2] *Ibid.*, p. 10.

fidence is essential as a basis for a credit system or credit transaction. In the second case, "credit" is apparently confused with "credit system," the latter consisting of the mechanical aids by means of which credit transactions are conducted.

Credit is also frequently confused with a "credit transaction," which involves the actual transfer of goods or services for a future equivalent. Then, too, a person is "given credit" upon the completion or performance of a heroic deed, or something which is looked upon with favor. Finally, from the bookkeeper's point of view, credit is something owed on an account; it is the converse of debit.[1]

Relation between Credit and Wealth.—The layman ordinarily confuses credit with wealth. Such conception must be emphatically denied. Credit is not wealth, although it is frequently used as such. Wealth is any material or physical thing that satisfies a human want, provided that thing is limited in amount. From the viewpoint of the seller, credit is, technically speaking, a right to the future use of wealth. The distinction between the two economic terms may be easily demonstrated by an illustration as follows:

	X		Y		Z		Total Wealth
Case I	. . . . .	....	Bldg. valued.	$10,000	Cash	$10,000	$20,000
Case II.	Bldg. valued.	$10,000	Cash	$10,000	Mortgage	10,000	20,000

In the foregoing illustration it is assumed that, in Case I, X possesses no property or money with which to purchase the building from its present proprietor Y, and that Z, a building and loan association, has the money available for loans on property. The total wealth in possession of the three parties, as given, amounts to $20,000. Case II shows that X has borrowed on a mortgage from Z the sum of $10,000 with which to make payment for the building to its present owner. In this transaction, credit is extended by the third party to the first. The total amount of wealth is not changed, however. The physical property still consists of the two items: the building, and cash. The mortgage is but a piece of paper granting the mortgagee the right to the use of the building in case of default in payment of the debt incurred, in accordance with the terms of the agreement, by the mortgagor.

Although credit is not wealth, nevertheless a very close and intimate relationship exists between the two. Credit is indirectly an aid in production. It leads to an enhancement in wealth through the transfers of title which it involves, as will be shown in another connection. "Credit makes possible an increase in the production of wealth and

[1] For a discussion of the concept of credit among writers on money and banking and the confusion that has resulted from the ambiguity of the term, see L. Currie, "The Supply and Control of Money in the United States," Chap. 5, Harvard University Press, 1934.

facilitates the utilization of capital. However, it is neither wealth nor capital."[1]

It should be noted at this point that the foregoing discussion, involving a definition of the exact relationship between credit and wealth, is viewed entirely from the standpoint of society at large. Society may thus be likened to a parent corporation, the balance sheets of whose subsidiaries are combined into one consolidated statement. In this process, numerous items on the assets side of some of the subsidiary balance sheets are automatically eliminated and canceled by corresponding items on the liabilities side of the statements of other subsidiaries, and only the net results are recorded on the final report of the parent organization. A similar procedure would be followed were the total wealth of society compiled in one statement. Many items listed among the assets of some individuals or businesses would be canceled by similar amounts listed among the liabilities of others.

From the standpoint of individuals or business firms, credit represents wealth and is usually reckoned as such. Thus, we find that the largest portion of the wealth of most of our millionaires consists in a great measure in securities of different types, which are but instruments of credit.

Functions of Credit.—One of the essential services rendered by credit to society at large consists in substituting for the regular mediums of exchange. Its use in that capacity is highly essential, and at the same time most convenient. Without it, the volume of business transactions would be entirely contingent upon barter or upon the supply of the precious metals making up our mediums of exchange. The amount of "hard," or metallic, money is far from adequate in caring for our normal business needs. Besides, the delay incident to the transfer of either gold or silver in payment for individual purchases would make such a process both clumsy and inconvenient. Furthermore, the expense involved in physically transporting the precious metals and insuring them while in transit would be considerable, thereby adding to the already high cost of doing business.

Were credit arrangements to cease entirely, the loss due to depreciation, incident to the considerable handling of "hard" money, would have to be taken into account. The existing scarcity of these metals would thus be further accentuated. Indirectly, the effect of the total cessation of credit machinery would be to lower the culture of the people through the removal, for business purposes, of gold and silver from the arts.

Credit makes available for business purposes capital that would otherwise lie idle. Its use causes the thrifty individual to entrust his

[1] HAGERTY, J. E., "Mercantile Credit," p. 17.

savings to a banking institution, which, in turn, lends it out to enterprising individuals for productive employment, in exchange for a promise to repay the amount at a future date. As a result, capital is employed more productively, and the benefits derived therefrom inure to all parties concerned. The individual who, through the medium of the bank, finds a profitable place for the employment of his funds is benefiting from the transaction by the interest compensation advanced to him by the banker. The ultimate borrower, assuming competency on his part, gains from the process through his ability to earn, by use of borrowings, an amount in excess of what he must pay the banker for the privilege of using funds belonging to others. The middleman—the banker—naturally absorbs the difference between what he receives from the borrower and what he pays to the lender.

Another common form in which capital is made more productive is through investments in bonds. In purchasing such a security, the investor virtually lends his capital to the issuing corporation in exchange for its written promise to pay at a future time a proportional equity in accordance with the specific agreement under consideration. This makes possible a third function, *viz.*, the growth of large-scale enterprises, which is, in turn, responsible for the specialized industrial society of the present age. Through the proper employment of capital by borrowers, more commodities of a larger variety and superior quality are produced, resulting in a direct benefit to borrower and lender, and indirectly serving society through keener competition, better products, and lower prices.

A fourth important advantage derived from the use of credit is that it enables an entrepreneur to adjust the volume of capital to the varying needs of his business. He may, by this means, enlarge the volume of production by borrowing additional capital during periods of extraordinary business activity and reduce the amount of capital with the approach of dull periods.

Chief among the minor functions of credit are the following:

1. Credit makes for independence of thought and action. It causes people to save. Capital would be useless and profitless to those who possess no means of employing it themselves. The use of credit offers many opportunities for the employment of capital, thereby making possible a return on the savings, which, in turn, serves as an inducement and encouragement to the further development of habits of thrift.

2. Credit prevents hoarding on the part of those who desire to save and provide for emergencies. The use of credit not only places the principal in a more secure position in relation to theft and other hazards to which hoardings are subjected, but also secures an income on the investments, frequently sufficient for running expenses and further accumulations.

3. Credit bridges the gap between capital and labor, by enabling the latter to secure its assistance in an attempt at independent enterprise.

4. Credit enables individuals to acquire an education on borrowed funds, and it also permits the purchase of all sorts of consumption goods, including homes, pending the receipt of income and before the entire purchase price is available.

Volume of Credit Business.—One of the ways of gaging the importance of credit in modern business is the extent to which credit is utilized in the conduct of business transactions. Unfortunately, there are no exact data available on the subject. An approximate idea of the situation may be gathered, however, from an analysis of the figures compiled by Dr. David Kinley in a comprehensive investigation conducted by him for the National Monetary Commission. According to this authority, the average retail and wholesale business done with various credit instruments, including checks, approximated 86 per cent of the total.[1]

In view of the fact that this investigation was made as early as 1910, the data presented cannot be taken as a final barometer of the present-day uses of credit. The changing character of both retail and wholesale business during recent years has brought about corresponding and significant changes in the volume of credit since that date.

With the growth and development of the chain store type of retail organization and its attendant "cash-and-carry" system, there has come about a diminution in the use of open book accounts. Some of the newer types of wholesale institutions, such as cash-and-carry houses, drop shippers, and cooperative firms, have had a similar effect on the volume of credit business.

On the other hand, this tendency toward a reduction in the use of credit has been more than offset by changes of a different character. Instalment credit, for example, while not new, has had its greatest development since 1910. Credit stores operating on this basis have increased rapidly in size and number. Many of the most reputable stores now extend the privilege of the "convenient payment plan."

[1] "In the opinion of the writer it would not be far out of the way to assume that 60 per cent of the retail trade of the country . . . is paid for with checks. . . . So far as the writer is aware, no one has ever produced any evidence that invalidates the truth of the common belief that 90 per cent or more of the wholesale business of the country is done by means of credit paper. In getting at our final average we may therefore take the figures on the face of our returns as substantially correct. If now we take the percentage of checks in the retail payments at 60 and the percentage in the wholesale payments at 95 and weight these in proportion of the deposits returned for the two classes of dealers, we get 86 as the average percentage of retail and wholesale business done with checks and other credit paper." National Monetary Commission, "The Use of Credit Instruments in Payments in the United States," report compiled by David Kinley, pp. 197–198, U.S. Government Printing Office, 1910.

At the same time the use of the "charge account" in retail stores has shown steady growth in recent years. Furthermore, the use of checks in payment of obligations has grown considerably since 1910. Also, since Dr. Kinley's study was made, the Federal Reserve System has been established. As a result, the amount of commercial paper increased tremendously, followed by issues of Federal Reserve notes which are based in large part on such commercial paper.

In the agricultural field alone, a number of important events have taken place during the past two decades, all tending to increase the use of credit. Among these may be mentioned the amendment to the Federal Reserve Act of Sept. 7, 1916, which gave to banks in the Federal Reserve System the power to utilize acceptances, thus making available banker's acceptance credit for cooperative marketing purposes; the United States Warehouse Act, passed in 1916, facilitating the financing of products stored under the Act; the Agricultural Credits Acts of 1921 and 1923, providing two sets of financing facilities—the Federal intermediate credit banks and the national agricultural credit corporation; the establishment of the Federal Farm Board in 1929 with power to make loans to various cooperative associations; and the Farm Credit Administration, established in 1933 by President Roosevelt's executive order, which provides for agriculture land bank credit, production credit, intermediate credit, and credit for cooperatives—a complete credit system.

In fields other than agriculture, a number of new agencies were established as part of the New Deal inaugurated by President Franklin D. Roosevelt, with the purpose of injecting more life into our credit system. Among these may be mentioned the Reconstruction Finance Corporation which, though started by President Herbert Hoover, was extended in scope to gigantic proportions. Other examples of purely credit agencies created by the Federal government are the Federal Housing Administration, the Home Owners Loan Corporation with its several subsidiaries, and the Rural Electrification Administration.

On the basis of these changes it may be conservatively estimated that credit instruments are involved in 90 to 95 per cent of all business in the United States. Obviously, credit wields a mighty force in modern business activity. It permeates and penetrates into every filament and fiber of our economic structure and affects everybody, regardless of race, creed, or station in life. It is almost universal in its influence. Credit alone, probably more than any other single factor, is responsible for the rapid development of the greatest manufacturing industry in the world which not only supplies us with automobiles but which has also been responsible to quite a degree for the continued progress of our country and its people.

Commercial Failures and Credit Losses.—Credit is important from still another angle. Like any force, it may be constructive or destructive.

TABLE I.—COMMERCIAL FAILURES IN THE UNITED STATES, 1907-1936[a]

Year	Number of failures	Number in business	Percentage of total failing[b]	Aggregate assets, millions	Aggregate liabilities, millions	Percentage of assets to liabilities[b]
1907	11,725	1,418,075	0.83	138.5	197.4	70.18
1908	15,690	1,447,554	1.08	146.2	222.3	65.76
1909	12,924	1,486,389	0.80	102.8	154.6	66.47
1910	12,652	1,515,143	0.84	136.5	201.8	67.67
1911	13,441	1,525,024	0.88	124 5	191.1	65.17
1912	15,452	1,564,279	0.99	126.3	203.1	62.17
1913	16,037	1,616,517	0.99	174.7	272.7	64.06
1914	18,280	1,655,496	1.10	265.3	357.9	74.12
1915	22,156	1,674,788	1.32	183.5	302.3	60.69
1916	16,993	1,707,639	1.00	113.6	196.2	57.90
1917	13,855	1,733,225	0.80	103.5	182.4	56.71
1918	9,982	1,708,061	0.58	101.6	163.0	62 35
1919	6,451	1,710,909	0.38	67.0	113.3	59.17
1920	8,881	1,821,409	0.49	195.5	295.1	66.24
1921	19,652	1,927,304	1.02	409 0	627.4	65.19
1922	23,676	1,983,106	1.19	413 4	623.9	66.25
1923	18,718	1,996,004	0.94	388.4	539.4	72.00
1924	20,615	2,047,302	1.01	337.9	543.2	62.21
1925	21,214	2,113,312	1.00	248.1	443.7	55.90
1926	21,773	2,158,457	1.01	202.3	409.2	49.44
1927	23,146	2,171,688	1.09	256.7	520.1	49.36
1928	23,842	2,199,049	1.08	255.5	489.6	52.18
1929	22,909	2,212,779	1.04	226.0	483.2	46.77
1930	26,355	2,183,008	1.21	442 8	668.3	66.26
1931	28,285	2,125,288	1.33	434.9	736.3	59.07
1932	31,822[d]	2,076,580	1.53	509.1	928.3	54.84
1933	20,307	1,960,701	1.04	270.7	502.8	53.84
1934	12,185	1,973,900	0.62	154.2	264.2	58.36
1935[c]	11,510	1,982,905	0.58	94.0	183.0	51.37
1936	9,185	2,027,594	0.45	[e]	147.3	[e]

[a] Figures for 1907 to 1934, inclusive, from Statistical Abstract of the United States, 1935, Table 325, p. 288. (The abstract figures were obtained from Dun & Bradstreet, Inc., N.Y.)

[b] The data in these columns have been computed.

[c] The 1935 and 1936 figures, except the computed ones, were obtained from *Dun's Statistical Review*, July, 1937, published by Dun & Bradstreet, Inc., and from the Statistical Abstract of the United States, 1936, Table 334, p. 294.

[d] This figure "was a record total for any year since these reports were first compiled back in 1857." (*Dun & Bradstreet Monthly Review*, January, 1935, p. 18.)

[e] Not available.

The use of every device involves necessarily the possibility of abuse. So it is with credit. It is not always used wisely by the ultimate con-

sumer. Neither is it always used properly by the business man who utilizes it for purchases of goods and supplies and in borrowing from the bank or other financial institutions. Above all, credit has been much abused by the creditors themselves. Owing to their extreme laxity and carelessness in making credit extensions, they may cause speculation and overtrading which sometimes lead to fraud and embezzlement. Such laxity aids debtors to live beyond their means and increases extravagance, frequently with disastrous consequences.

It is this condition that has been at least partially responsible for the increase in the number of failures in recent years, even when the effects of the depression that reigned from 1930 to 1934 are completely discounted. From the figures shown in Table I it is evident that the average number of commercial failures was larger during the prosperous period of 1924–1929 than during any other similar period since 1907. In fact, the number of such failures in 1928 was the largest recorded up to that time. Furthermore, the liabilities reported by the commercial failures in 1929 were almost double the amount of all fire losses in the United States and Canada, the latter amounting in 1929 to $332,426,600.[1]

As might be expected, the largest number of failures ever recorded (such records dating back to 1857) occurred in 1932 when the full effects of the depression were felt in the business world. Naturally the number of failures decreased sharply after 1933, since most businesses in difficulty had already ceased operations during the preceding four years, and relatively few new enterprises were started during the period; also general business conditions improved considerably after 1933.

It should be noted that the figures concerning commercial failures are but approximations, inasmuch as the mercantile agency uses the number of firms listed in its rating, or reference, books as a basis. While the rating books of the general mercantile agency are the most comprehensive available, they do not by any means include all concerns engaged in business.

The failure statistics published by Dun & Bradstreet, Inc., do not include banking failures and suspensions of other fiduciary institutions. Then, there is the technical definition of a business failure to be considered. Ordinarily, a failure, to be included in these figures, must involve some loss to creditors.

It is also important to bear in mind that the actual losses due to commercial failures can be obtained only after the assets of the failing concerns have been deducted from the total liabilities. Such assets are usually seized for the benefit of creditors, and the proceeds from their sale are applied as dividends to the creditors. The value of the assets of failing concerns at time of failure has been generally appraised at

[1] *Bradstreet's*, Jan. 11, 1930, p. 39.

about one half of the total liabilities of such concerns. Even during the depression year of 1933, the assets of the failing business enterprises were valued at $270,729,920 as compared to liabilities of $502,830,584. Similarly, for 1934 the assets of the commercial failures during that year were appraised at $154,225,653 as against liabilities of $264,248,176.[1] From the recovered assets must, of course, be deducted all costs of administration, which are sometimes so considerable as to leave nothing or very little for the creditors.

To the losses from commercial failures must be added many others, since commercial-failure statistics do not include failures of professional men or of stockbrokers and real estate dealers. Nor do such figures cover losses from bad debts, which are taken as a matter of policy, in order to retain good will, even in the absence of any serious financial deficiency on the part of debtors. Furthermore, these figures do not include bad-debt losses resulting from credit extensions to household consumers. When all these figures are added to the tremendous costs involved in the various attempts to collect overdue accounts, then the magnitude and the importance of the credit problem from the standpoint of society at large become apparent.

Need for Skill in Credit Management.—All authorities agree, however, that the abuses of our credit system as reflected in the tremendous losses from bad debts and in the social costs incident to elaborate credit and collection machinery are not necessarily inherent in a credit economy, and that the fault lies not so much with the credit system per se as with the use made of it and the efficiency with which it is operated and maintained. Credit abuses are dangerous. They tend to undermine the entire structure upon which business is founded. When used properly, the advantages of credit inure to the benefit of all concerned; it is a veritable blessing. But, when it is abused, it is not only apt to deal a crushing blow to the credit grantor, but will at the same time work hardships on the honest consumers and business men, and, in the end, will tend to shake the confidence which is now so generally prevailing in our business relationships.

Credit has practically ceased to be a privilege granted to the purchaser of goods by the graciousness and generosity of the seller. The vendor is no more granting favors to his customers, by allowing them to buy on credit, than a bank is extending a favor to its borrowers. The bank is in business to make loans, and stores are in business to sell merchandise. But, inasmuch as the desired volume cannot be reached when sales are made strictly on a cash basis, credit becomes an indispensable sales stimulant. It is no longer a privilege; it has practically become a necessity.

[1] *Dun & Bradstreet Monthly Review*, January, 1935, p. 23.

Whether or not credit should be extended to one customer and refused to another is a matter for the judgment of a credit expert. Similar discretion and judgment must be used in determining the amount of credit that should be extended and the means to be used in enforcing payment. The tremendous force of credit should not be meddled with by unskilled hands. It should be placed in the hands of those who can manipulate it in a way which would make the sales curve rise and at the same time cut losses to a minimum. The more efficient credit management becomes, the less likely are the abuses to be repeated, and the greater will be the benefits from our credit system.

Credit and the Business Cycle.—The oscillating movement of business, commonly known as the business cycle, which has attracted so much attention during the immediate postwar reconstruction period and during the world-wide depression which began in 1929, has been variously pictured and charted, depending upon the number of stages or periods into which it has been divided.

According to most authorities, the business cycle has been divided into four principal stages, following the shape of a wave and characterized by a crisis, depression, revival, and prosperity, the first of which is usually very brief and dramatic. In still other instances, the business cycle is conceived of as consisting of two alternate periods of dullness and prosperity, the former characterized by an abnormally large number of failures and liquidations and the latter by general buying movements. Wesley C. Mitchell views the businesss cycle as a wavelike pattern, consisting of four distinct phases: revival, expansion, recession and contraction.

A number of different theories have been advanced in an attempt to explain the causes of business cycles. Some of them are cosmic in character. In this group are included Jevons's "Sunspot Theory," according to which economic fluctuation is caused by variations in sunspot activity, and Moore's "Rainfall Theory," which relates the business cycle to the 8-year cycle of the planet Venus. A second group of explanations may be termed psychological either from the standpoint of the entrepreneur, as viewed by such authorities as Pigou and Schumpeter, or from that of the consumer, as exemplified by Aftalion's theory of "Diminishing Utility." However, the third group of explanations of the causes of business cycles appear to be the most plausible and are known as institutional explanations. According to these, depressions may be caused by maladjustments between income and prices (part of Hobson's theory, also similar to the income theory advanced by Foster and Catchings); by maladjustments between the production of consumers' goods in relation to the production of producers' goods (chief exponent of this theory is Spiethoff, although Sombart also advanced it); by maladjustments between capital

accumulation and the production of capital goods, as advanced by Cassel; by maladjustments between the prices of producers' and consumers' goods early advanced by Carver; by overproduction, as represented by Aftalion; by the discrepancy between profits and current capitalization, as represented by Veblen; and by a number of theories which center around the subject of credit. Hawtrey's explanation of the bank-credit theory of business cycles is notable in this respect. Keynes also places much emphasis upon the credit factor, and even Veblen's and Lescure's explanations, which center around the profit idea, focus much of their attention upon the volume of credit that is available at the different stages of the business cycle.[1]

It is interesting to note that a number of the theories so far advanced in explanation of the causes of business cycles relate to the credit factor, either directly or indirectly. Of this group, at least two may be mentioned in some detail.

According to Professor Thorstein Veblen, a rise in prices (which may be caused by an increase in demand for supplies on the part of heavy purchasers or by a sudden discovery of gold) brings about increased activity. On a rising market everybody feels confident, optimism is the prevailing keynote, large profits are earned by all, still larger profits are anticipated, and investments in plant and machinery are increased correspondingly. Values of properties rise, and this fact makes them more readily acceptable as collateral behind loans, hence expansion of credit. As long as the confidence in anticipated higher earnings lasts, so long will the upward movement of the process continue. Finally, the bottom drops out and the process undermines itself. As anticipated margins of profit are not realized, prices begin to tumble. Pessimism replaces optimism, credit for the most commendable enterprises is refused, collateral shrinks in value, loans are called in, and collections are made closer. Deflated prices enhance the difficulty in meeting obligations, and liquidations follow.

Professor Irving Fisher asserts that the upward movement of the business cycle is greatly accelerated by the lagging adjustment of interest rates to prices on a rising market. As prices advance, interest rates rise, but not so rapidly. Borrowers take advantage of this opportunity and increase their borrowings. Since such loans are made through banks, an enhancement in deposit currency is effected, which, when coupled with a more rapid circulation of money and credit instruments, causes prices to climb still higher. The process continues until interest rates are effec-

[1] For a more detailed discussion of causes of business depressions, see W. C. Mitchell, "Business Cycles," pp. 6–18, University of Columbia Press, 1913; and his article on "Business Cycles," in the Encyclopaedia of the Social Sciences, Vol. III, pp. 92–106. See also E. Wagemann, "Economic Rhythm," Chap. XXIV.

tively adjusted, when the reverse process begins and the downward movement of the business cycle commences.

To remedy the situation, several suggestions have been made. And the important thing to bear in mind is that none of these proposals makes any attempt to remove the various stages of the business cycle completely, for it has been justly concluded that crises, for instance, are not "sudden catastrophes interrupting the normal course of business," but are treated as normal occurrences inherent in our present-day money-economy system. No less than 20 depressions have occurred in the United States alone since 1857, and all of them with remarkable regularity, each major cycle culminating every 7 or 10 years in a crisis followed by a state of dullness and inactivity of varying length. What these plans aim to do is to *control* the business cycle properly, so that peaks of prosperity may be lowered and valleys of depression raised, with a view to equalizing or stabilizing business conditions and buying movements.

To eliminate the deep fluctuations and iron out the enormous folds, it has been suggested that, just prior to the big business boom preceding the peak of prosperity, interest rates be raised through the Federal Reserve System with a view to preventing undue expansion.[1] It is now regarded as extremely doubtful whether such a method can prove effective in preventing business declines. Another plan consists in the use of governmental and railway purchases as a balance wheel. It is based on the belief that public works should be contracted for during depressions and that long-range planning could and should be applied to railroads, public utilities, and even large private industries. Unemployment insurance is still another remedy. Government planning of business is another possible remedy, which was tried to a limited extent in connection with the so-called "New Deal" started in 1933. Finally, it is believed that greater knowledge of current business conditions coupled with better business forecasting is likely to reduce considerably the expansion peak and correspondingly raise the valley of depression.

From the foregoing it is obvious that credit is dangerous when out of proportion to available capital. Business is sound only to the extent to which credit is sound, and vice versa. Credit apparently is one of the principal controlling factors in business. Credit men can contribute a sizable share toward the alleviation of the sufferings incident to the violent fluctuations referred to in previous paragraphs by scrutinizing credit risks more carefully during and at the beginning of a business boom This practice would obviate the necessity of adopting an extremely rigid policy when the depression is finally reached. They should always bear

[1] MITCHELL, W. C., "The Crisis of 1920 in the United States," paper read before the American Economic Association on Dec. 27, 1921; see also E. Wagemann, "Economic Rhythm," Chap. XXIII.

in mind that good times do not last forever, and that inferior business conditions are likely to coincide with the periods in which payment is expected from debtors.

Through a continual improvement in credit methods and a keener appreciation on the part of credit grantors of the essential causes of depressions, it should be possible to eliminate excessive peaks and depressions and to minimize the disastrous effects of crises. Credit men should ever remember that abuse of the credit system and an unsound credit policy make speculation possible, maintain unprofitable enterprises, cause waste and extravagance, and generally pave the way to failure and ruin.

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Questions and Problems

1. What is credit? How may it be characterized? In what way do the legal and business concepts of credit differ?

2. When a store operates on a credit basis, does it give or accept credit? Explain.

3. How and in what ways does credit affect you as an individual, both directly and indirectly?

4. The interdependence, introduced into modern business by credit, subjects our economic system to derangement every time business men make unwise credit decisions. How does this statement illustrate the importance of credit? In what other ways may the importance of credit to modern business be demonstrated? Explain.

5. If you were asked to ascertain the total loss from bad debts in the United States, how would you proceed to obtain the desired figure?

6. Should losses from bad debts be decried or are they desirable? Explain.

7. What effect does credit have upon the medium of exchange? How does credit differ from money? From cash? From capital? From wealth?

8. The Progressive corporation issued and sold $500,000 worth of bonds. How would the ownership of these bonds affect the wealth of the investors? What effect did the issuing of the bonds have upon the wealth of society? Explain.

9. "It is good business to borrow money for working capital needs." Do you agree? Why?

10. If credit were entirely eliminated, what would be the effect upon the total volume of business? The scale of business operations? The volume of savings? The cultural level of the people?

11. From the standpoint of the creditor, is credit a privilege or necessity? What is it from the point of view of the debtor? Explain.

12. Does a credit system tend to favor a socialistic or a capitalistic regime? Why?

13. What should be the attitude of a credit manager toward customers and applicants for credit during the various stages of the business cycle? Why? Is it "natural" to follow such a policy?

14. In interpreting the position of the business cycle, what indices can be used to good advantage and from what general sources can they be obtained?

15. Is credit a blessing or a curse? Explain.

CHAPTER II

FORMS OF CREDIT INSTRUMENTS

Definition and Characteristics.—To comprehend properly and fully the principles underlying credit work, one must familiarize himself with the meaning and uses of the different types of credit instruments. The instruments of credit must not be confused with credit itself. They are evidences of obligations to pay in money or goods at a future time. They supply evidence that credit has been extended. Such evidences may or may not be in writing; they may be explicit or merely implied. It is of utmost importance, however, to bear in mind that all credit instruments possess certain common characteristics. They all have definite earmarks by which they can be readily recognized. All of them involve the element of time or futurity, risk, and a debtor-creditor relationship.

It is this yardstick that justifies the assertion that stocks, for example, are not credit instruments. While stocks deal with the future and hence entail considerable risk to their possessors, they do not represent in the slightest any debtor-creditor relationship. The purchaser of stocks does not lend his money to the issuing corporation; he merely invests in it, and thus becomes part owner and not a creditor.

Classes of Credit Instruments.—Credit instruments are the tools in credit work, a knowledge of which is essential to effective credit management. They may be divided into two classes: instruments of general or unlimited acceptability, and instruments of limited acceptability. Instruments of the first division are universally acceptable, because of the virtual guarantee by the Federal government. They are a part of our money and currency system, generally acceptable in the country in which they are issued. The second division comprises all other forms of credit instruments, with which credit managers are particularly concerned.

It is not intended to discuss in this treatise, in detail, any of the credit instruments of general acceptability. A great deal has been written in various specialized books on money and banking. A brief treatment, nevertheless, may prove useful and profitable to the student of credit.

CREDIT FORMS OF UNLIMITED ACCEPTABILITY

The forms of credit which are generally acceptable in the United States represent an important part of our currency and money system in

circulation, in the Reserve Banks, or in the Treasury. They include treasury notes of 1890 which were retired long ago but of which about $1,180,000 are still outstanding, United States notes or greenbacks, national bank notes, Federal Reserve bank notes, Federal Reserve notes, subsidiary silver and minor coins. Prior to the New Deal reform of 1933, only greenbacks and, of course, also gold and gold certificates and silver dollars were full legal tender. Since that date, however, it appears that all kinds of money enjoy a full legal-tender status with no limitation on the amount. Since that time, too, gold has been nationalized, and all monetary gold withdrawn from the public. Because of that the gold reserve required back of some of the paper money adds nothing to the soundness of such money but merely serves as a check on the amount that can be issued.

United States Notes.—These notes, commonly known as "greenbacks," came into existence during the Civil War period. They were issued as a forced loan and the security behind them consisted merely of the general credit of the Federal government. A total of $450 millions was issued originally, of which approximately $346 millions are still outstanding. They have been redeemable in gold from 1879 to the spring of 1933, when gold was nationalized, the redemptive feature withdrawn, and the President empowered to expand the issue to $3 billions.

National Bank Notes.—In 1865 the new national banks were given a monopoly of note issue against government bonds deposited in the United States Treasury. In 1935 these notes were officially retired, but there are still outstanding around $769 millions of this paper money.

Federal Reserve Bank Notes.—Under the provisions of the Federal Reserve Act of 1913, national banks were allowed the privilege of retiring the national bank notes which they previously issued. To maintain a market for the government bonds and at the same time prevent a reduction in the volume of money in circulation the Federal Reserve Banks were authorized to buy the bonds from the national banks and issue Federal Reserve bank notes against them. These notes, too, are now in the process of retirement and only about $84 millions are outstanding.

Federal Reserve Notes.—Thus the major task in making exchanges must be borne by the Federal Reserve notes, which are obligations of the Federal government and are authorized by the Federal Reserve Act. Their main purpose was to provide an elastic currency which can be readily expanded or contracted with the requirements of business. Through the Federal Reserve agents the twelve Federal Reserve Banks can secure these notes by depositing at least 40 per cent of their value in gold certificates and for the remaining 60 per cent commercial paper and bills discounted by member banks may be offered or even government securities.

Are Bank Notes Credit Instruments?—It is frequently argued that bank notes are not credit instruments, because they are used as money or currency. Nevertheless, it seems that, although they are universally as acceptable as gold itself would be, they are no more synonymous with gold than are bonds of corporations or promissory notes of individuals whose reputation for paying promptly is established beyond the shadow of a doubt. To prove this contention, it is but necessary to look into the early history of our nation, when wildcat banks were plentiful, and bank notes were carefully scrutinized and valued in direct proportion to the reputation of the bank whose name they were bearing. The only reason why bank notes constitute, at the present time, an accepted part of our monetary supply is because of the virtual guarantee of these notes by the national government, and the fairly sound banking structure, particularly since the establishment of the Federal Reserve System and later supplemented by the Federal Deposit Insurance Corporation. Even now, banks are not immune from failure, as will be shown later in the chapter.

CREDIT FORMS OF LIMITED ACCEPTABILITY

The remaining credit instruments may be properly subdivided into promises to pay and orders to pay. The former group includes book accounts, bank deposits, promissory notes, and bonds. The latter classification comprises checks and drafts of all kinds, including acceptances and letters of credit.

Promises to Pay

Book Accounts.—The book account is probably the oldest form of credit instrument. Even in primitive times, records were kept of commodities loaned. When a consumer purchases goods from a retail dealer and has them "charged," the only evidence of the transaction is an entry on the retailer's books debiting the customer with the amount under consideration. In many stores this evidence of the obligation is supported by a sales slip of the transaction which may be signed by the customer. Again, when a retailer buys goods from a manufacturer, wholesaler, commission house, or other source, the transaction is usually evidenced merely by an entry of the charge in the ledger of the vendor, and the invoice for the amount is forwarded to the buyer. When the invoice is paid, the deal is closed. Supporting evidence in such cases may be had in the form of a written order, the invoice, the bill of lading, or a signed delivery receipt. The amounts of credit extended to customers on open account are regarded by creditors as accounts receivable, and those entered on the books of debtors are accounts payable.

Although the record of the debt on the books of the creditor gives the latter a right of action against the customer for the value of the goods, the book entry is rarely as satisfactory as a written acknowledgment of the debt on the part of the debtor. More disputes as to the amount of indebtedness are likely to arise than when a promissory note or other written evidence is given for the amount. Furthermore, while the book account may be sold or assigned and the buyer or the assignee thereof has the same right of action against the debtor that the original creditor had, such action is often regarded with suspicion, for it frequently denotes financial weakness on the part of the seller or assignor of such accounts. It is also at the same time difficult and inconvenient to discount accounts receivable and borrow money on them, whereas other forms of credit instruments are normally discounted at the banks.

Open book accounts are the simplest form of credit, however, and the effect of their use is to stimulate sales, to minimize the time required in making settlement for small purchases in retail stores, and to do away with the necessity of carrying large sums of money for cash payments.

Bank Deposits.—A considerable proportion of our circulating medium of exchange is composed of bank deposits. These may be demand deposits, subject to withdrawal upon demand, or time deposits which can be withdrawn only upon due notice of such intention in advance. Most of the deposits made in commercial banks are of the former type, while those made in savings banks and in building and loan associations are of the latter variety. Upon deposit of funds in a banking institution, all the depositor receives as acknowledgment of the debt on the part of the bank is a duplicate record of the account on the institution's books. Thus the depositor exchanges his funds for the bank's promise to pay at a future time, and the credit transaction takes the form of a book account; hence, bank deposits are fundamentally not unlike open book accounts arising out of commercial transactions.

Promissory Notes.—A negotiable promissory note is an unconditional promise, in writing, made by one person to another, signed by the maker, promising to pay on demand or at a certain or determinable future time a definite sum of money to order or to bearer (see Fig. 1). Promissory notes are given by purchasers in payment of goods, or by borrowers in exchange for funds or credit extended to them by lenders. They are among the most popular credit instruments and may be either negotiable or non-negotiable. If all the requirements outlined in the definition are fulfilled, the instrument is negotiable. The promise must be in writing and signed by the maker; it must be an unconditional promise to pay a definite amount of money; the maturity date must be either fixed or determinable; it must be payable to order or to bearer, and not to a particular person or firm; and, finally, the instrument

No. ..... Due..... NOTE .....193..... $.....

I

..... after date, for value received, we jointly and severally promise to pay to the order of

.....At.....

..... DOLLARS

In UNITED STATES gold coin, or its equivalent, with interest after maturity at the rate of eight per cent. per annum, payable quarterly.

On the non-performance of this promise, or upon the non-payment of any liabilities of the undersigned, or any or either of us, to said payee, or to the legal holder hereof, or in case of insolvency, bankruptcy or failure in business of the undersigned, or any or either of us, or in the case an application is made for or there is an appointment of a receiver, assignee, referee, trustee in bankruptcy, creditor's committee or guardian for the undersigned, or any or either of us, then and in any such case, this note and all other liabilities of the undersigned, or any or either of us, to this payee, or to the legal holder hereof, shall forthwith become due and payable, at the option of the holder hereof, without demand or notice. The undersigned, or any or either of us, do hereby authorize and empower the said payee, or the legal holder hereof, at its option at any time to appropriate and apply to the payment and extinguishment of any of the above named obligations or liabilities, whether now existing or hereafter contracted, all property, securities or monies given unto or left in possession of the said payee, or legal holder hereof, by the undersigned, or any or either of us, and any and all monies now or hereafter in the hands of said payee, or legal holder hereof, on deposit or otherwise to the credit of or belonging to the undersigned, or any or either of us, whether the said obligations or liabilities are then due or not due.

And we do hereby authorize and empower any Attorney-at-Law, in the State of Ohio, or elsewhere, in our names and behalf, or in the name and behalf of any or either of us, to appear before any Court in said State of Ohio, or elsewhere, at any time after this obligation becomes due, in an action thereon, and waive process and service thereof, and without notice, confess judgment against us or any or either of us, in favor of payee, or legal holder hereof, endorsee, or assignee of the said note, against us or any or either of us for the amount that may appear to be due thereon, for principal and interest, damages and costs of suit, and five per cent. attorney's commission if collected by process, and to waive and release all errors in the judgment so confessed, and all petitions in error, to waive and release all right and benefit of appeal, and any and all proceedings to set aside, vacate, open, suspend, stay or reverse such judgment, or any execution issued for the collection thereof.

.....

Address .....

175 B .....

.....

FIG. 1.—Unsecured promissory note.

must be delivered. Not until a promissory note is delivered does it create an obligation or right of action, except in case of a holder in due course.

The promissory note is an excellent evidence of debt. It practically eliminates all disputes regarding the amount owed by the debtor, the date when payment must be made, the amount of discount allowed, etc. It is an effective means of enforcing prompt payment of bills. Notes are usually paid at maturity or renewed under favorable conditions, whereas book accounts are often neglected and the due date thereby extended. Furthermore, most promissory notes are negotiable and, therefore, more readily transferable by indorsement and delivery. The fact that promissory notes may be transferred a great many times causes them to perform the function of a medium of exchange. Such function is greatly facilitated by the indorsement of the payee, which makes it a double-name paper, and by the fact that a third innocent party, namely, a *bona fide* purchaser, is ordinarily free from all the defenses which may be advanced against the original payee. Lastly, promissory notes can be used as collateral for loans obtained from banks more readily than can book accounts.

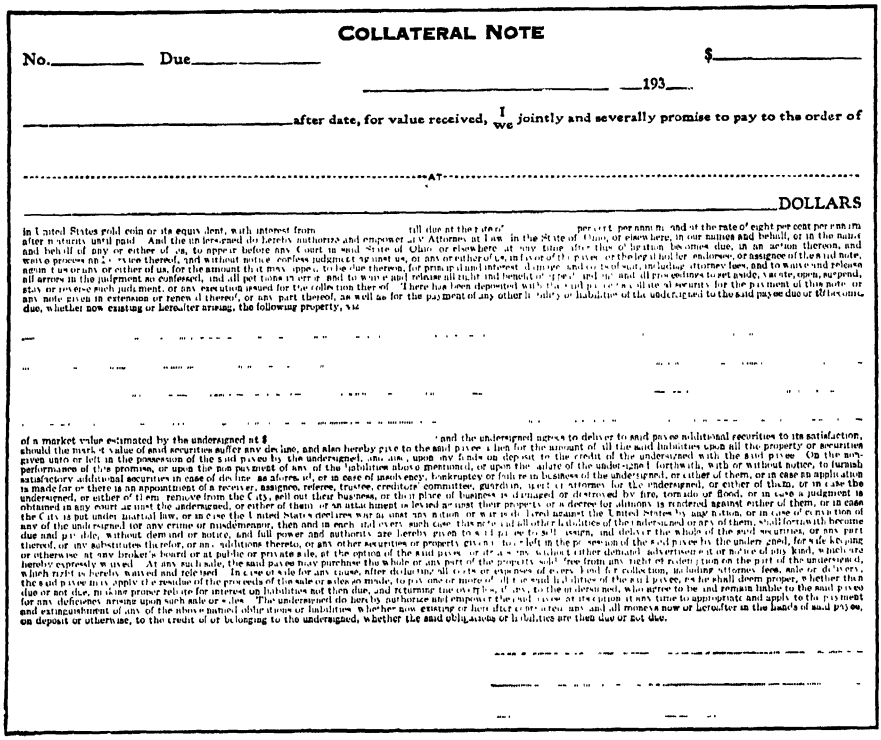
Notwithstanding the advantages of promissory notes over book accounts as a form of credit instrument, from the standpoint of the creditor, the latter are more extensively employed. Consumers seldom give promissory notes in exchange for goods purchased from retailers, unless an instalment transaction is involved. The same observation, though to a lesser degree, applies to dealings between retailers and wholesalers or between wholesalers and manufacturers. It is still uncommon for a merchant to give a promissory note to the seller in the ordinary course of business, save when the account is past due and an extension is granted on that basis, or when the customer is regarded as an inferior credit risk.

The limited use of promissory notes in settling accounts between merchants is due primarily to the use of "cash discounts." Many merchants are anxious to pay cash within a specified period of time and receive cash discounts. If a note is to be given, it is difficult to determine the exact amount when it is not known definitely whether or not the option of paying the bill before due and receiving a cash discount will be exercised.

Another explanation of the limited use of promissory notes lies in the ever-growing tendency on the part of merchants to buy in small quantities and frequently, and thereby increase stock turns. It is obviously inconvenient to settle frequently by note for small amounts. Lastly, it is to the advantage of buyers to use open book accounts instead. Adjustments are more easily secured before the bill is paid when no written evidence of the debt is given.

However, in borrowing from banks or other financial institutions the promissory note is the standard form of credit instrument. The same applies to commercial paper sold in the open market through note brokers. These notes may be secured (see Fig. 2) or unsecured (see Fig. 1).

Bonds.—A bond is a written promise to pay a definite sum of money at a fixed time in the future and a certain rate of interest. In the case of income bonds, however, payment of interest is contingent upon the extent of the excess earnings over and above the interest payments on all



COLLATERAL NOTE

No._____ Due_____ $_____

_____ —193—

_____after date, for value received, I / we jointly and severally promise to pay to the order of

_____AT_____

_____DOLLARS

in United States gold coin or its equivalent, with interest from _____ till due at the rate of _____ per cent per annum; and at the rate of eight per cent per annum after maturity until paid. And the undersigned do hereby authorize and empower any Attorney at Law in the State of Ohio, or elsewhere, in our names and behalf, or in the name and behalf of any or either of us, to appear before any Court in said State of Ohio or elsewhere, at any time after this obligation becomes due, in an action thereon, and waive process and service thereof, and without notice confess judgment against us, or any or either of us, in favor of the payee or holder hereof for, endorsee, or assignee of the said note, as in law or any or either of us, for the amount that may appear to be due thereon, for principal and interest, damages and costs of suit, including attorney fees, and to waive and release all errors in the judgment so confessed, and all petitions in error, and to waive and release all right and benefit of appeal and the said all proceedings to set aside, vacate, open, suspend, stay or reverse such judgment, or any execution issued for the collection thereof. There has been deposited with the said payee as collateral security for the payment of this note or any note given in extension or renewal thereof, or any part thereof, as well as for the payment of any other liability or liabilities of the undersigned to the said payee due or to become due, whether now existing or hereafter arising, the following property, viz

_____

_____

_____

of a market value estimated by the undersigned at $_____ and the undersigned agrees to deliver to said payee additional securities to its satisfaction, should the market value of said securities suffer any decline, and also hereby give to the said payee a lien for the amount of all the said liabilities upon all the property or securities given unto or left in the possession of the said payee by the undersigned, and also upon any funds on deposit to the credit of the undersigned with the said payee. On the non-performance of this promise, or upon the non payment of any of the liabilities above mentioned, or upon the failure of the undersigned forthwith, with or without notice, to furnish satisfactory additional securities in case of decline as aforesaid, or in case of insolvency, bankruptcy or failure in business of the undersigned, or either of them, or in case an application is made for or there is an appointment of a receiver, assignee, referee, trustee, creditors' committee, guardian, agent or attorney for the undersigned, or either of them, or in case the undersigned, or either of them, remove from the City, sell out their business, or their place of business is damaged or destroyed by fire, tornado or flood, or in case a judgment is obtained in any court against the undersigned, or either of them, or an attachment is levied against their property or a decree for alimony is rendered against either of them, or in case the City is put under martial law, or in case the United States declares war or any nation or war is declared against the United States by any nation, or in case of invasion of any of the undersigned for any crime or misdemeanor, then and in each and every such case the notes and all other liabilities of the undersigned or any of them, shall forthwith become due and payable, without demand or notice, and full power and authority are hereby given to said payee to sell, assign, and deliver the whole of the said securities, or any part thereof, or any substitutes therefor, or any additions thereto, or any other securities or property given or left in the possession of the said payee by the undersigned, for safe keeping or otherwise, at any broker's board or at public or private sale, at the option of the said payee, or its assigns, without demand, advertisement or notice of any kind, which are hereby expressly waived. At any such sale, the said payee may purchase the whole or any part of the property sold free from any right of redemption on the part of the undersigned, which right is hereby waived and released. In case of sale for any cause, after deducting all costs or expenses of every kind for collection, including attorneys' fees, sale or delivery, the said payee may apply the residue of the proceeds of the sale or sales so made, to pay one or more of the said liabilities of the said payee, as he shall deem proper, whether then due or not due, no time being required for interest on liabilities not then due, and returning the overplus, if any, to the undersigned, who agree to be and remain liable to the said payee for any deficiency arising upon such sale or sales. The undersigned do hereby authorize and empower the said payee at any time to appropriate and apply to the payment and extinguishment of any of the above named liabilities, whether now existing or hereafter arising and all moneys now or hereafter in the hands of said payee, on deposit or otherwise, to the credit of or belonging to the undersigned, whether the said obligations or liabilities are then due or not due.

_____

_____

_____

FIG. 2.—Secured promissory note.

fixed-interest-bearing obligations. Another exception to the definition is that, in case of participating bonds, part of the interest payment is conditional upon the available net earnings of the issuing corporation.

Bonds may be issued by private corporations and by local, state, and Federal governments. These promises are under seal and vary in denomination from $50 to as high as $100,000. The most common denomination is $1,000. The rate of interest promised varies considerably, depending upon the nature of the security behind the instrument, the credit standing of the issuing corporation, the current rate of interest

at time of issue, and the life of the security. The chief difference between bonds and promissory notes consists in the length of life of the security. Obligations maturing within five years from date of issue are generally termed notes, while those running beyond that nominal period are bonds.

Bonds may be classified according to the type of the issuer, in which case they are divided into government (Federal, state, and municipal), railroad, public utility, mining, and industrial bonds; or on the basis of maturity date, in which instance they are segregated into short-term bonds, medium-, and long-term obligations. Short-term bonds usually mature within 5 to 15 years from date of promise; medium-term bonds have a life of 15 to approximately 40 years; and the life of long-term securities extends beyond this period.

The average investor and credit manager, as will be shown in the chapters on financial statement analysis, are interested not so much in the length of life of a bond and the type of industry from which it originates as in the nature of the security behind it. A classification of bonds according to security is therefore submitted, on which basis bonds are divided into those specifically and directly secured by property, and those which are secured largely or entirely by the general credit of the issuing, guaranteeing, or assuming corporation. The first class may be subdivided into (1) first or senior liens, including general first-mortgage bonds, divisional mortgages, and specific direct lien bonds; (2) secondary or junior lien mortgage bonds, including second and subsequent mortgages, general and consolidated mortgage bonds, and refunding mortgage obligations; (3) collateral trust bonds; and (4) equipment trust obligations. The second class consists of (1) obligatory promises, including receivers' certificates, assumed bonds, guaranteed bonds, joint bonds, and debentures; and (2) conditional promises, comprising income bonds and participating bonds.

Unless they are registered, bonds are easily transferable by indorsement and delivery and in many instances are negotiable. They can be utilized as collateral for loans and are especially valuable when listed on an important stock exchange, owing to the ready market in which they may be disposed of should need arise.

Orders to Pay

Checks.—Of the forms of credit instruments termed "orders to pay," the most generally used and, therefore, the most important is the check. It is a written order by a depositor on his bank, directing the bank to pay at sight a certain sum of money to himself or to order of some person or firm named thereon (see Fig. 3). Legally, checks are defined as drafts drawn on a bank, payable on demand.

The popularity of the check may be accounted for by the convenience it affords. While promissory notes and drafts are used for long-term payments, checks are employed for cash and immediate settlements. It is the most popular substitute for mediums of exchange, and its use is still on the increase, owing, undoubtedly, to the development of banking facilities and thrift on the part of the lower income groups of society. Final payment in the wholesale trade is almost invariably made by check, and the tendency on the part of consumers to adopt a similar practice is continuously growing.

Checks are negotiable instruments, are readily transferable, and one check may, because of its free circulation, be used in the cancellation of many obligations. It facilitates payment not only locally, but also

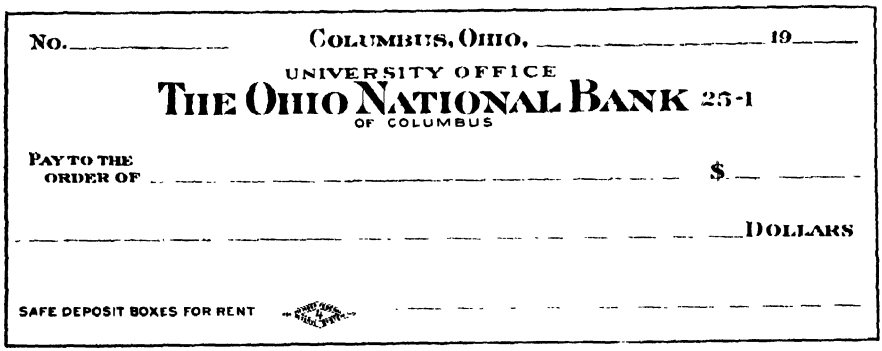


FIG. 3.—Bank check.

between debtors and creditors geographically far removed from one another.

Certified and Cashier's Checks.—When payment is to be made where the depositor is not known, or when goods are purchased on C.O.D. terms and the depositor wishes to establish the fact that he has sufficient funds in the bank upon which the instrument is drawn and that the check will be honored, one of two devices may be employed. The depositor may have the bank certify the check, in which instance the word "Certified," "Good," or its equivalent is stamped across the face of the instrument and the certification initialed by the bank teller or cashier. The certification adds to the value of the check, because payment is guaranteed by the bank, and the check becomes the bank's promise to pay.

Another method open to the depositor is to use the cashier's check. The cashier's check is the bank's order to pay, drawn upon itself and signed by the cashier, payable to the person or firm designated by the depositor.

In both instances, the amount of the check is charged immediately to the depositor's account, thereby eliminating all danger incident to lack of sufficient funds. When a bank refuses to honor an ordinary

check because of insufficient funds, the check not only becomes the direct promise of the maker and the direct obligation of all but the qualified indorsers, but also makes the maker liable to punishment under the Bad Check Law.

Bad Check Law.—The purpose of so-called "bad check laws," is to prevent and eliminate ultimately the pernicious practice of issuing and negotiating worthless or "rubber" checks, with intent to defraud. All states but Vermont and New Hampshire have enacted laws defining the crime involved in issuing checks under such circumstances and providing appropriate punishment. The act of issuing such checks is regarded variously as a misdemeanor, felony, larceny, an extension of the false pretense law, or as simply unlawful.

Under most of these statutes the mere nonpayment of a check, whether the check is presently payable or is postdated, constitutes evidence of intent to defraud, and of knowledge of insufficient funds or credit at the bank. (This law usually does not apply to checks given in payment of pre-existing or antecedent debts.) The presumption of fraudulent intent, however, is rebutted by payment to the holder by the maker or drawer of the face amount of the check plus costs and protest fees, usually within 10 days after receiving notice of dishonor, with reason therefor. On this account the law has been criticized, because it apparently gives a person an opportunity to condone his crime. The criticism is nevertheless unsound, for the crime exists, even though the amount due on such check is repaid and made good. This payment merely restores to the maker the common law presumption of innocence with respect to intent to defraud and knowledge of insufficient funds or credit at the bank, and places the burden of proof on the prosecution.

The principal reason for the exceedingly small number of convictions under these statutes is the difficulty in enforcing the law, since it is necessary to prove the existence of criminal intent at the time the act was committed before conviction can be obtained. Insufficiency of funds and dishonor of the check merely constitute prima facie evidence of an intent to defraud, but such presumption, as already pointed out, could be rebutted by payment of the amount due and by a direct denial, under oath, of such intent on the part of the maker, thereby leaving the burden of proof to the state. In this lies the chief weakness of the bad check laws, since they have for this reason failed to furnish mercantile creditors that degree of protection from the abuse which was anticipated would result from the enactment of such laws.

Are Checks Credit Instruments?—It is sometimes argued that, notwithstanding the fact that checks, bank notes, and all sorts of drafts payable on demand are commonly recognized as credit instruments, they are strictly not credit instruments at all. The basis of this contention is

that they are not evidences of deferred or postponed payment, which is an essential characteristic of all credit transactions.

Accordingly, it is argued that checks, for example, are credit instruments only in the sense that they must be honored by the bank before they become equivalent to cash; that there is no more credit involved in a transaction involving payment by check than there is in an ordinary cash operation when a brief interval elapses between the passing of the goods to the customer and the receipt of the money from him; and that neither of these transactions is really regarded in practice as a credit transaction, because neither involves a deferred payment.

Obviously, the analogy drawn between a cash transaction and one involving payment by check is far from satisfactory. Although the interval between the transfer of the goods and receipt of payment in cash is very brief in both instances, nevertheless the former involves no risk or confidence, depending upon the way in which it is viewed. The acceptance of a check, however, does involve considerable risk.

That risks are present when checks are accepted in payment in place of cash is evidenced by the tremendous losses incurred. It is estimated that worthless checks cashed by merchants cost them annually more than $100 millions. It is for this reason that business men exercise great precaution in accepting checks. Many merchants, for example, have inaugurated a policy of accepting only cash, or of limiting the amount of a check to be accepted from any one individual, and of confining such practice to the hours when checks can be verified by banks over the telephone. Furthermore, practically all checks exceeding a certain minimum must be approved by the credit manager or some other responsible executive.

The acceptance of a check, unless it be very small in amount, is directly contingent upon the confidence which a seller has (1) that the maker has the requisite funds to his credit in the bank on which the instrument is drawn, and (2) that it will be honored by the bank. The precautions taken by business men in accepting checks and the existence of bad check laws are sufficient evidence that these risks are real, but risks would not exist unless there were a time element present. It follows, therefore, that checks possess all of the characteristics of a credit instrument.

Even where checks are certified or signed by the cashier, confidence must be had in the bank's ability to pay upon presentation. To be sure, the soundness of our banking system has made such checks, as well as bank notes and bank drafts, almost as satisfactory a means of payment as cash. But is not this merely the result of increased confidence to a point where all risk is practically eliminated *under ordinary conditions?* It may even be argued that the confidence we have in our banking system is hardly justifiable. An examination of the figures in Table II will

convince even the most stubborn that the risk incident to dealing with banks is not negligible (see Table II). In fact, the percentage of banks suspending business operations even during prosperous years was greater than the percentage of commercial failures, as reported by the mercantile agencies. In the 9 years from 1921 to 1929, inclusive, no less than 766 national and 4,645 state banks went out of business. During the 4 depression years (1930–1933), 1,385 national and 5,319 state banks were suspended, involving an aggregate of $7 billions of deposits.[1]

TABLE II.– BANK FAILURES IN THE UNITED STATES, 1923-1936[a]

Year	Number of bank failures[c]	Number of banks in operation[f]	Percentage of banks failing[h]	Percentage of commercial failures[i]
1923	577	29,505	1.96	0.94
1924	664	28,806	2.31	1.01
1925	537	28,257	1.90	1.00
1926	814	27,367	2.97	1.01
1927	540	26,416	2.04	1.09
1928	446	25,576	1.74	1.08
1929	590	24,630	2.40	1.04
1930	1,193	22,769	5.24	1.21
1931	2,018	19,966	10.00	1.33
1932	1,166	18,390	6.34	1.53
1933	1,749[d]	15,011[g]	11.65	1.04
1934	984[e]	16,042	6.13	0.62
1935[b]	34	15,837	0.21	0.58
1936[j]	44	15,628	0.28	0.45

[a] *Twenty-first Annual Report of the Federal Reserve Board for* 1934. Figures are of Dec. 31 of the calendar year.

[b] From *Twenty-second Annual Report of the Board of Governors of the Federal Reserve System for* 1935, pp. 41, 134.

[c] Figures for 1923–1932, inclusive, from Table 79, p. 167 (derived). These figures do not include banks which were suspended but later reopened.

[d] Figures from Table 81, p. 168, Table 82, p. 169, and Table 83, p. 170. This figure includes 628 banks which were suspended, some of which may have been reopened later. The other 1,121 were liquidated or placed in receivership.

[e] From Table 82, p. 169, and Table 84, p. 171. This figure includes nonlicensed banks absorbed or succeeded by other banks. Of this figure, 927 banks were liquidated or placed in receivership while the remaining 57 were suspended, some of which may have been reopened later.

[f] Figures are from Table 60, p. 140, and are as of Dec. 31 of the calendar year. "Comprises all national banks in the continental United States and all state commercial banks, trust companies, mutual and stock savings banks, and such private and industrial banks as are included in abstracts issued by state banking departments. Also includes, beginning with June, 1934, private banks which . . . have agreed to examination by the Comptroller of the Currency or a Federal Reserve bank. . . . "

[g] Beginning with 1933, all figures (other than for mutual savings banks) relate to licensed banks only, with some exceptions as to nonmember banks.

[h] Computed.

[i] From Table I.

[j] *Federal Reserve Bulletin*, September, 1937, Table I, pp. 868, 921.

[1] UPHAM, C. B., and LAMKE, E., "Closed and Distressed Banks," pp. 4–5, The Brookings Institution, 1934.

No one can effectively deny the fact that checks are credit instruments involving a certain element of futurity, risk, and debtor-creditor relationship. They are credit instruments in form and promise directly or by implication to pay cash upon demand. Because of this element of postponed payment, though it be brief, there is a certain amount of risk,

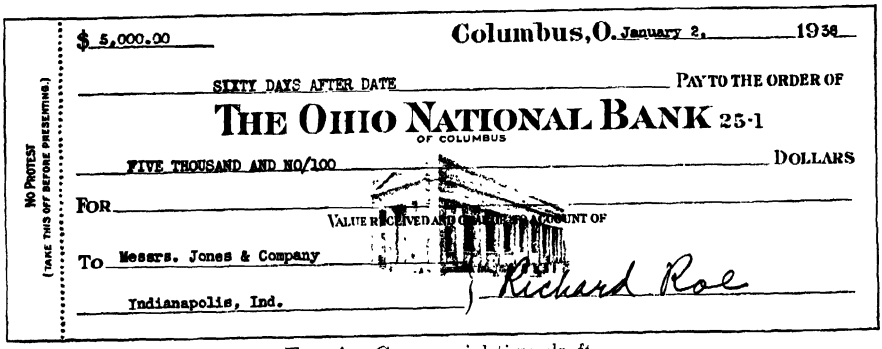


FIG. 4.—Commercial time draft.

which may be reduced to a minimum by virtue of sound legal and banking systems, that the instrument may not be convertible into cash. Whenever a doubt arises as to the possibility of conversion, as *it has arisen in the past*, the *difference* between such instruments and standard money (most of which is also in the form of credit) is forcefully revealed.

Drafts.— A draft is a written order by one party on a second party to pay to a third party a certain amount of money at sight or at a fixed time

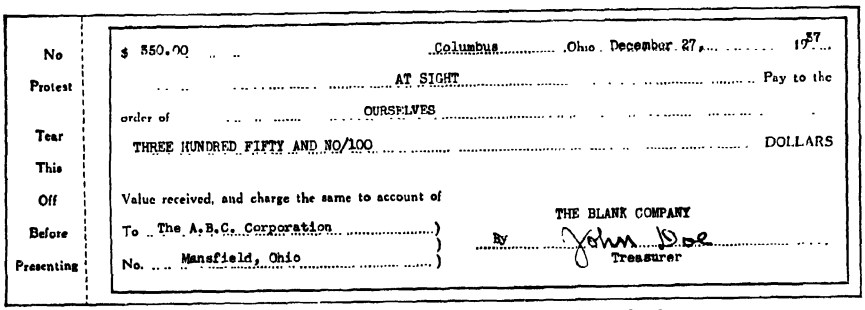


FIG. 5.—Common form of commercial sight draft.

in the future. There are three parties to every draft: the drawer, drawee, and the payee. Drawer and payee, however, may be the same person or firm (see Figs. 4 and 5).

Classification of Drafts.—Drafts may be classified according to date of payment, the character of the drawee, place where the parties reside, whether the draft is accepted or not, and whether it is free or documented.

Following the first basis, these credit instruments are divided into sight drafts and time drafts. The former are payable on presentation or a specified number of days after sight. Express and postal money orders are examples of this kind of draft. Time drafts are payable a stated number of days after date or after sight.

According to the character of the drawee, drafts are divided into commercial and bank types. The former are drawn by one merchant on another, while the latter are drawn by one bank on another.

Drafts are also divided on the basis of the places wherein the parties reside. This classification gives rise to domestic drafts, as when the parties reside within the United States, and foreign drafts, commonly known as bills of exchange.

Again, drafts may be classified into ordinary and accepted. The accepted instruments may, in turn, be divided into trade acceptances and bank acceptances.

Finally, drafts may be documented, as when bills of lading or other papers, such as warehouse receipts, are attached, giving title to the goods upon acceptance or payment of the draft. Undocumented instruments are free or clean drafts.

Express and Postal Money Orders.—These instruments resemble very closely checks and bank drafts. A postal money order, for instance, is an order issued by one post office on another, requiring payment of the amount specified therein to the person designated in the instrument, or to his order. The maximum amount for which a single money order may be issued in the United States is $100. When larger sums are to be sent, additional orders may be obtained, since no limitation is placed on the number of orders which may be drawn on any office on any one day. The rates vary from 6 to 22 cents, depending upon the amount of the order.

As in case of checks and bank drafts, the function of express and postal money orders is to transfer money to someone at a distance. They are purchased by the debtor, made payable to the person or firm specified on the face of the instrument, and are forwarded by mail to the payee. In case of postal money orders, the payee receives payment upon presentation of the instrument to the nearest post office. Express money orders may be cashed at the banks. Neither of these credit forms have to be returned to the place of the debtor before final payment; hence their superiority over ordinary checks.

Bank Drafts.—A bank draft is an order of one bank on another in which it has deposits or credit relations to pay a certain sum of money to a person or firm named in the draft (see Fig. 6). These drafts are used to facilitate the making of distant payments. This method of payment does not require drafts to be returned to the place of the drawer bank for

final payment. It also facilitates personal traveling, through the reduction of risks incident to transferring money to places where it is desired by depositors.

Bills of Exchange.—A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the giver, ordering the person to whom it is addressed to pay on demand or at a fixed or determinable future time a certain sum of money to order or to bearer. The payee may be the drawer of the bill or a creditor of the drawer. In each instance the drawer's account is debited with the amount paid.

These credit instruments are used extensively in the settlement of debts arising from foreign trade. Since the occasion that gives rise to such a draft consists in a business transaction, it is regarded as a comparatively safe form of credit. The common procedure followed in

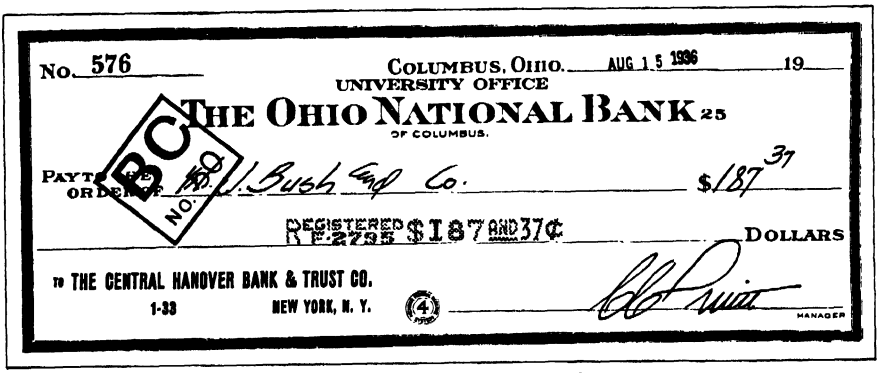


FIG. 6.—Common form of bank draft.

making settlement by the use of bills of exchange is for the seller of merchandise to draw upon the buyer, attach the draft to the various documents denoting shipment, and sell or discount the instrument at his local bank. This bank soon forwards the draft, with the documents attached, to its correspondent bank in the country of the buyer. The draft is then presented by the correspondent bank to the drawee for collection or acceptance, depending upon whether it is a sight draft or a time draft. If it is a time draft, it is accepted, and may then be sold to investors or other bankers until it becomes due.

Trade Acceptances.—A trade acceptance is a time draft or bill of exchange accepted by the purchaser or drawee by signing his name under the word "Accepted" across the face of the draft. The date of acceptance and the bank at which it is payable, together with the place of payment, are also commonly stated on the face of the instrument. Another difference between a trade acceptance and a commercial draft is that the former has on its face the following statement: "The trans-

action which gives rise to this instrument is the purchase of goods by the acceptor from the drawer" (see Fig. 7).

To the banks trade acceptances minimize the risk in the handling of commercial paper. They effect a substitution of double-name for single-name paper. Then the banks are able to rediscount this commercial paper, which is, in turn, utilized by the Federal Reserve Bank as a basis for the issue of Federal Reserve notes. Furthermore, trade acceptances are regarded as a good investment by banks and strengthen the position of their customers; and banks are not limited to 10 per cent of their capital and surplus, as when loans are made on single-name paper.

Because of the supposed willingness on the part of bankers to deal in them, trade acceptances can be readily discounted by the seller of mer-

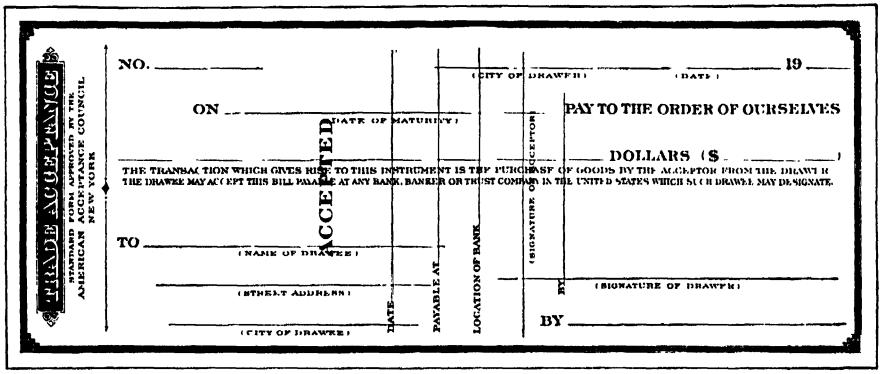


FIG. 7.—Trade acceptance in domestic commerce.

chandise. In doing so, the seller is not obliged to furnish the banks such a "cushion" or margin of safety as would be required when open book accounts are assigned. Immediate possession of funds from a sale of goods enables the merchant to operate with a smaller capital investment, which he can turn rapidly, and thereby reduce his cost of doing business. All questions pertaining to the taking of unearned discounts are at once completely removed. By admitting the correctness of the amount, the buyer is precluded from setting up any grievances or controversies to which a seller is normally subject when the mere evidence of the debt is an open book account. There is likely to result a diminution in the tendency to return merchandise, an evil which in some trades has already assumed enormous proportions. Above all, the use of trade acceptances in the settlement of debts tends to reduce the use of open book accounts, thereby placing credits on a higher moral plane (see Fig. 8).

The general adoption of trade acceptances is not without its objectionable features from the standpoint of sellers. In discounting a trade acceptance at his bank, the seller must indorse it. This means that the

merchant, by becoming an indorser for all of his customers, is contingently liable for all of their purchases from his house. Then, too, there is a tendency to convert customers, who discount their bills, into buyers by acceptance, the net result of which is to lengthen the credit period unduly. Lastly, it is said that payment for goods before they are received, as necessitated by the acceptance method of settlement, will tend to

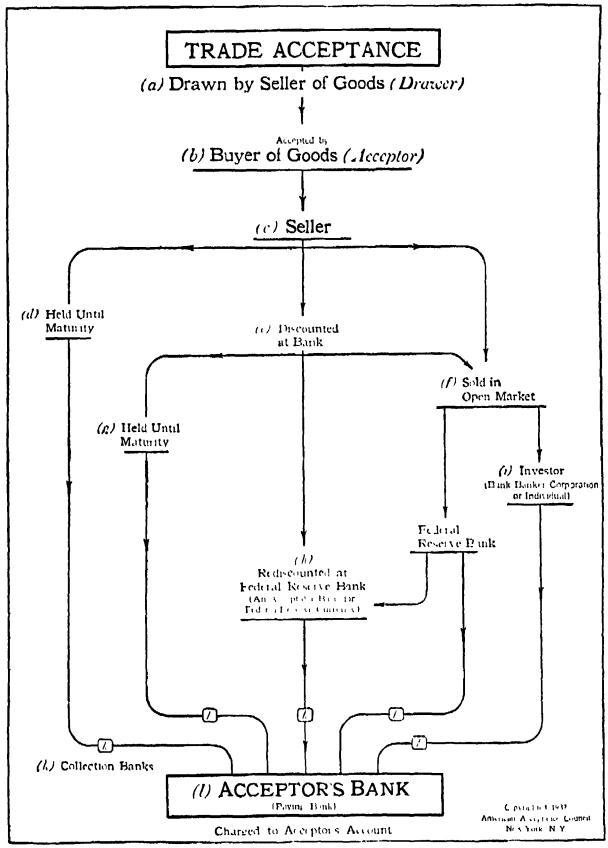


FIG. 8.—Possible routes which a trade acceptance may travel from its origin to maturity and liquidation. (*Courtesy of Robert H. Bean, formerly executive secretary of the American Acceptance Council, Letter of Apr.* 8, 1937.)

influence buyers to trade with the larger and more reliable houses, and thus eventually crowd out the smaller competing concerns. From the standpoint of the purchaser of goods, the trade acceptance offers some advantages but the objections are more significant as will be shown below.

During the first half of the past century the mercantile credit system of this country was based largely on the promissory note and the trade acceptance. Toward the latter part of the century the book account came into prominence, involving cash discounts as a means of stimulating

payment in advance of due date. This change was regarded in many quarters as undesirable. Consequently a number of attempts have been made to restore the trade acceptance to its former position.

Under the authority of Sections 13 and 14 of the Federal Reserve Act, the Federal Reserve Board encouraged the use of trade acceptances by establishing a discount rate on such acceptances "somewhat lower than that applicable to other commercial paper." Since the adoption of this regulation in 1915 the Federal Reserve Board and Banks have made efforts to further the use of trade acceptances and thereby develop what they regarded as a high-class double-name paper. The trade acceptance movement was sponsored during the World War as a device for mobilizing commercial credit, resulting in the creation in 1917 of the American Trade Acceptance Council. In 1919 this council was reorganized as the American Acceptance Council and its scope widened to include bank acceptances. After nearly 20 years of effort the council was finally dissolved in July, 1936.

The efforts to popularize the trade acceptance have met with indifferent success. One of the major reasons is that the trade acceptance is not adapted to transactions involving short periods of time. Second, it is not adapted to lines of trade in which purchases by customers are made in small amounts and at frequent intervals. For these reasons the acceptance has never been popular in the grocery trade and in other lines of business where the net credit period is 30 days or less and where customers have what may be termed "running accounts." Third, a buyer may not know in advance whether he will be able to take the cash discount or whether he will be forced to let the account run the full free credit period allowed by the terms of sale. Fourth, it is estimated that about 50 per cent of the buyers take cash discounts; hence, buyers by acceptance are likely to be the poorer risks. Fifth, it is felt that the use of the trade acceptance tends to convert discounting customers into buyers by acceptance, thereby tending to lengthen the credit period. The limited use of the acceptance may be further explained by the reluctance of merchants to change their habits of doing business.[1]

Finally, certain abuses have developed around the trade acceptance, such as using it to cover a past-due account, taking it from drawers who would not be given open-account credit, and extending credit to a buyer merely because he is willing to sign an acceptance.

Bank Acceptances.—A bank acceptance is a draft drawn upon a bank by a depositor or borrower, payable to a third party and accepted by the

[1] For a further discussion of the trade acceptance, see T. N. Beckman, "Mercantile Credit," Encyclopaedia of the Social Sciences, Vol. 10, pp. 329-333; and W. H. Steiner, "The Mechanism of Commercial Credit," Chaps. 7 and 8, D. Appleton-Century Company, Inc., 1922.

drawee. This instrument may be used advantageously by a buyer who wishes to buy on a cash basis but is unwilling to make payment until the goods are shipped, or until they have actually arrived. On the other hand, the seller may be unwilling to make shipment on an open account or upon a time draft, except at a great discount which is reflected in higher prices. This is especially true in foreign trade where buyers and sellers are not in close contact with one another and unfamiliar with each other's credit responsibility. Both parties may, however, be satisfied by the buyer having his bank pledge itself to accept and pay the seller's draft, provided all the terms of the transaction have been complied with. The buyer then makes arrangements with his bank to take care of his obligation on the due date. He thus secures a loan at a much lower rate than could be obtained otherwise.[1]

Bank acceptances may also be used for borrowing purposes in the general discount market. Thus, merchants or producers may store their products with a properly organized warehouse, deposit the warehouse receipt as security, and obtain the acceptance of a reliable bank. When the bills are thus accepted, a drawer can then sell them in the open market at the lowest rate of interest.

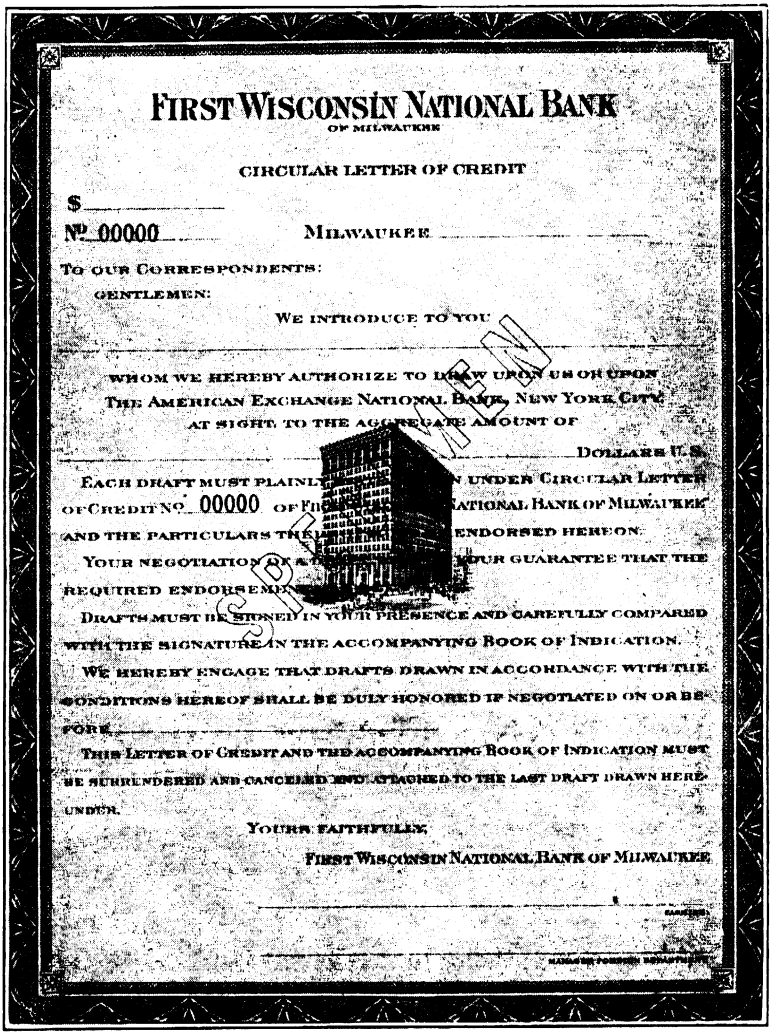
Traveler's Checks.— These checks can be obtained at practically every bank and from express companies. They are issued in four denominations ($10, $20, $50, and $100) and can be made up in any amount in book form, from which they may be torn as occasion requires. Traveler's checks are used for long-distance travel among strangers where the carrying of much gold or currency is unsafe. By the use of these instruments funds may be easily secured. All that is needed is to establish one's identity by signing one's name, which is then compared with the signature appearing on each check.

Traveler's Letter of Credit.—A traveler can also secure from his bank a letter of credit. A traveler's letter of credit may be defined as a request from a banker or firm to other banks or firms, with whom the former has credit relations or deposits, to advance money not exceeding the face value of the letter to the person named therein. It is the bank's agreement to accept the drafts of the traveler up to the face value of the letter, which is to be returned with the last draft. Its chief function is to facilitate the transfer of funds to foreign countries for the convenience of travelers. The purchaser of such an instrument has the right to draw at different times from different banks or firms up to the amount stated in the letter (see Fig. 9).

Each time a sum of money is drawn by the holder of the letter, the instrument is presented to the official making payment. He then notes

[1] FITZGERALD, J. A., "Making Use of a Bank," pp. 218–219, Henry Holt & Company, 1923.

on the reverse side of the letter the date when paid, by whom paid, and the amount drawn. The holder is also required to sign his name on a separate piece of paper so that his signature may be identified, by comparison, with that appearing on the letter of indication which is attached



FIRST WISCONSIN NATIONAL BANK
OF MILWAUKEE

CIRCULAR LETTER OF CREDIT

$_____

№ 00000 MILWAUKEE _____

TO OUR CORRESPONDENTS:

GENTLEMEN:

WE INTRODUCE TO YOU

_____

WHOM WE HEREBY AUTHORIZE TO DRAW UPON US OR UPON
THE AMERICAN EXCHANGE NATIONAL BANK, NEW YORK CITY,
AT SIGHT TO THE AGGREGATE AMOUNT OF

_____ DOLLARS U. S.

EACH DRAFT MUST PLAINLY [illegible] UNDER CIRCULAR LETTER
OF CREDIT NO. 00000 OF THE [illegible] NATIONAL BANK OF MILWAUKEE
AND THE PARTICULARS THEREOF [illegible] ENDORSED HEREON.

YOUR NEGOTIATION OF [illegible] YOUR GUARANTEE THAT THE
REQUIRED ENDORSEMENTS [illegible]

DRAFTS MUST BE SIGNED IN YOUR PRESENCE AND CAREFULLY COMPARED
WITH THE SIGNATURE IN THE ACCOMPANYING BOOK OF INDICATION.

WE HEREBY ENGAGE THAT DRAFTS DRAWN IN ACCORDANCE WITH THE
CONDITIONS HEREOF SHALL BE DULY HONORED IF NEGOTIATED ON OR BE-
FORE _____

THIS LETTER OF CREDIT AND THE ACCOMPANYING BOOK OF INDICATION MUST
BE SURRENDERED AND CANCELED AND ATTACHED TO THE LAST DRAFT DRAWN HERE-
UNDER.

YOURS FAITHFULLY,

FIRST WISCONSIN NATIONAL BANK OF MILWAUKEE

_____

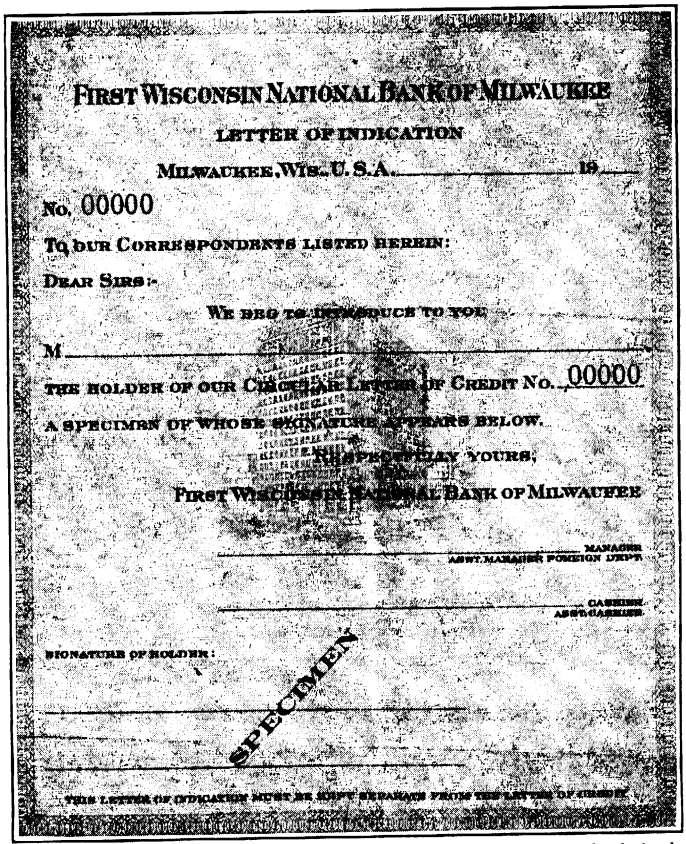
SPECIMEN

FIG. 9.—Traveler's letter of credit.

to the accompanying Book of Indication, in which are listed the names of all correspondents of the issuing bank (see Fig. 10).

Most travelers' letters of credit are made payable in London. If the traveler is in Berlin and finds himself in need of funds, he goes to a bank specified in the letter and identifies himself. The bank ascertains the

price of pounds sterling at the time, and draws a draft for enough pounds to equal the number of marks desired by the holder of the letter. This draft is then forwarded to London by the Berlin bank, and proper notation is made on the reverse side of the letter of credit, which is then returned to the traveler, together with the desired amount of money.



FIRST WISCONSIN NATIONAL BANK OF MILWAUKEE

LETTER OF INDICATION

MILWAUKEE, WIS., U. S. A. _____ 19____

No. 00000

TO OUR CORRESPONDENTS LISTED HEREIN:

DEAR SIRS:-

WE BEG TO INTRODUCE TO YOU

M_____

THE HOLDER OF OUR CIRCULAR LETTER OF CREDIT NO. 00000

A SPECIMEN OF WHOSE SIGNATURE APPEARS BELOW.

YOURS RESPECTFULLY YOURS,

FIRST WISCONSIN NATIONAL BANK OF MILWAUKEE

_____ MANAGER
ASST. MANAGER FOREIGN DEPT.

_____ CASHIER
ASST. CASHIER

SIGNATURE OF HOLDER:

_____

_____

SPECIMEN

THIS LETTER OF INDICATION MUST BE KEPT SEPARATE FROM THE LETTER OF CREDIT

FIG. 10.—Letter of indication which must be presented each time a draft is drawn under the traveler's letter of credit.

The London bank then charges the issuing bank's account with the amount of the draft and forwards it to that bank. If the draft exhausts the letter of credit, the latter is retained by the Berlin bank and returned through the proper channels to the issuing bank.

Commercial Letters of Credit.—A commercial letter of credit is defined as "a guarantee of payment, or a promise in writing on the part of a bank, to pay to a designated beneficiary a certain sum of money under specified conditions."[1] It is an instrument usually issued by the

[1] POOLE, G. C., "Export Credits and Collections," p. 75, Prentice-Hall, Inc., 1923.

foreign department of a bank to an importer to facilitate financing of importations. The letter of credit specifies a maximum amount of credit, the quantity and quality of goods to be purchased, the time within which shipment must be made, full instructions as to the shipment, the

LETTER OF CREDIT.

THE BRITISH BANK OF SOUTH AMERICA, Limited,
LONDON.

No._____

NEW YORK,_____

_____

_____

DEAR SIRS:

You are hereby authorized to value upon THE BRITISH BANK OF SOUTH AMERICA, LTD., LONDON,

at_____ for account of

_____

for any sum or sums not exceeding_____

for cost of_____ to be shipped from_____

to_____ on board any vessel or vessels.

The Bills of Lading must be made out to the order of THE BRITISH BANK OF SOUTH AMERICA, LTD., and two of such Bills of Lading, together with invoice properly certified, must be forwarded to THE BANK OF NEW YORK, N. B. A., NEW YORK, by the vessel bringing the goods.

The shipments must be completed and the Bills of Exchange drawn_____ from this date. All drafts under this credit, when presented for acceptance, must be accompanied by one Bill of Lading and abstract of invoice, and advice of all drafts must be sent direct to the drawees. Insurance to be effected in the United States.

And THE BRITISH BANK OF SOUTH AMERICA, LTD., hereby agree with the drawers, endorsers and *bona fide* holders of bills drawn in compliance with the terms of this credit, that the same shall be duly honored on presentation at their counting-house.

For THE BRITISH BANK OF SOUTH AMERICA, LIMITED,
THE BANK OF NEW YORK, N. B. A., Attorney,

By_____

For £_____

_____
Assistant Cashier.

*Please sign Bills as being drawn under Credit No.*_____
and have each Bill endorsed hereon at the time of drawing. *Dated*_____

SPECIMEN

FIG. 11.—Commercial letter of credit.

drawing of the draft, and the disposition that should be made of the documents. One copy is retained by the issuing bank, one is given to the buyer, and the original is sent to the foreign exporter or shipper. The shipper then presents the instrument, with the shipping documents and draft attached, to his local banker. The local banker negotiates the draft and thereupon forwards it, together with the documents, to the

bank which issued the letter of credit, through his correspondent bank. If it is a time draft, the issuing bank accepts it, and if a sight draft payable on demand, the bank pays the amount involved. In each instance the shipping documents are surrendered to the issuing bank (see Fig. 11).

The documents which are usually specified in the letter of credit, and which must be presented to the bank to secure payment, consist of shipper's invoice in triplicate; consular invoice, when required; insurance policy or insurance certificates in duplicate; certificate of origin, when required; packing lists in duplicate; and a full set of ocean steamer bills of lading.

The importer finally secures the documents from his banker in exchange for a trust receipt executed by him whereby the banker is given a first lien on the merchandise until payment has been made on or before maturity of the accepted draft. If a sight draft, the importer is expected to reimburse his banker before the shipping documents are surrendered, unless arrangements are made with the bank for a loan of the amount for an extended period. Under the trust receipt the importer binds himself to hold the goods in trust, keep them insured in favor of the bank, and to turn over all proceeds, from the goods sold, to the banker until the full amount involved is repaid, when the trust receipt is surrendered.

Letters of credit may be confirmed and irrevocable, unconfirmed and irrevocable, or unconfirmed and revocable. Some letters of credit may not be confirmed either because no request is made to that effect by the issuing bank or because the credit relations with the correspondent bank which is to confirm the letter may be such as not to warrant confirmation, for the effect of such action by the correspondent bank is virtually to extend credit to the issuing bank for the amount involved. If the issuing bank reserves the right to withdraw the credit at any time at its option, the letter of credit is known to be revocable. On the other hand, if the terms stipulate that the credit may not be withdrawn, at least prior to a given date, the letter is said to be irrevocable.

Confirmed and irrevocable letters of credit afford the greatest security to the seller, because they represent an obligation of two banks and cannot be withdrawn until payment has been made in accordance with the provisions therein. Unconfirmed and irrevocable letters of credit are safe only to the extent to which the issuing bank is responsible financially. Unconfirmed and revocable letters are the poorest from the standpoint of safety to the seller and should not be accepted by him unless full confidence is placed in the reputation and financial responsibility of the importer and the issuing bank.

It should be observed that the credit extended in the form of commercial letters of credit is secured solely by the merchandise imported.

It is, therefore, essential that the goods be properly handled, well insured, and otherwise given good care. To avoid fraud on the part of the exporter and to guard against inability of the importer to meet his obligations at maturity, the issuing banker requires the purchaser of a letter of credit to sign an agreement to the effect that the terms of the contract will be closely observed and that, in case of depreciation in the value of the goods while in transit, he will furnish additional security as may be required of him, and that, in default thereof, the banker is given the right to dispose of the merchandise, irrespective of the maturity of the drafts drawn under the letter of credit.

CERTIFICATES OF OWNERSHIP

Gold certificates, silver certificates, warehouse receipts, bills of lading, stocks, and stockholders' "rights" are sometimes included among credit instruments. Although used as such, they are not to be considered credit instruments at all, for they merely represent ownership on the part of their respective holders. One of the important characteristics of credit instruments is the divided equity or ownership which they bring about, in which case the user of the property is separate and distinct from its owner. Thus, the user of a house which is mortgaged remains its owner only as long as the requirements of the mortgage are fulfilled, and the house technically and legally belongs to the mortgagee, at least provisionally. A similar situation obtains when merchandise is sold on an open book account or on the basis of a draft or promissory note. The possessor or user of the merchandise is separate from its technical owner or creditor, and the equity in the goods is, therefore, divided. On the other hand, certificates of ownership merely constitute evidences that certain property is owned by the holder thereof, who has seen fit to place such property in custody of certain responsible persons or institutions. There is no postponement of payment involved, for the property deposited for safe keeping or management may be withdrawn at will, except, of course, in case of stockholders, where it is necessary that all act in unison in order to bring about a dissolution and liquidation; technically speaking, therefore, the principle applies even to stocks, which represent joint ownership, consequently requiring the consent of at least a majority in order to effect desired results.

Stocks.—Because of their peculiar characteristics, stocks call for further treatment. A share of stock represents a partnership right to participate in the earnings of the issuing company and in the amount of money or property received upon liquidation, according to priority. It is a certificate of ownership in the issuing corporation. Each share of stock is entitled, in case of liquidation or upon declaration of dividends,

to a proportional share of the equity behind the total issue of which it constitutes a part.

There are two principal classes of stock, preferred and common. A preferred stock represents a particular portion of the shares, having certain preferences and limitations. The nature and extent of the privileges and limitations with which they are endowed are determined in each particular case. A preferred stock differs from a common share only to the extent to which such differences are definitely and specifically stated in the provisions of the charter and by-laws of the corporation. A preferred stock may be preferred as to assets or as to dividends, or both; is usually made nonvoting; includes many protective provisions; and is ordinarily limited as to the amount it may receive in dividends, which, again, may be cumulative or noncumulative. It should be borne in mind that a preferred stock is identical with the common stock in every respect, except to the extent of definite provisions to the contrary, by means of which it is endowed with special rights and limitations.

When viewed from one angle, a stockholder is a creditor and stocks are credit instruments. According to law, a corporation is an entity; it can sue and be sued in its own name. Again, from the economic viewpoint, a corporation may be considered an organization separate and distinct from its stockholders and bondholders. Frequently, stockholders take no more active interest in the business than the other security holders and merchandise creditors, particularly in the large corporations, so that even in practice the business is virtually divorced from its legal owners. Therefore, it is argued, stockholders are in a sense creditors and stocks are forms of credit. Besides, certificates of stock are negotiable and readily salable by indorsement and delivery, as are bonds and promissory notes. They are also frequently put up as security for loans at the banks, and are particularly valuable when listed on an important stock exchange and actively traded in.

From another standpoint, however, stocks must not be considered credit instruments. They are but certificates of ownership. Legally, again, a stockholder is a part owner of the issuing corporation. He cannot enforce claims against the corporation either for dividends (unless they have already been declared) or for principal, as long as the company remains a going concern, unless it can be proved that fraud or unbusinesslike methods have been exercised on the part of the board of directors. This is so because the board of directors serves in a fiduciary capacity for the stockholders to whom they are responsible or, rather, accountable for the manner in which the property is handled. It appears, therefore, that, although from many angles stocks partake of the features characterizing credit instruments, they are nevertheless, in reality, but evidences

of ownership involving no postponement of payment so long as the company remains a going concern.

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Questions and Problems

1. Define and characterize credit instruments. How do they differ from credit?

2. Is negotiability an essential characteristic of credit instruments? Cite examples to justify your position.

3. Select from among the following items all credit instruments and indicate how each of them may be classified: gold certificates, United States notes, stocks, bonds, checks, national bank notes, stockholders' rights, Federal Reserve bank notes, promissory notes, warehouse receipts, book accounts, Federal Reserve notes, drafts, bank acceptances, trade acceptances, silver certificates, commercial letters of credit, postal money orders, traveler's letters of credit, cashier's checks, traveler's checks, coins other than gold, and trust receipts.

4. In what respects are promissory notes superior to book accounts?

5. How do you explain the popularity of open book accounts?

6. Distinguish between bonds and promissory notes.

7. Argue that checks are credit instruments.

8. Why have practically all states enacted bad-check laws? Does this fact help or hinder your argument that checks are credit instruments? How?

9. How does the bad-check law operate in your state? What are its weaknesses?

10. A check reads "Pay to John Jones the sum of fifty dollars." Is it negotiable?

11. Distinguish between a certified and a cashier's check. Is there any difference in the procedure as far as the bank is concerned?

12. Name and classify the various types of drafts.

13. What are the purposes of trade acceptances? How do you explain their limited use?

14. What is the difference between a trade acceptance and a promissory note from the standpoint of legality and trade practice?

15. Show, by diagram, the use of a commercial letter of credit by a New York importer in his purchase of silks from Japan.

16. If you were to make a short tour through Europe, which of the following credit instruments would you use in providing yourself with the requisite financing: traveler's checks or traveler's letters of credit? Why?

17. Are shares of stock credit instruments? Why or why not?

CHAPTER III

INVESTMENT AND BANK CREDIT

Classes of Credit.—All credit may be grouped under two principal heads, public and private. In the following pages the discussion will be entirely confined to the latter type of credit.

Private credit may, in turn, be variously classified, depending upon the bases used. Thus, on the basis of its purpose, credit is divided into consumers' and producers' credit; on the basis of length for which it is extended, it is spoken of as short-term, intermediate, and long-term credit. Again, credit may be classified according to the type of instruments evidencing it, as in the case of open book credit, acceptance credit, etc. Finally, the type of lender as well as borrower sometimes characterizes the credit involved by a special designation, as is true of "industrial loans" made to workingmen in small amounts based on earnings, personal property, and other similar security.

Probably, the most useful classification, at least for the purposes of this treatise, is that based on functions. Accordingly, credit is divided into investment, bank, retail or consumer, and mercantile credits.

INVESTMENT CREDIT

At its inception, as well as thereafter, a business enterprise requires three classes of credit: investment, banking, and mercantile. Investment credit is utilized for the purpose of obtaining funds with which to purchase and acquire fixed assets, such as land, buildings, machinery, fixtures, delivery equipment, and intangible assets of a more or less permanent character. A sufficient amount must also be provided in this manner for the working capital which a concern requires in its normal condition of business activity. Permanent working capital is that portion of the funds of a business which is constantly needed from week to week and from month to month. It is the sum required to carry minimum inventories of merchandise and supplies.

Characteristics of Investment Credit.—Investment credit is obtained through the issue of relatively long-term obligations. These obligations take the form of bonds, real estate mortgages, chattel mortgages, equipment obligations, and long-term promissory notes. They are promises to pay definite sums of principal and in most cases also certain rates of interest. Stocks and shares in joint-stock companies, which are merely

evidences of ownership or partnership rights to participate proportionally in the residual equity of the business enterprise, are used practically in the same way. These loans are made purely for investment purposes, hence the term "investment credit." The money obtained in either of the forms enumerated is permanently or for a relatively long period of time invested in the business.

The Credit Period in Investment Credit.—The purpose of investment credit is to provide needed funds for more or less permanent use. Consequently, such credit is extended for relatively long periods of time. The length of the credit period in any one case is determined primarily by the life of the asset which is to be acquired with the money secured through the utilization of investment credit. Thus, chattel mortgages issued on movable goods are usually of a much shorter duration than mortgages on real property. Sometimes, the permanency of the borrowing organization tends to determine the length of the credit period. Railroad bonds generally enjoy a longer life than industrial securities of a similar nature, while industrial bonds issued by manufacturing corporations have a somewhat longer life than bonds issued by trading corporations.

Sources of Long-term Investment Credit.—Five principal sources are available from which long-term investment credit may be secured. The chief source is the ultimate individual investor, of whom there are numerous gradations. These are individuals who have saved, inherited, or married wealth. Instead of hoarding or engaging in business primarily for the purpose of utilizing these funds, they are invested in long-time securities. Hoarding is both insecure and profitless. Funds may be destroyed by fire or stolen, and if insured against these contingencies, additional expenses are incurred. Again, many individuals possessing wealth are either unwilling or incapable of actively managing their own business. Accordingly, these persons are constantly searching for places where their funds can be invested so as to bring a fair return and where the principal will at the same time remain secure.

Some of the ultimate individual investors are interested primarily in securities of an investment character, namely, obligations which bring a steady return and the prices of which do not fluctuate to any considerable extent. The income on such securities is usually low, since, as a rule, security of principal and a high rate of return are incompatible. On the other hand, a great many investors are attracted by promises of high rates of return. These are interested in speculative securities the prices of which fluctuate frequently and violently and from which income may be high at times. Many persons are anxious to invest in them also in the hope of their appreciation in value. Between the two extremes, we find numerous types of individual investors seeking different combinations of security, maturity, and rate of return. This is why so many

different types of bonds and stocks have come into existence, all for the purpose of satisfying the whims and fancies of the investing public and thereby widening the market for the securities. Sometimes, in cases of reorganization, bondholders may be forced or coerced to accept income or participating bonds rather than doing it by preference.

A second class of investors in long-term obligations are trustees of funds of individuals and estates. Funds of deceased persons are thus invested by the trustees for the benefit of the beneficiaries. In this class are also to be included investments of educational and eleemosynary institutions.

Insurance companies constitute a third class of heavy purchasers of investment securities. They are primarily interested in high-grade obligations the prices of which lack the nervousness attending the more speculative securities and the marketability of which is well assured. It is thus possible to put the surplus funds and part of the reserves to work, thereby enhancing the profitableness of the enterprise.

Fourth, banking institutions commonly invest in long-time securities. Certain savings banks operating on a nonprofit basis invest the funds for their depositors in this manner. The same situation obtains in case of investment in real estate mortgages on the part of building and loan associations. Although most of the high-grade bonds and stocks pass through the hands of investment bankers, they are nevertheless excluded from among the sources of investment credit. Such bankers are merely middlemen, standing between the issuers of the securities on the one hand and the ultimate investors on the other.

Finally, business concerns invest some of their surplus in the securities of other enterprises. Very often the companies whose securities are so purchased are subsidiaries of the investing firm or are closely affiliated with it.

Sources of Short-term Investment Credit.—In addition to long-term investment credit, most commercial and industrial concerns frequently require capital for an intermediate period of from 1 to 5 years. Long-term financing is normally used to procure the necessary plant and equipment, to refinance existing long-term obligations, and to acquire capital goods for replacement purposes or for expansion. Intermediate-term financing is needed to maintain a minimum of goods in process of production or trade, to meet working requirements of concerns with a slow turnover, to carry large inventories for seasoning purposes, as in the case of lumber, and, as an aftermath of depressions, to replenish depleted working capital.

In a study made by the author for the Business Advisory Council of the United States Department of Commerce, the need among most relatively small-scale manufacturers for this type of credit was found to be

incredibly great and urgent. Under normal conditions, the commercial banks of this country, contrary to sound commercial banking practice, take care of such need. During the depression which began in 1929 this source of supply for intermediate credit dried up completely and thousands of small business enterprises faced ruin as a result. In consequence of this situation, constructive effort was being made in certain quarters to provide an intermediate credit banking system in order to enable business men to secure loans of a legitimate character for periods exceeding 6 months, similar to what has been done in some of the other countries, notably England and France.[1]

BANK CREDIT

Meaning of Bank Credit.—The treatment of bank credit, at least in this treatise, is confined to the operations of commercial banks, trust companies, and other banking institutions which deal in short-term credit, as distinguished from investment banks which deal in long-term credit utilized for investment purposes. Since most of the so-called "time deposits" in commercial banks are in reality demand deposits drawing interest, they are included in any consideration of bank credit.

In the last analysis a bank is an institution that specializes in credit, just as a grocery store deals in groceries.[2] In doing this, its principal function is to facilitate the exchange of goods by providing methods for settling obligations. In addition to this clearing function,[3] the bank's credit operations revolve mainly around three things: deposits, loans, and note circulation. Bank credit may, therefore, be defined as the power which enables a commercial banking institution to attract funds of depositors, to make loans, and to issue bank notes which are used as money. In securing money on deposit the bank sells its credit to the depositors, while in making loans either through the discounting of single-name promissory notes or through the discounting of commercial paper obtained from customers, the bank exchanges its credit for that of the borrower.

[1] For detailed information on this subject, see published report prepared by the author (although not printed in full) entitled "Survey of Reports of Credit and Capital Difficulties Submitted by Small Manufacturers," U.S. Government Printing Office, 1935; "Intermediate Credit Corporation Hearings before the Committee on Banking and Currency of the House of Representatives," 74th Congress, 1st Session (H.R. 5918), U.S. Government Printing Office, 1935; "Report on the Availability of Bank Credit in the Seventh Federal Reserve District," by C. O. Hardy, and J. Viner, U.S. Government Printing Office, 1935; and "What about Loans to Industry?" prepared by Committee on Direct Loans of the National Conference of Business Paper Editors and the Associated Business Papers, Inc., 1935.

[2] JOHNSON, J. F., "Money and Currency," p. 44, Ginn & Company, 1914.

[3] WILLIS, H. P., CHAPMAN, J. M., and ROBEY, R. W., "Contemporary Banking," pp. 1–6, Harper & Brothers, 1933.

Quite frequently deposits are made in the form of checks rather than in money. In either event the deposit transaction, as well as that of lending, is purely a dealing in credit, no different from the issuing of paper currency, which is simply a representative of bank credit.

The Credit Period in Bank Credit.—The chief purpose of bank credit is to help in the financing of producing and distributing operations, as far as current needs are concerned. Bank credit helps concerns whose businesses are subject to seasonal variations, as practically all businesses are, to carry the peak of the load until the goods are sold and remittances are received from customers. It also furnishes a means whereby business men can take advantage of cash discounts by paying their bills with the proceeds from bank loans long before the goods have been disposed of.

It is for this reason that commercial banks ordinarily grant credit in the form of short-term loans, varying from 30 to 90 days. When a business establishment borrows money from a bank for periods considerably longer than 90 days, it is using the bank as a source of permanent working capital. To this there are some exceptions, as when merchandise is placed in storage for speculative or other reasons and loans for a period of several months are required. Normally, however, consistent lending for periods longer than 90 days is contrary to the original intent of such banking institutions. As further proof of this intent, attention should be called to the fact that all banks require their borrowers to clear their accounts at least once a year.

Another factor limiting the length of the period in bank credit is the rediscount provision of the Federal Reserve System. Only notes maturing within 90 days can be rediscounted by member banks, with the exception of paper used for agricultural purposes or arising out of foreign-trade transactions. If drawn for agricultural purposes, the paper will be rediscounted by the regional reserve banks if it matures within 9 months. This provision does not mean that paper drawn for a longer period than stated above is not eventually eligible for rediscount. What it does mean is that the paper at time of discount must have a maturity not to exceed the period stated. It is probable that this provision was made a part of the Federal Reserve System in order to cause banks to adhere to the original purpose for which their lending operations were intended.

Nature of Bank Credit Work.—Were a census taken of all the commercial banking houses in the country, it is believed that relatively few would be found to have complete and up-to-date credit departments. Yet practically every institutional bank is in some way performing the services a credit department is designed to render. In numerous instances, the cashier or his assistant is combining credit work with his other functions. This is especially true of the smaller banks with a limited clientele and of banking institutions in smaller communities.

Hardly a bank, irrespective of size, can successfully operate without full credit data concerning its customers and prospects.

A bank's credit department has as its duty the investigation of the credit standing of applicants for credit. Some institutions have even gone so far as to require their credit departments to carry on investigations concerning prospects prior to soliciting their accounts. These are still in the minority, for in most banks no investigations are undertaken until an application for credit is formally made.

The next most important service rendered by the bank's credit department is that of keeping the officers of the organization informed as to the standing of its borrowing customers. Credit files are frequently revised and changes in customers' standing noted. Additional information concerning risks is constantly pouring into the credit department from many and varied sources. These additional facts may prove favorable or unfavorable. If the former obtains, it might be advisable to increase the customer's credit limit when requested or at least to continue the account on the existing basis and remove all doubt that might have existed in the minds of the bank's officials concerning the risk. If the outlook is unfavorable, it may be good policy either to discontinue the account, decrease the credit limit, or confidentially review the situation with the customer in the hope of extricating him from his financial difficulties. In all of these cases, the credit department is looked to for the necessary data to guide the bank's officers properly in their decisions.

A third service rendered by the credit department is to furnish correspondent banks with credit information in response to inquiries concerning names in which they are interested. And, lastly, the credit department must reciprocate with credit departments of other banks and commercial houses in the giving of credit information. As will be pointed out in another connection, banks are considered one of the important sources of credit information by merchants, and in some communities they constitute the only means of gaining some degree of knowledge pertaining to customers located therein.

The problem of gathering the necessary credit facts and properly keeping them is none too simple. To be sure, no elaborate systems or special records need be kept in the small banks. Here the cashier may know personally all his customers and may, in addition, possess a substantial degree of knowledge of local conditions affecting their credit standing. With the growth of cities, size of deposits, and number of borrowers, personal contact can no longer be relied upon. The work then requires careful and sometimes minute subdivision, and memory becomes inadequate. An up-to-date credit department, which collects all the necessary credit information and properly files it, thus becomes a neces-

sity, without which the functions a bank is called upon to perform cannot be effectively discharged.

Banks and Commercial Houses Compared.—In credit granting, the difference between banking institutions and commercial houses lies in the standards set for such purposes. As a rule, banks are far more conservative in extension of credit, as they should be, chiefly because they deal with other people's money in a fiduciary capacity. When a bank acts in the capacity of custodian for the funds of depositors, whose deposits furnish the basis for the bulk of the loans made, a high degree of certainty and confidence is required concerning the bank's ability to meet its obligations at all times, and particularly at maturity, unless it experiences a "run." Unlike a mercantile house, a bank cannot ask for extensions of its obligations without jeopardizing its reputation and good will. Such a request may result in the cessation of its business activity and consequent failure. This delicate situation in which a commercial bank finds itself requires a high degree of liquidity, which the various bank examiners, representing the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the state bank department, make it their business to enforce.

A second reason for the bank's conservative attitude, as compared to mercantile creditors, is to be accounted for by the difference in margins of profit. Banks normally operate on comparatively narrow margins; consequently they cannot afford to assume undue risks. A third element in the situation is the relative size of the loan. Most business men deal with a single bank but buy merchandise from many sources of supply. Thus, comparatively large sums are borrowed from banks.

To reduce risks to a minimum, a bank credit department is forced to investigate its risks more thoroughly, scrutinize its information with greater care, and base its loans wherever possible on collateral capable of quick realization. An attempt is also made to diversify loans in regard to lines of business, locations, and maturities. Businesses dealing in staples selling on short-credit terms are usually given preference over those dealing in luxuries or lines which sell on long-credit terms. Finally, well-established concerns, the managements of which are known to be conservative, are sought in preference to new and unseasoned organizations. All of these considerations, naturally, are affected by the stage of the business cycle and the condition of the money market.

Basis for Loans and Discounts.—Profits of a banking institution are made on loans extended to individuals and firms. Loans are generally made in the form of credit, for when one secures a loan from a bank, this loan usually appears as a deposit and the borrower merely obtains the privilege of drawing checks up to a certain amount in return for his promise to repay an equivalent at a specified date in the future, or on

demand, as in case of "call" loans. Similarly, when one discounts another's note at the bank, one simply *exchanges* the maker's credit, plus one's own as indorser, for that of the bank. Even when money is paid immediately to borrowing or discounting customers, this money may take the form of its own or other banks' notes, which are payable on demand and considered as satisfactory a means of payment as gold.

As a basis for loans, a bank may use its own funds, secured from the sale of stock over and above the amount required for buildings, fixtures, and supplies. Part of the paid-in or contributed capital takes the form of surplus, which is augmented from time to time by earned surplus. These funds, however, constitute a very small, and in some instances an almost negligible, percentage of the total amount loaned. Hence, the necessity for another basis or reserve behind loans. This basis consists of deposits made by individuals and firms who prefer to use bank credit instead of the funds thus deposited. Deposits originate in two ways—by actual deposit of funds and by deposit of credit from loans. Since deposits of the latter kind are usually withdrawn within a short time, banks attempt to secure as many of the former kind as possible. The greater the amount of net deposits—the difference between total deposits and checks—the larger the sums that may be loaned, and, consequently, the greater the profit a bank will earn. Other sources of capital for commercial banks are paper money or notes issued by banks and borrowings from a central bank through open market operations, advances, or rediscounts.

Both *loans* and *discounts* are designations applying to advances made by a bank to its customers. The chief distinction between them lies in the fact that in the case of loans interest is ordinarily collected at maturity, while in the case of discounts the interest is deducted in advance. In both instances, the interest is computed as a per cent of the total amount of the loan; hence, when the loan is discounted, *i.e.*, when the interest is deducted in advance, the rate charged is somewhat higher than the stated percentage. Discounts are usually unsecured, while loans are generally secured by collateral.

Kinds of Bank Loans.—A bank may loan on any one of a number of credit instruments, as already pointed out somewhat in the preceding chapter. These instruments may be secured or unsecured. A secured loan is one made by the bank on a note or draft secured by collateral, *i.e.*, property pledged in payment of the debt. Security offered may consist of real estate, bonds, stocks, warehouse receipts, pipe-line certificates, bills of lading, merchandise, notes receivable, or other property, both tangible and intangible. Thus, "commodity paper" is secured by a warehouse receipt attached to the note; "collateral notes," by a deposit of bonds and stocks, etc.; and "mortgage notes," by mortgages on prop-

erty. Collateral deposited in numerous cases consists of bonds and stocks. Securities listed on an important stock exchange are the most desirable for such purposes, owing to the relative ease with which they are convertible into cash. A typical form of a collateral note denotes clearly the nature and extent of security underlying a secured loan (see Fig. 2).

Unsecured loans consist of loans or discounts based upon the financial and credit responsibility of the maker or makers, acceptors, or indorsers (see Fig. 1). Unsecured loans involve no specific pledge of property as security. Examples illustrative of this type of bank loans are numerous. Persons or firms enjoying a good credit standing may borrow on their own notes; this gives rise to "single-name" paper; or they may indorse and sell notes payable to them. This latter process gives rise to "double-name" paper, sometimes termed by bankers, "two-name" paper, "indorsed" paper, or "receivables." When the indorser places his signature on a note merely for the purpose of accommodating the maker, the resulting "double-name" paper is known as "accommodation paper." Banks frequently guarantee the credit of individuals and thus make it immediately available by accepting their drafts, payable at a future date, for a commission. In doing so, the value of the draft is enhanced and its sale facilitated considerably. Under such an arrangement the borrower obligates himself to supply the bank with the necessary funds in order to meet the acceptance at maturity, in which case the bank has merely loaned its good name. It is only when the borrower fails to provide the necessary funds that the bank is forced to make an actual loan in the form of money or credit actually paid out to the holder of the acceptance.

Discounting Single-name Paper.—It should be noted at this point that the discount method merely involves an exchange of the bank's credit for the individual's or business firm's credit. The advantage from such an exchange is the general acceptability of the bank's credit as contrasted with the limited acceptability of the other.

A purchaser of a bill of goods may immediately satisfy the seller in one of three ways. If he is a person of ready means in whose ability to meet obligations at maturity the bank has full confidence, his own note will be taken to the bank and discounted, whereupon he is immediately credited upon the bank's books for the amount of the note, less the discount. A discount is but interest paid in advance. Subsequently, a check is forwarded to the seller and the account is settled. Such a note constitutes single-name paper, since at maturity the maker is the only person to whom the payee may look for satisfaction.

Another way of satisfying the seller is for the buyer to offer his credit in exchange for the merchandise obtained. If accepted, the latter is debited or charged on the books of the former for the amount of the bill

until the expiration of the credit period. Meanwhile, the seller in need of funds may have his own notes discounted at his bank, so as to enable him to finance the purchaser. In this case, the bank is extending a loan on the basis of single-name paper offered by the seller.

Double-name Paper.—A third method open to the buyer is to tender his promissory note in exchange for the goods purchased. This gives rise to notes receivable, which, when indorsed by the seller, are discounted at the bank. In this instance, the seller or indorser remains secondarily liable on the note, so that, when the maker defaults in payments, the bank will look to the indorser. Notes receivable are the commonest form of double-name paper and the discounting of such instruments constitutes the simplest form of bank loans.

Accommodation Papers.—Accommodation paper is another form of double-name paper. It is a note bearing an accommodation indorsement and hence is not regarded with favor by banks. Frequently, would-be borrowers exchange their notes, take them to their respective banks, and have them discounted as double-name paper. Both of these borrowers are likely to be weak financially and neither of them could therefore borrow on his name alone. In reality, the indorsement of one weak concern's paper by another weak concern does not improve the character of the note. It does give the note, however, a semblance of strength which it does not inherently possess. Again, an individual with a good credit standing might be urged by a friend to accommodate him by indorsing the latter's note, thereby lending it an appearance of strength which it would not otherwise possess. In case of default in payment by the maker, it becomes difficult to collect from the accommodation party. From the foregoing it is obvious that accommodation paper is inferior as contrasted with notes arising out of the sale of goods, and should be accepted by banks only with great hesitancy.

LOANS THROUGH NOTE-BROKERAGE HOUSES

Rise of Brokerage Houses.—Note-brokerage business is of relatively recent origin. Before 1870, single-name paper was little known. Banks seldom made loans on one signature or even one indorsement. Then, too, very few open book accounts are to be found prior to this date. Buyers ordinarily gave notes which were indorsed by sellers and discounted at the bank. The widespread use of double-name paper led to the abuse of the system through flooding the market with accommodation notes which are difficult to distinguish from *bona fide* double-name notes arising out of commercial transactions. As a result, banks suffered considerable loss and the demand for renewals grew by leaps and bounds. Consequently, banking institutions commenced to scrutinize such paper

more carefully. This fact, coupled with the growing competition among sellers, served to stimulate the use of open book accounts.

Because of the risk in carrying customers on the books for extremely long periods—the credit period formerly averaging from 4 to 6 months—liberal discounts were offered for cash payment. To take advantage of the opportunity of making extra profit through discounts, the stronger merchants borrowed at the banks on their own single-name paper. As the local banks were often limited in their financial resources, merchants began to sell their notes through brokers to outside banks. This practice grew so rapidly that, according to reliable estimates, each year from about 2,000 to 3,000 business firms use the open market through a number of representative note-brokerage houses and their numerous branches and connections.

Methods of Operation.—Brokers usually operate on a commission basis, the size of the commission normally amounting to 0.25 per cent flat. Most brokers immediately advance a certain percentage, say 80 per cent, against the paper, and remit the remainder after deducting the commission when the paper is finally disposed of. Some few brokers even discount the whole block of paper outright at the current rate of discount and then sell it to banks or other investors.

It should be observed that no definite method or formula is adhered to by any one brokerage house. The methods of operation may vary according to the business house giving the notes for sale and the stage of the business cycle, whether money is "hard" or "easy," and numerous other similar considerations.

Advantages of Selling in the Open Market.—The advantages of selling through brokers are many and varied. To begin with, the borrower secures by this means a wider market for his paper, frequently at rates of interest considerably lower than those prevailing in the locality in which he is situated. Again, borrowings from his local bank are limited to 10 per cent of the bank's capital stock and surplus. Difficulties may be experienced as a result, particularly during peak seasons. Through the broker, additional banking connections are secured. Futhermore, local banks require the borrower to maintain approximately 20 per cent of the loans in cash at all times. Then, too, when borrowing in the open market through note brokers, the borrower's name becomes known to many banks and his credit standing may improve substantially when the obligations are promptly discharged and few renewals are demanded. Finally, the extended investigations with reference to open-market paper indirectly benefit the borrower by keeping the firm "on its toes."

Advantages of Buying Paper in the Open Market.—From the standpoint of the banker, note brokers equally offer many advantages. Paper purchased in the open market is usually regarded by banks as a particu-

larly attractive investment. This kind of commercial paper is highly marketable and readily convertible into cash. Maturity dates can be chosen to provide for liquid capital to meet current needs. Higher rates than those prevailing in the section tributary to the purchasing bank are often obtainable. Commercial paper can be readily rediscounted by the purchasing bank at the Federal Reserve Bank of which it is a member. A minor advantage is that these notes can be had in practically all denominations. Moreover, few of these notes are renewed. There is no obligation on the part of the banker to renew them even when requested to do so, owing to lack of personal influence. Last, but not least, the security is of a premier character. Although legally note brokers are merely guaranteeing the genuineness of the signature, in practice their responsibility is greater than is apparent. Brokers frequently have their own funds invested to a certain extent in the paper they handle, but, most important of all, they have a reputation at stake, which constitutes a substantial part of their stock in trade. In addition, brokers give banks, as a rule, a 10-day option within which to investigate the credit standing of the borrower, and, if results of the investigation do not warrant the purchase, the notes can be returned, without any further obligation to the bank.

Disadvantages of Selling Notes in the Open Market.—Some houses are known to object to the sale of commercial paper in the open market through brokers. The principal reason for the unfavorable attitude is the constant inquiry to which a borrower using this method is subjected. He is asked for a great mass of more or less detailed information over and over again. This in itself has two objectionable features: first, it may arouse suspicion among the borrower's commercial creditors; and, second, it necessitates a complete removal of secrecy which many houses regard as essential to success.

Recording Commercial Paper Purchases.[1]—Some banks record all purchases of commercial paper on special forms. The several columns of these forms give the date and amount of the purchase, due date, rate, from whom bought, and remarks. Enough spaces are provided so that all sorts of transactions may be recorded. These forms are generally made out in triplicate, a white sheet being placed in the liability ledger where all names are arranged alphabetically; a yellow sheet in the maturity tickler, in which all accounts are arranged according to date of maturity; a pink or triplicate sheet is given a number and placed, according to a numerical arrangement, in the discount register. A form is made out for each note purchased or discounted.

[1] For a detailed discussion of a bank's credit department operations see Chap. XXIII.

Another form commonly used by banks is a control sheet, one for direct liability of the account and one for indirect liability. These sheets are placed in front of the various individual note records of the respective accounts. Each control sheet contains a summary of all the notes held by the bank against any one account, showing the date of purchase, sureties, indorsers and collateral, when paid, due date, charges, credits, and balance.

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Questions and Problems

1. The X company incorporated for the purpose of manufacturing a certain staple product in the drug field. It is planning to purchase a site and erect a structure at a cost of approximately $400,000. The company will require machinery valued at about $75,000; an inventory of raw materials, goods in process, and finished products involves a minimum investment of $100,000 and a maximum of $150,000; and some $15,000 are required for the purchase of delivery and drayage equipment. In addition the company will have to finance its sales which are to be made on 30-day terms. This will require a minimum of $125,000 to carry the receivables during the slow seasons and as much as $200,000 to care for them during seasons of peak activity. A few thousand dollars will also be needed to care for the first payroll and for other immediate expenses. Show how and to what extent these financial needs can be provided through the use of the different classes of credit.

2. From what general sources may capital be borrowed for investment purposes? What instruments can be used in obtaining it?

3. What determines the length of the credit period involved in the use of investment credit?

4. Explain the original purpose of commercial bank credit, and show how it has been buttressed by the Federal Reserve Act of 1913.

5. Have commercial banks ever departed from their original function with respect to bank credit? What bearing does the Banking Act of 1935 have upon this situation?

6. Analyze the nature of the credit transaction when:

a. A person deposits money in a bank.
b. A person deposits his salary check at the bank.
c. You draw a check on a bank in which you have an account and present it to the bank for payment.

d. You borrow money from your bank.

e. A bank issues a Federal Reserve note.

7. What factors determine the length of the credit period on loans made by commercial banks? Can money be borrowed from such a bank for a longer or shorter period than indicated by the maximum and minimum, respectively? How?

8. Why are banks relatively more conservative in the extension of credit than are commercial firms?

9. If you indorse a note to accommodate a friend, in what way and to what extent would you be liable?

10. Distinguish between:

a. Loans and discounts.

b. A cognovit note and an ordinary promissory note.

c. Single-name and double-name paper.

11. What connection, if any, is there between the use of accommodation paper and the rise of note-brokerage houses?

12. Describe the functions of note-brokerage houses. Are they likely to increase or decline in importance?

13. What advantages accrue to a firm from selling its commercial paper in the open market? Why do some firms object to the practice?

14. Is it advantageous to a banker to buy commercial paper in the open market? Why or why not?

CHAPTER IV

MERCANTILE CREDIT

Definition and Purpose.—Mercantile or commercial credit is the credit one business man extends to another when selling goods on time for resale or commercial use. Theoretically, it is the power to obtain merchandise for business purposes in return for a promise to pay an equivalent at a specified time in the future. It includes the credit granted by different sellers of goods in the process of production and distribution from the time the goods are in the state of raw materials until they reach the hands of the retailer or industrial consumer. The principal purpose of mercantile credit is to facilitate the movement of goods through the various stages of production and marketing. It does not include credit given by the retailer when selling on time, or that extended by manufacturers and functional middlemen when selling directly to the individual consumer.

Mercantile and Retail Credit.—The fundamental difference between retail and mercantile credit is that the former comes into existence as a result of a sale of goods for consumption purposes, whereas the latter results from transactions involving transfers of goods for business purposes. The scale on which transactions involving mercantile credit are conducted is also much more extensive than that on which retail credit transactions are carried on.

Attention must be directed at this point to the fact that much of our credit structure is built around retail or personal credit. The motives compelling the retailer to grant credit to his customers will be presented in Chap. VI. In order to be able to operate on a credit basis, the retailer, in turn, requests credit from the wholesaler. Accordingly, the wholesaler must be given time within which to collect from his trade and pay the manufacturer out of the proceeds. Since many growers and original producers of raw materials are financially weak and seldom in a position to finance their credit extensions to manufacturers or wholesale middlemen, these concerns turn to financial houses, such as selling agents, factors, commission houses, or supply houses, to supply them with necessary funds.

Viewed from another angle, mercantile credit makes the neighborhood store possible by enabling its owner to overcome financial limitations. Without this intimate financial aid, men with limited capital would be

handicapped in entering business, and many struggling merchants of ability would be unable to continue if credit arrangements were to cease and cash were demanded for all purchases. To the extent to which these stores are desirable is mercantile credit beneficial. This class of credit also tends to stimulate competition by bringing into existence numerous small retailers. Keen competition, if not excessive, fosters improvements in management and operation and reduces prices to the consumer.

Mercantile and Bank Credit.—The close relationship existing between mercantile and bank credit becomes evident upon even a superficial examination of the subject. Mercantile credit brings into being a vast amount of credit instruments. These instruments in turn become the feeders for bank credit. When goods are bought for resale or for industrial and commercial use, the purchaser either pays cash or buys on time. In order to secure the cash with which to make immediate payment or with which to take the cash discount, the buyer frequently borrows at his bank by giving the bank his promissory note. Should the buyer fail to make payment prior to due date, the seller must carry the financial burden, which he may in turn transfer to his bank by giving his own promissory note or by discounting the notes or acceptances obtained from his customers. In either case, mercantile or commercial credit is translated into bank credit. In the first instance, the bank discounts the buyer's paper. In the second instance, the bank either discounts the seller's paper or the buyer's paper indorsed by the vendor.

If local banks are unwilling or unable to finance some of the mercantile transactions, particularly when large amounts are involved, the necessary capital may be secured through borrowings in the open market, as has been explained in the preceding chapter, or through discount companies, factors, or finance companies which in turn frequently borrow from their respective banking institutions. The larger the amount of commercial paper arising out of mercantile transactions, the greater the circulating medium of exchange in the form of bank deposits and certain paper money issued on that basis. In recent years commercial banks have become reluctant to finance small business in its seasonal operations. Hence, a greater burden has fallen upon the large manufacturer or wholesaler who, in addition to extending credit on the merchandise sold, must assume responsibility for financing the smaller customers.

History and Development of Mercantile Credit.—Traces of mercantile credit may be found in antiquity. It is doubtful, however, whether it had come into extensive use before the money economy system had been definitely established. As late as A.D. 847 the trade carried on by the wandering Jewish merchants—the Radanites, from the Persian words "rah dan" (knowing the way)—who carried on the commerce between the East and Europe, was mainly conducted on a cash basis or on barter,

although mercantile credit was already in use.[1] This type of credit was used to some extent in the days of Roman domination, but its most rapid development awaited the establishment of fairs and other periodical markets in Europe and Asia. At the fairs which thrived during the latter part of the Middle Ages, obligations incurred at previous fairs or on other occasions were settled, usually by offsets or a kind of clearing-house method. Since the fairs were held at intervals of from 3 to 12 months, the bills of exchange arising out of the commercial transactions ran for a relatively long time. Gradually mercantile credit grew in importance until in some lines of business it became a dominant feature, giving rise to special institutions dealing in such credit, as exemplified by factors in the woolen industry in England which already occupied an important position in the seventeenth century.

As the factory system of production assumed its place in our economy the wholesaler came to the front as the outstanding middleman serving both manufacturers and retailers. One of his major functions was to finance the manufacturers who operated on a small scale and were weak financially and to extend credit to retailers for several months at a time. As manufacturers grew in size, large-scale retailing came into being, and banking made important strides, the dependence upon the wholesaler for financial assistance diminished, but it resulted in no diminution in the use or volume of such credit; it merely shifted the burden to manufacturers and others or shortened the period of time for which such credit was extended.

Tendencies in Mercantile Credit.—Prior to the Civil War, jobbers and manufacturers were visited by retailers approximately every 6 months to purchase goods. Transportation facilities were exceedingly poor and the journey consumed considerable time. Because of the great distances separating retailers on the one hand and jobbers and manufacturers on the other, and owing to the many handicaps incident to inferior and inadequate transportation means, some of the smaller retailers were compelled even further to limit their trips to the sources of supply. Sometimes purchases were made only once a year. Owing to these conditions, retail dealers had to anticipate the local demand a long time in advance, and purchase infrequently and in large quantities. As a result, much of the stock on the shelves was unsalable and obsolete, although changes in style were fewer than today. The retailer was financially unable to carry the large merchandise inventories necessitated by the conditions described, hence he turned to the jobber or manufacturer for credit. This was granted, usually in exchange for a promissory note payable, as a rule, in 6 or 8 months from date of purchase.

[1] JACOBS, J., "Jewish Contributions to Civilization," Chap. 6, The Conat Press, 1920.

Long terms of credit were not limited to the dry goods trade or to any other line of business, but were pervasive. During the first half of the nineteenth century, jobbers in the boot and shoe trade bought their goods from Eastern manufacturers "on six, eight, and ten months' time, and sold them to their customers to be paid for when the crops came in."[1] In the drug trade "the selling terms were six months or five per cent off for cash. Interest was charged after six months, and sometimes the Southern trade would take an additional six months when the cotton crop failed."[2]

The development of railway transportation, coupled with the introduction and extension of adequate and suitable means of communication, such as the telephone, the telegraph, and expeditious mail service, brought about a complete change in the circumstances surrounding the mercantile credit system. Retailers also increased in number and thus competition became keener. Retail dealers now visit the market more frequently and buy in smaller quantities but at close intervals. Orders are also taken at present by traveling salesmen representing sources of supply, who visit the trade periodically. In the absence of traveling representatives, orders may now be placed by mail more expeditiously. The radio is also likely to produce marked changes in buying in the days to come.

Because of the importance assumed by the style element and frequency of its changes, the practice of carrying small inventories of up-to-date and fresh, salable merchandise becomes a necessity. Consequently, credit periods are considerably shortened. An additional factor contributing to the shortening of credit periods is the development of banking facilities, so that a retailer may now borrow at his bank and pay his bills with the proceeds from the loan.

Volume of Mercantile Credit.—Unfortunately there are no complete data by which the total volume of mercantile credit business can be accurately determined. Its importance is indicated, however, by the fact that the 5,783 manufacturing and wholesale firms, which gave data concerning their credit policies for the years 1928, 1929, and 1930, reported a credit business for the 3-year period of a little over 90 per cent of their total net sales. Moreover, in about 24 per cent of the firms credit business amounted to 100 per cent of their volume.[3] More complete data on this point were made available by the Censuses of Distribution. For the year 1935 a total credit business of more than $11 billions was reported by the 62,086 of the 88,931 full-service and limited-function wholesale establishments in the entire United States, amounting to

[1] DEPEW, C. M. (Ed), "One Hundred Years of American Commerce," p. 571, D. O. Haynes & Co., 1895.

[2] *Ibid.*, p. 609.

[3] "Mercantile Credit Survey," Part III, Domestic Commerce Series, No. 78, U.S. Government Printing Office, 1932.

81.5 per cent of their total business. Of the 11,634 manufacturers' sales branches with stocks, 9,397 reported credit sales of more than $5 billions or 82.5 per cent of the total. Furthermore, credit business was pervasive and in some lines of trade, as in dry goods, clothing and furnishings, hardware, and paper products, the amount of business done on credit was in excess of 90 per cent of total net sales of the reporting firms.[1]

TERMS OF SALE

In buying goods on time, a credit relationship is established upon a certain basis which is expressed in terms of sale. Such terms commonly comprise two distinct elements: the extension of credit for a given time and the discount which is usually coupled with it.

The Credit Period.—The length of the credit period granted (frequently referred to as the net credit period or the period of free credit) varies not only with different lines of business, but also with different houses in the same line, and not infrequently no rigid policy is adhered to within any given establishment handling a single line of merchandise.

Rate of Stock Turnover.—In general, the credit period tends to conform roughly to the receipt of income, on the part of buyers, from the sale of the goods. The rate of turnover of the purchaser's stock of goods, *i.e.*, the marketing period, is the most fundamental and determining factor as to the time involved in mercantile credit. Around it all the other factors revolve. These may, however, at times so modify the credit period as to, at least immediately, almost completely obscure any relationship existing between credit extension and stock turnover. Thus we find 30 days to constitute the prevailing terms in the grocery trade. In the hardware and dry goods trades, where the rates of turnover are lower on the average, we find 60 and 70 days, respectively, generally given to the retailers. Again, from 60 to more than 120 days are granted retailers in the jewelry business, where the turnover is still less frequent than in the aforementioned trades.

Location of Customers and Transportation Facilities.—The rate of turnover is, in turn, affected by such considerations as the geographical location of the customer and the transportation facilities available for shipment of goods to him and the time consumed in the process. The longer the goods are in transit the slower the rate of turnover, since larger quantity purchases are necessitated and more merchandise must be kept on hand, therefore, the longer the credit period that is required of sellers. With the improvement of transportation service and the growth of appreciation on the part of merchants of the economies resulting from

[1] Census of Business: 1935, Wholesale Distribution, Vol. VII, pp. 7–9, U.S. Department of Commerce. March, 1937.

rapid stock turns there is a possibility of shortening credit extensions to a considerable degree.

Length of Credit Received from Preceding Sellers.—In numerous instances the credit period, as well as the discount offered for cash payment, is determined in large measure by terms granted by the preceding seller. Jobbers' terms to retailers on both anthracite and bituminous coal, for example, are similar to those received by them from the coal mine operators. Terms on automobile accessories given by accessory jobbers, in general, parallel those obtained from the manufacturers. On electrical products, wholesalers generally give their customers the same cash discount as they receive from the manufacturer, but the credit period varies.

Competitive Conditions.—Competitive conditions are often responsible for deviations from the regular terms in any given trade. Under such circumstances it is not uncommon to find many customers taking advantage of the situation and running their accounts even beyond the extended net period. A case in point is afforded by many wholesalers of electrical supplies. Here the keen and growing competition has forced them to give many concessions to their customers. A similar situation obtains in the coal business. Sometimes even exclusive connections are established when the buyer is carried financially by the seller.

Character of Commodity.—Distinction in terms is frequently made on the basis of the character of the commodities in the transaction. Fresh meat is generally sold on "cash terms," requiring payment within 7 days after delivery, whereas provisions, including hams, bacon, lard, and barreled beef and pork, are sold on 30 days net. Both of these classes of products are sold by the same meat-packing houses, yet the terms are different. In the grocery trade the credit period is longer and the cash discount larger on tea than on coffee, the time on the former ranging from 60 days to 4 months and the discount from 2 to 5 per cent, whereas the time on the latter ranges from 30 to 60 days and the discount from 1 to 2 per cent. Where little competition is experienced from exclusive tea and coffee houses, the tendency is for wholesalers to reduce the terms on both teas and coffees to 1/10, net 30 days. Ordinarily terms are short when the article is perishable, highly standardized, bought for current use, or otherwise enjoys a short marketing period, and also, when the margin of profit is relatively narrow. On the other hand, longer terms are extended on seasonal merchandise and especially on new lines. In the latter instance it amounts to selling credit with the goods.[1]

The Credit Risk.—The character of the credit risk must also be considered in accounting for the length of the credit period in any trans-

[1] For a discussion of this subject, see E. M. Meyer, "Are Unusual Terms Justified in Introducing a New Line?" *Credit and Financial Management*, July, 1934.

action. When the risk is doubtful or inferior, the terms are very short. In many cases they may be sold on C.O.D. or "cash" terms, or cash may be required with the order.

Type of Ultimate Consumer.—The type of ultimate consumer is a contributing factor in the determination of the length of credit extensions. In certain mining regions where the ultimate consumer—the miner—demands retail or personal credit and where sales fluctuate violently at times, due to local conditions of employment, the terms granted by jobbers are longer normally—save to bad risks—than in communities where business is done by retailers largely or entirely on a cash basis. The same situation obtains in railroad and steel-mill towns where the retailer carries the wage earners from one pay day to another. Terms to the retail trade must thus be adjusted to local conditions and corresponding adjustments must frequently be made in selling to the wholesale trade. Again, wholesalers dealing in farming communities, where many of the soil tillers are carried by the retailer, must grant such terms to the retail merchant as to enable him to meet the demand of his customers for credit extensions.

Some concerns offer their customers the choice between two sets of terms. They may be allowed to buy, for instance, on a 15-day basis when the terms are 1/10, net 15 days; or on a 30-day basis with 2/10, net 30 as the terms of sale. In other instances, distinction is made between city and country trade. One or the other class may be favored, depending upon the keenness of competition and the convenience in making payment for both seller and purchaser.

Sectional Differences.—The distribution of income throughout the year in different parts of the country, even in a single line of trade, is a question vitally affecting both the length of the credit period and the extent to which violation of regular terms of sale may be expected. Farming, for example, is highly seasonal in the South Atlantic, South Central, and Far Western states, so that in the first two groups a typical farmer sells about four times as much in October as he does in June, while in the last group of states a typical farmer receives five times as much income from the sale of his products in October as he does in February. In both of these sections income is at a minimum during the summer months and reaches a maximum during the months of October and November. On the other hand, the diversification of farming practiced in the North Central states, including Ohio, Indiana, Illinois, Michigan, and Wisconsin, has almost eliminated the seasonal aspect from the farming industry. Although crops still mature in the summer and fall, the seasonal high points of income resulting from the sale of crops immediately after the harvest months of June, August, and September are

flattened and practically offset by the heavy sales of livestock during December and January.

Because of the even distribution of income in the agricultural communities of the North Central states, relatively short terms of sale to retailers located in farming communities will suffice. There would also seem to be little justification for such retailers to run beyond the usual credit period. Furthermore, an overdue account in a Southern agricultural community in the month of December is a matter far more serious than a similar past-due account in December in a farming community in Illinois, for a substantial amount of income is not expected by a retailer in the South for about 7 or 8 months thereafter, whereas in Illinois income flows in almost evenly during the entire year and the account may be liquidated during any of the subsequent months.

The Business Cycle.—All factors used in the determination of the credit period are greatly modified with reference to the business cycle. During periods of stress and depression, when business activity is more or less suspended, regular credit terms are often disregarded. To stimulate sales and energize business, all sorts of devices are brought into play. Credit men depart from the usual terms in favor of buyers, and sales are correspondingly increased. On the other hand, during periods of prosperity, when business is to be had for the asking, credit men are and should be more conservative and considerably stricter in the enforcement of their usual terms of sale, thereby contributing toward the prevention of undue business expansion.

The Cash Discount.—The discount used in connection with terms of sale is commonly referred to as a "cash discount," to distinguish it from "trade discounts." The former is a premium granted the purchaser for cash payment, whereas a trade discount simply constitutes an allowance or deduction from the list price of the goods. Cash discounts are in a sense interest payments made to buyers for the settlement of accounts not yet due. They are inducements offered customers for the payment of bills before the due date. The cash discount, however, offers a rate considerably higher than the prevailing rate of interest, because of the additional advantages that are derived by the seller from such procedure.

Advantages of Cash Discounts.—When the discount is taken advantage of by the buyer, it not only gives the grantor quicker possession of the money, which can be turned again, but also reduces the credit and moral risks. Immediate use of the money tends to increase the rate of capital turnover, and less of it is required to operate the business. A great deal of credit and collection machinery can be dispensed with when all bills are discounted. Losses from bad debts are reduced accordingly, and the cost of doing business is decreased. Hence, the rate of discount frequently varies directly with the length of the credit period. Lastly,

the taking of a cash discount by buyers tends to promote and maintain a spirit of good will between seller and customer, there being less occasion for friction.

From the standpoint of the buyer, the cash discount offers two worth-while advantages. In the first place, considerable savings can thus be effected, since the discounts normally offered by sellers are much higher than current rates of interest. In the second place, a buyer who takes the cash discounts offered to him becomes a preferred customer. Consequently he is given superior treatment and is much sought for by vendors.

Significance of the Cash Discount.—The significance of the cash discount can be fully appreciated only upon the determination of the equivalent rate of interest per annum. To determine that, the intervening period—in days—between the optional dates of payment should be divided into 360 days—the number of days contained in a year as reckoned by banks—and the quotient multiplied by the rate of discount under consideration. To illustrate, assume that a bill of goods is purchased Jan. 2, and that the terms are 3/10, net 30. The bill may be paid on the eleventh of January and the 3 per cent discount taken by the buyer, or remittance may be made on the thirty-first, the date the account is due net. If the latter option is exercised, the purchaser indirectly pays 3 per cent for the use of the amount of the bill for 20 days—the intervening period between the two optional dates of payment. Since there are 18 times 20 days in a year the equivalent rate of interest per year is 3 times 18, or 54 per cent.

The above computation is subject to two corrections. In the first place, the actual rate of interest is somewhat larger if it is figured on the amount payable when the cash discount is taken rather than on the full amount of the invoice. For example, if the invoice covers a sale of $1,000 worth of merchandise and the terms are 3/10, net 30, as stated above, the amount payable when the discount is taken is $1,000 less $30, or $970. Since payment of $970 in cash earns $30 for the unexpired part of the credit period, or $30 for a period of 20 days, the earnings for a full year at this rate would be 18 times $30, or $540, making the actual rate $540/$970 or 55.67 per cent. In the second instance, it must not be inferred that the computed rate of interest involved in the cash discount represents net income to the discounting customer. It is probable that money may have to be borrowed from a commercial bank at the rate of 6 per cent per annum in order to take the discount. Furthermore, although the *rate* of such earnings may be high, it cannot be assumed that the amount thus borrowed from a bank can be utilized in such a lucrative manner throughout the year, *i.e.*, 18 times a year at such a high cash discount. If it is assumed that 10 such transactions would take place in a year, the benefits

through the cash discounts when taken would amount to ten times $30, or $300, the interest to the bank at the rate of 6 per cent for 12 months would be $970 times 6 per cent or $58.20, and the net gains from the process would be $300 less $58.20 or $241.80. When this last figure is divided by the $970 involved in the transactions it results in approximately 25 per cent.

Cash Discount Misapplied.—For cash payment, a discount of 5 per cent is not uncommon, and as high as 7 to 10 per cent is granted in some lines. On some electrical products the regular terms are 5/10, net 30. In this instance, the buyer would be paying interest at the rate of 90 per cent if the bill is not paid within 10 days. On the other hand, the grantor would be paying a similar rate when the discount is taken advantage of. An absurd situation! If the business is lucrative, chances are that the credit standing of the purchaser at the banks or in the open market would be sufficiently high to enable the concern to secure the required capital at a much lower rate. If the business is poor and unprofitable, the merchant cannot continue payments at the rate of 90 per cent on the capital employed much longer than warranted by his proprietorship equity.

The situation, as it occurs to the author, is that when cash discounts become so large as to exceed the equivalent of approximately 30 or 40 per cent per annum, they are *in fact* a combination of "cash" and "trade" discounts. These large discounts continue today largely from sheer custom. The general tendency, however, is to reduce both the cash discount and the credit period. Shortly after the Civil War the cash discounts granted were very large, partly because of the length of the customary credit period and attending credit and moral risks, and partly because of the unsettled monetary and other business conditions. The large cash discounts offered today can, in large measure, be traced to the times when the credit period consisted of approximately 6 months, when transportation and banking facilities were few, stock turns considerably slower, and business and monetary conditions extremely uncertain. When large so-called "cash discounts" are offered today, they are intended to be taken, and the seller prices his merchandise accordingly, so that the true price is considered by the grantor to consist of the invoiced price less the portion of the discount which constitutes *in fact* a trade discount.

Abuses of the Cash Discount.—A very serious matter which credit managers have to cope with constantly is that relating to the practice on the part of many buyers of taking unearned discounts. Although allowed only as a premium for cash payment within a specified time definitely stated on the invoice, or otherwise agreed upon, nevertheless many purchasers deduct discounts even when remittance is made long

after the expiration of the discount period. This abuse has originated principally as a result of the practice which leaves the matter of taking cash premiums to the honor and good faith of the buyer. It is generally believed that no such difficulties would be experienced if provision were made at the outset for the buyer to remit the full amount of the invoice and for the seller either to credit his account or return a check covering the amount of the discount in case remittance is received within a specified time. As it is, the buyer has the power to deduct the premium. The cash discount is attractive. Not wishing to lose it, he therefore makes every effort to exact it, even though it necessitates the use of threats.

So long as the buyer enjoys the privilege of determining whether the cash discount is to be taken when making remittance, this abuse is likely to continue. The vendor is then faced with several alternatives. In a desire to be obligingly lenient, he may simply disregard such infractions upon the terms of the sales contract in the hope that few buyers will take this unfair advantage. Second, the seller may accept payment but inform the customer of the irregularity with the expectation that the abuse will not be repeated. Third, the creditor may either bill separately for the amount of the cash discount which was unjustly deducted from the invoice or may add the amount to the next invoice, in each case notifying the customer of the action taken and reasons for it. Finally, if a very strict policy is to be pursued, which is seldom justified, the check for the inadequate sum may be returned and one for the full amount required. Under all circumstances it is essential that sellers insist upon the closest observance of cash discount terms, pointing out to buyers that cash discounts are contract terms, not unlike those relating to price, quality of merchandise, and delivery.

Another abuse that has crept into the cash discount system is that buyers of large business organizations frequently insist upon receiving extra large discounts for cash. These unusual terms are demanded in full knowledge of their superior position as buyers on the one hand and the fear of sellers of losing trade on the other. Thus, some department-store buyers make it a practice to shop for cash discounts rather than merchandise. This condition of affairs is due partly to the method employed by some stores of penalizing departments whose buyers fail to secure a specified minimum discount. If the buyer fails to receive the required discount, his department is charged with the difference between the discount obtained and the discount required. Similarly, the department is credited with any discounts which are secured in excess of the required figures. This practice is known as "loading," and is regarded by the enterprises which use it as a means of making sure that buyers secure the largest possible discounts. Another argument in its favor is that it enables executives to judge the abilities of various buyers on a

uniform basis. Furthermore, the advantages gained by securing a large cash discount are equivalent to a price reduction when considering the net profit of the department. Finally, terms once established are usually granted on future transactions. Because of this loading practice, hard and unusual terms are demanded of sellers, with the result that the cash discount system is greatly harmed and sentiments are thereby created for its abolishment. To remedy the situation it should be pointed out to buyers that cash discount terms are taken into consideration as a definite item in a determination of the prices at which merchandise should be sold, and that premiums for cash are too large "and mean too much in dollars and cents to be given as many interpretations as there are buyers."

TERMS OF SALE CLASSIFIED[1]

Terms in any given trade are often referred to as "usual," "common," or "regular," meaning thereby such terms as are considered well established and general in the trade under consideration, and fixed by custom or contract, and sometimes by resolution of an associated group in the trade. It should also be kept in mind that the accepted usage is to commence to count the period of credit extension from the date of shipment or invoice of the order, and not from date of receipt of the goods by the buyer, unless R.O.G. (receipt of goods) terms are agreed upon by the contracting parties.

The customary terms of sale in mercantile transactions consist of C.B.D., C.O.D., Cash, "Ordinary," E.O.M. and M.O.M., Proximo, R.O.G., "Extra" or Dating Ahead, and Season Dating terms.

C.B.D. and C.O.D. Terms.—C.B.D. (cash before delivery) or cash with order terms are applied to bad risks when the seller is unwilling to extend any credit whatever. Under these terms no credit is extended and no risks are assumed by the seller. The terms are rather uncommon, since C.O.D. (cash on delivery) terms are usually employed instead.

If the purchaser on C.O.D. terms refuses to accept the goods unless credit is extended, the seller, of course, must have the goods returned, and thus lose the freight both ways, and perhaps suffer on account of deterioration of the products while in transit, or else resell the bill of goods to another customer in the locality of the original consignee or thereabouts. C.O.D. terms are, therefore, a poor substitute for C.B.D. terms and must not be used unless some confidence is had in the purchaser, or unless a deposit is made by the buyer sufficient to cover the freight charge.

Occasionally terms are quoted "S.D.-B.L.," meaning thereby that a sight draft to which the bill of lading is attached must be honored before delivery. This arrangement closely resembles C.O.D. terms, and may

[1] For complete list of customary terms of sale, see Appendix.

be said to constitute one way of enforcing them. Carload shipments of flour are frequently made against arrival draft with bill of lading attached. S.D.-B.L. terms also apply to sales of hides and skins, grain, carload shipments of canned meats and lard, lumber, and many other products.

"Cash" Terms.—Most establishments do a certain amount of "cash" business. The credit period of a "cash" transaction may be as high as 14 days, *i.e.*, a transaction is deemed by some concerns to be consummated on a "cash" basis if payment is made within the number of days specifically or impliedly agreed upon, which usually amounts to a week or 10 days. The discount is naturally absent when goods are sold on "cash," C.B.D., or C.O.D. terms, since no option is to be exercised by the buyer as to the date of payment and consequently no inducement is required to obtain the remittance of accounts.

Ordinary Terms.—Terms involving no special features, such as datings and extras, are, for lack of a better name, termed as "ordinary." They consist of nothing but the two component parts of terms of sale—the credit extension, and the cash discount—both simply and definitely stated. In some lines, sales are made on 2/10, net 30 terms (2 per cent, 10 days, net 30 days). This means that if the bill is paid within 10 days from the date of invoice, a deduction or discount of 2 per cent from the face of the bill is allowed, and that the bill becomes due at the end of 30 days from the date of the invoice or shipment. It is optional with the buyer, who may either pay in 10 days or else make remittance in 30 days and void the discount privilege. These are the regular terms in mill supplies, on certain petroleum products, on some automobile accessories, and many other articles. In the hardware trade the usual terms are 2/10, net 60 days—also of the ordinary type.

E.O.M. and M.O.M. Terms.—Both E.O.M. (end of month) and M.O.M. (middle of month) terms are special forms of datings. All shipments made during any one month are dated as of the first of the month following, if E.O.M. terms apply. M.O.M. terms are an amended form of the former, in that goods shipped between the first and fifteenth of any month are dated as of the fifteenth of that month and those shipped between the fifteenth and the end of the month are dated as of the first of the month following, the terms beginning to apply on the fifteenth and first, respectively.

The primary purpose of both these terms is to accommodate "running" accounts, where the purchases are relatively small and frequent. It is convenient for the buyer to settle once or twice a month for all his purchases from any one house instead of making the daily settlements which would otherwise have to be made in order to take advantage of cash discounts. It also adds to the convenience of the seller from the standpoint of bookkeeping.

The practice is subject to serious abuses, however. There is danger that sales will slump toward the end of the month unless the seller is persuaded to date the shipments as of the following month, thus extending the credit period by 30 days. Some customers may insist for various reasons that their purchases be billed as of the first of the month following when goods are bought toward the end of the month, thereby forcing the seller to discriminate between customers. Both of these terms are to be looked upon with suspicion, since their tendency is to lengthen the credit period and to increase the risks correspondingly.

Proximo Terms.—These terms are employed to a considerable extent by coal jobbers, automobile-accessory jobbers, wholesalers dealing in electrical products, and many other houses. Under them, payment for all purchases made during any one month is to be made on a specified date in the month following. They differ from E.O.M. terms in that the latter may be stated as 2/10, etc., E.O.M., under which circumstances the 2/10 do not begin to apply until after the first of the month following, whereas, when proximo terms are stated, a definite date for payment is usually specified, such as the tenth, fifteenth, twentieth, or twenty-fifth.

In certain cases where proximo terms are employed, anticipation at from 6 to 8 per cent per annum is provided when the bill is paid before it becomes due. A similar rate is usually charged on overdue accounts.

R.O.G. Terms.—Refined sugar is sold to wholesalers by manufacturers on "2/7, R.O.G." terms, which means that a discount of 2 per cent is to be taken by making payment within 7 days after "receipt of goods." Thus the time allowed for discount purposes is measured from the date the shipment arrives. The prime object in employing these terms is to meet and overcome objections of distant purchasers who are at a disadvantage in taking discounts as compared with buyers close to sources of supply. As indicated in another connection, all invoices, with few exceptions, are dated the day goods are shipped, and the credit period is measured from that date. A supply house located in the eastern part of the country with selling connections throughout the nation must, of necessity, employ R.O.G. terms, sometimes designated as A.O.G. (arrival of goods) terms, if competition of distant houses is to be met effectively and all purchasers are to be treated alike with respect to terms of credit. It is obvious that a purchaser located within a short distance from the supply house would enjoy a distinct advantage over a customer in the Far West. If the discount must be taken within 10 days, assuming that both buyers will take advantage of it, the former would have sufficient time to check up his purchases and even sell some of the goods prior to making payment, while the latter would have to pay long before the goods are received. It should be noted that the benefits from R.O.G. terms are enjoyed by the purchaser only when the bill is discounted. If the

discount is not taken advantage of within the stated period, the net period is measured from the date of invoice.

"Extra" or Dating Ahead Terms.—Under these circumstances the terms of discount do not begin to operate until the expiration of the "extra" period. Thus, one finds the terms in the dry goods jobbing trade expressed as "3/10, 2/10-60," or "3/10, 2/10-60 extra." Not infrequently they are stated as "3/10, 2/70," or "2/30, 30 extra." These terms are also often expressed as "2/10-60," or "2/10-60 extra," in which instance there is 1 per cent anticipation. An anticipation discount may be viewed as a reduction taken from the face of the invoice when the bill is paid before maturity but after the cash discount period. In each of these cases cited above the terms of the so-called "cash discount" do not begin to operate until the expiration of the "extra" period, which amounts to 60 days in all but one instance. Accordingly, if cash is paid in 10 days from the date of invoice, a 3 per cent discount is usually allowed as a deduction from the gross amount of the bill. If the amount is paid 10 days after the "extra" period, or at the end of 70 days from date of shipment, the customer is allowed a 2 per cent discount. In many cases the practice is to allow the purchaser a certain rate of interest on the *net* amount due if payment is made after 10 days from date of shipment, but before the expiration of the 70-day period.

Upon a close examination of these terms, the reader will readily concede that, for all practical purposes, the only true *cash* discount under these terms consists of 1 per cent of the gross amount of the bill taken only when remittance is made within 10 days. The other 2 per cent is an evasion and a misnomer and not in keeping with the true meaning of the term "cash discount." The 2 per cent is but a "trade discount," a reduction from the list price which has been first "marked up" so as to allow a "mark down" in the form of a 2 per cent so-called "cash discount." The bill becomes due at the end of 70 days and the 2 per cent discount is then taken as a matter of course. The 2 per cent does not possess any of the characteristics of a cash discount. It is not a privilege to be exercised at the option of the buyer. It is not an inducement in the sense in which a cash discount is employed. Payment is due at the end of 70 days and the bill *must* be paid—the gross amount less 2 per cent, which is, as already indicated, a trade discount. It is said that the practice originated when the 2 per cent was offered as a cash discount and the bill did not become due until 90 days, but since the "net 90 days" part of the terms was dropped and eliminated and not even anticipated in most instances, hence the change in the purpose and nature of the 2 per cent involved. Thus, when the "extra" or dating ahead terms are simplified and the mask is torn off, they would be expressed as "1/10, net 70 days."

Season Dating Terms.—Season datings constitute merely an extension of the credit period, similar in nature to any other sort of dating ahead. The season dating is made necessary because of the unwillingness of manufacturers to carry the entire burden incident to unfavorable changes. Wholesalers are thus frequently required to place their orders with the manufacturers or importers ahead of production or importation, which often embraces a period of at least 7 or 8 months. In the meantime a number of things may happen. Business in general may decline, or the demand for the goods ordered may slump or cease entirely, owing to changes in style and the like. Prices may fall, owing to the downward movement of the business cycle, and numerous other uncertainties may add to the risks involved in ordering in advance. Season dating is a device to induce retailers to share the risk and carry part of the burden incident to the advance ordering of a stock of goods. By such arrangements responsibility is at least partly shifted from the wholesaler to the retailer. In like manner is the risk burden partially shifted by the manufacturer or importer onto the shoulders of the jobber and functional middleman.

The length of the season dating period varies considerably in different lines and houses. Spring and summer goods, for example, sold and delivered any time after Jan. 1, in the dry goods trade, are dated as of May 1, after which the discount terms begin to apply. Rubber boots and shoes are generally marketed by jobbers on a Dec. 1 dating, with delivery commencing with the month of April, thus allowing a maximum of 8 months as a season dating. Usually these datings vary from 1 to 4 or 5 months. Season dating terms are used by practically all houses dealing in seasonal products. Business men not infrequently refer to these terms as "terms on futures."

CRITICISMS OF TERMS OF SALE

Unscientific Construction.—Many of the terms of sale now in use are too complicated for a clear understanding of what is involved. Not infrequently, the cash discounts are confused with trade discounts, as has already been pointed out earlier in the chapter. Sometimes, the terms are so constructed as to invite delays in taking the cash discount. Occasionally, the terms of sale are so absurd that they cannot stand any analysis whatsoever.

An excellent illustration of some of these defects in terms of sale is the following announcement which was made by a southern tobacco company. The company states that it will grant a discount of 10 per cent from the net amount of the invoice when check is mailed within 30 days of the date of the invoice. If check is mailed within 31 to

45 days, a discount of 8 per cent will be granted, and for every additional 15 days that the bill remains unpaid 1 per cent will be deducted until 90 days from date of invoice. The bill is due at the end of 90 days, when a cash discount of 5 per cent is allowed, but if the check is mailed after 90 days, the net amount must be paid.

The absurdity of such terms is so obvious as to need little explanation. Just what is the 5 per cent given when the check is mailed from 76 to 90 days from date of invoice? It seems to be neither a cash nor a trade discount. The 5 per cent is allowed only when payment is made at a certain time, which savors of a cash discount. On the other hand, a cash discount is granted only as an inducement to pay the bill before it is due. In this case, however, there is no inducement to pay in advance of maturity. The bill is due at the end of 90 days, and the 5 per cent will be granted even on the ninetieth day, but not on the ninety-first day.

Furthermore, there is no inducement to discount the bill until 30 days from date of invoice when the best terms are obtainable, amounting to an equivalent of 48 per cent interest. For the customer is granted a discount of 10 per cent if he pays the bill at the end of 30 days and only 8 per cent if he pays the bill 15 days later. This amounts to a cash discount of 2 per cent for payment 15 days in advance, or at the rate of 48 per cent per annum. Thereafter, an equivalent of 24 per cent per annum is obtained until 90 days from date.

Lack of Uniformity.—Throughout the entire mercantile field, lack of uniformity in terms of sale is characteristic. Even in a single industry or trade different sellers quote different terms of sale to customers of like standing. The effect of such a lack in uniformity of terms of sale within a single industry is anything but wholesome. The tendency, under such conditions, is to compete for business on credit terms. This invariably leads to laxity in the observance and enforcement of whatever terms are granted, thereby endangering the entire credit structure. While terms should and must vary as between different industries and lines of merchandise because of differences in margins of profit and rates of stock turn, it is of supreme importance that they be uniform within each industry and when goods are sold under similar conditions. Only in this way will proper standards be developed that will place credit dispensation on a plane even higher than that occupied at present.

Lack of Enforcement.—It is a matter of common knowledge that little effort is directed toward the enforcement of terms of sale. This is probably one of the greatest weaknesses in the system. Extenuating circumstances, which are in reality nothing more than a desire to meet competition, are usually offered as an excuse for deviation from a policy which is supposedly in existence but seldom exercised.

Terms of Sale under the NRA.[1]—As is known to every student of contemporary economics, the National Industrial Recovery Act was passed in 1933 as an attempt to codify industry and trade and, through such collective action, to improve the lot of labor and bring about general business recovery. An integral part of the various codes that were promulgated consisted in the adoption of rules relating to fair-trade practices, among them being some rules pertaining to credit terms. Even though this law was declared unconstitutional in a decision handed down by the Supreme Court in May, 1935, the codes and the hearings that preceded their adoption still exercise an influence on the credit terms in use today. Furthermore, the action taken under the NRA codes is indicative of the thinking of vast numbers of business leaders along this line. It may, therefore, not be inappropriate to call attention to the several points bearing on terms of sale that featured in some of the more prominent codes.

In a number of codes a provision was included which made it unfair to give or accept unearned discounts, thus outlawing a practice against which progressive credit managers have long registered strong resentment. A large variety of codes contained such a provision, including among them the shipbuilding industry, the wholesale stationery industry, and the wholesale coal and coke industry. A second provision of significance was aimed at standardizing cash discounts and net credit periods. For example, the iron and steel industry adopted the following terms: 0.5 per cent in 10 days, net 30 days, or settlement three times a month (on invoices dated from first to tenth of the month the discount was allowed if the bill was paid on or before the twentieth, etc.), but if the products were shipped from plants east of the Mississippi River to Pacific Coast ports the terms were to be 0.5 per cent in 25 days, net 45 days. Similarly, the electrical manufacturing industry provided that no employer shall sell on more favorable terms than those provided in his current net price lists or discount sheets, while the fishing tackle industry established terms of 2/10 E.O.M., 60 days net, and no dating.

In some codes an attempt was made definitely to limit the size of the cash discount and the condition under which it was to be granted. Illustrative of this was the wholesale automotive trade whose code limited the cash discount to 2 per cent which was not to be allowed for payment by note or trade acceptance or when a balance was still due. A similar limitation was placed in some codes on the amount of interest allowed on anticipation, *i.e.*, on payments made after the cash discount period but before due date. In most instances it was limited to 6 per cent per year. A fifth credit provision encountered in the codes limited the

[1] For a concise statement of the provisions regarding credit terms under the NRA, see reports, Nos. 39, 39-A, and 39-B, Research and Planning Division of the NRA.

"period of free credit" to the terms of sale stipulated at time of sale, thus requiring the purchaser to pay interest on overdue accounts and temporarily, at least, settling a controversy that has been raging in credit circles for decades. Another curb was placed upon certain unfair dating practices as illustrated by the code submitted by the wholesale stationery industry. This code provided uniform datings on seasonal goods, as follows: on valentines, Feb. 1; Easter goods, Apr. 1; sporting goods, Apr. 1; school supplies, Sept. 1; and on holiday goods, Nov. 1.

Not all of the credit clauses contained in the NRA codes were beneficial, however. Some of them tended to perpetuate the confusion in the meaning and use of the term cash discount, while others permitted the continued use of unsound terms of sale. A case in point is the corset and brassiere industry which stipulated the following terms in selling to retailers: 8/10 days E.O.M., or 6/50 days from date of invoice, net 51 days. On sales to jobbers and variety chains the terms were 3/10 E.O.M., net 11 days E.O.M. Obviously no cash discount whatever is involved in these terms, yet the same code elsewhere stipulated that "no trade discounts, rebates, or extra dating shall be allowed."

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Questions and Problems

1. What is meant by "terms of sale" and how are they affected by stock turnover, the credit risk, and the nature of the article?

2. To what extent is uniformity in terms of sale possible and desirable?

3. Arrange the various classes of terms of sale according to the degree of risk entailed.

4. What is the purpose of cash discounts? In what respect does a cash discount differ from a trade discount?

5. Show good reasons why cash discounts should be taken by purchasers. Suppose you had no ready cash available, would it be worth your while to borrow at your bank in order to take the discount? Why or why not?

6. Garfield purchased a bill of goods amounting to $1,000. The terms designated payment at the end of 30 days, with a 2 per cent discount for payment within 10 days from date of shipment. Assuming that Garfield could borrow money from his bank for any length of time that he desired, how much will he save by taking advantage of the cash discount, through payment of the bill with funds secured from the bank at the rate of 7 per cent per annum?

7. A buyer for a department store received a 3 per cent cash discount on goods billed at $3,000. The standard discount required by the store is 4 per cent:

a. At what price were the goods charged to the department?

b. To what abuses might such practice lead?

8. A creditor has sold a bill of goods to a customer on terms of 10/10 proximo, the 10 per cent being understood as a cash discount. The debtor failed to remit by the tenth proximo.

a. What is the real significance and meaning of the 10 per cent?

b. Can the debtor legally deduct part of the 10 per cent on the theory that it is to that extent a trade discount?

9. A dealer in builders' supplies bought a shipment of goods, billed at the regular terms, at $3,500, on Apr. 12. What is the amount of the cash discount and when must the bill be paid in order to take advantage of it?

10. What is meant by an "anticipation rate" and how is the practice justified?

11. In what respects are E.O.M. and R.O.G. terms similar? How do they differ? What is the chief purpose of each?

12. The usual terms of sale in the following lines of business are assumed to be:

a. Bearings: 5/10, net 30.

b. Carpets: 4/10, 60 extra.

c. Feathers: 2/10, E.O.M., net 30.

d. Meats, fresh: "cash."

Briefly explain the meaning of these terms of sale and compute the equivalent rate of interest involved in the respective discounts given to purchasers of such goods.

13. Criticize the following terms of sale which were found in actual use:

a. 3 per cent if paid within 10 days of invoice, or
2 per cent if paid within 70 days.
Bills will be due—net without discount, after 70 days.

b. 7 per cent if bill is paid within 30 days.
5 per cent if paid within 45 days.
2 per cent if paid within 60 days.
Net amount due at 90 days.

14. In what specific ways did the codes promulgated under the NRA affect terms of sale? Has their influence ceased with the outlawing of the Act by the Supreme Court? Explain.

CHAPTER V

CONSUMER CREDIT

Nature of Consumer Credit.—This type of credit may be treated institutionally, by type of creditor, or functionally, on the basis of its use. For purposes of definition, the latter approach is to be preferred, while the former point of view is superior in an analysis of the anatomy or structure of the consumer credit mechanism.

Consumer credit may, then, be defined as the credit granted to consumers to facilitate the process of consumption, in contradistinction to producer credit which is intended to further the process of production and marketing. Theoretically, and from the consumer's angle, consumer credit is the power which an individual uses in obtaining goods and services or in borrowing money for consumption purposes, on the promise to repay an equivalent at a future time. It may be of short term, as in the case of regular charge accounts, or of long term as when goods are bought on the instalment plan which calls for repayment over a period of more than a year.

In a broad sense, consumer credit would include all credit extensions for personal use, whether granted by manufacturers and other producers who sell direct to consumers, by retailers, professional men, service organizations, or the various types of financial institutions. Although fundamentally all these kinds of credit extensions are alike in principle, the treatment in this chapter will be narrowed to what is deemed pertinent for this book. No consideration will be given to mortgage loans on homes, because the subject is too intricate and specialized for this brief analysis. Excluded also are discussions of pseudo credit transactions, exemplified by loans against insurance policies, loans by banks against "pass books" on savings accounts, borrowings by veterans on life insurance, and loans by building and loan associations against borrowers' shares. Such loans are in reality forms of dissaving or withdrawals from previous accumulations which belong to the borrower but which he does not wish to disturb permanently. The treatment will therefore be confined to open book credit, to credit underlying instalment sales transactions, and to the credit arising out of cash borrowings by consumers.

Reasons for Consumer Credit.—From the standpoint of the creditor there is but one principal reason for consumer credit and that is profit.

To the retailer it spells increased volume and remunerative business; to the lender of money, it means a worth-while return on his investment and compensation for his efficient method of operation. From the point of view of the consumer, however, the matter is not quite so simple. In using credit, he is motivated by a complex of impulses and desires not so easy to unravel and comprehend. In general, however, the consumer may be said to be prompted by one or more of four sets of motives: convenience, the desire to improve his lot, necessity, speculation.

Millions of consumers in the United States utilize credit because they find it convenient to obtain goods and services on that basis. Orders can be placed by telephone, better service is usually secured from stores when goods are bought on a charge account, and several members of the family can buy on a single account without the necessity of carrying cash. Periodic payments facilitate home budgeting, and the person who pays the bills at intervals can control expenses more readily.

Perhaps equally large numbers of consumers use credit, especially of the instalment type, to raise their standard of living, to better their condition, by purchasing costly commodities like radios, automobiles, refrigerators, washing machines, and the many other articles which make their home life more pleasant and their lot in general easier to bear. Or, they may borrow to finance a vacation, to make home repairs or improvements, or for educational purposes. If they can ultimately pay for them, there is every justification for such purchases and borrowings.

Then there is the large and growing volume of consumer credit that has its *raison d'être* in necessity and in human want and misery. Millions of our industrial workers and others live from hand to mouth and have no ready cash until pay day. Farmers must wait for the harvests and in the meantime need credit to tide them over. Periods of temporary unemployment deplete the meager reserves, if any, and credit may be resorted to until work is resumed. Consumer credit may be the only way to meet emergencies caused by sickness, death, and accident, or to meet infrequent or nonrecurring expenses, as in hospitalization, special dental care, and the like. Another very important reason for consumer credit, especially for borrowing money, is to reorganize one's financial obligations by consolidating many relatively small but pressing debts into one amount owed to a single creditor who is more willing to wait. Some of the old creditors may threaten garnishment of wages, repossession of furniture, or other drastic action that may prove detrimental to the consumer. In addition there is a miscellany of other reasons. Funds may be needed to cover moving expenses, to purchase an automobile needed to secure or hold a job which requires the use of the vehicle, to help a relative in distress, to pay taxes, to care for insurance premiums, or to meet interest on a mortgage.

Some consumers borrow money for speculation. For this kind of consumer credit there is little justification unless the borrower can afford to take the chance and the loan is well protected by collateral or by the character phase of the risk.

Volume of Consumer Credit and Debt.—There are no data whatever on the total volume of consumer credit. Not even estimates have been ventured along this line. All that one knows reliably is that for 1935 the sales made by retailers on open account amounted to $7,041 millions and sales on the instalment plan reached the $3,599 million figure. For the year 1936, it was estimated that open-account sales by retailers reached the $8 billions mark and that instalment sales accounted for at least $4½ billions of business. The sources from which these data have been derived and the accompanying discussions are presented in the two chapters immediately following. Beyond these two sources of consumer credit, practically nothing of an authoritative nature is known with regard to total volume contributed by the various creditor sources.

An approach to this problem, however, can be made from the standpoint of the total indebtedness of consumers. Several estimates on this score have been ventured by leading authorities on the subject. The estimates for the most recent year, which are frequently quoted, are presented in Table III. But it is evident that even in these estimates certain items were excluded, such as the debts owed to doctors, dentists, lawyers, and other professional men, as well as the large amounts owed to service institutions such as hospitals, undertakers, garages, and the like. Furthermore, no debts are included that have their basis in real estate. On the other hand, some items are included in these estimates that cannot be regarded as *bona fide* for they are in essence withdrawals from savings and other reserves.

There is also a serious question as to the reliability of all such estimates. For example, retailers' open accounts outstanding as of the end of 1935 were estimated at $2,800 millions. According to the "Retail Credit Survey" for 1936, published by the Bureau of Foreign and Domestic Commerce and based on a representative number of reporting stores, during the year 1935 the average number of days open accounts were outstanding was 66. This means that such accounts turned over approximately 5½ times during the year (365 divided by 66). If the open-account sales reported by the Bureau of the Census are divided by the turnover, it would seem that retailers' open accounts outstanding at the end of the year should have been $1,280 millions ($7,041 millions divided by 5.5) instead of $2,800 millions as given in the table. Thus debts to retailers on open accounts seem to be grossly overestimated. On the other hand, a similar calculation of debts on instalment transactions indicates a high degree of accuracy in the estimate. For such

TABLE III.—CONSUMER DEBT, BY TYPE OF CREDITOR, ESTIMATED AS OF BEGINNING OF 1936

Class and type of creditor	Outstandings (in millions of dollars)
A. Merchandise creditors:	
Extensions on open account	$2,800
Extensions on instalment sales (by retailer or finance company)	2,100
	$4,900
B. Philanthropic agencies:	
Advances by relatives and friends	$1,000
Employer, student, and other special loan funds	25
Remedial loan associations	26
	$1,051
C. Cooperative or mutual agencies:	
Aktsias	$6
Credit unions	40
	$46
D. Commercial agencies in small-loan business:	
Pawnbrokers	$110
Industrial banks, including Morris Plan	110
Commercial banks:	
Personal loans, not segregated	500
Loans made by personal-loan departments	40
Illegal lenders	119
Personal finance companies	225
	$1,104
Total debts owed by consumers on merchandise and cash loans	$7,101[a]
E. Debt based on savings and other reserves:	
Life insurance policy loans	$2,300
Savings bank loans on pass books	8
Building and loan association loans against shares	105
Loans by other savings, loan, and investment companies	50
Veteran borrowings through Veteran's Administration (on life insurance, etc.)	1,666
	$4,129

Source: Adapted from "Credit for Consumers," by L. R. Foster, p. 21. Estimates for previous years that have been much used are by M. R. Neifeld in his book "The Personal Finance Business," and by Evans Clark in his book "Financing the Consumer." Other estimates have been made by F. W. Ryan and Rolf Nugent.

[a] The total given in this table does not include the amount owed by consumers on real property, nor does it cover the debts to professional people or to service organizations.

business the Retail Credit Survey shows that during 1935 the accounts were outstanding 216 days on the average. This resulted in a turnover of such receivables of 1.69 times a year (365 days in the year divided by 216). When the instalment sales for the year, as reported by the Bureau of the Census, are divided by the turnover, the outstandings amount to $2,130 millions ($3,599 millions of sales divided by the turnover of 1.69 times a year), compared with an estimated figure shown in the table of $2,100 millions.

Despite the shortcomings of estimates such as presented in Table III, they are of value in giving some intelligent and sophisticated approximations of the total amount owed by consumers for merchandise purchases and for cash loans. If the average turnover were known for each type of consumer credit, the total volume of credit business could then be ascertained by the use of average outstandings estimated by type of creditor. But the greatest value of these estimates lies in the variety of facilities which they show are now serving the consumer's needs, so that adequacy of the service may be properly evaluated and the reasons for their being determined. They add further value by showing the relative position which different types of lending agencies and other sources of consumer credit occupy in the structure, so that each may be examined in its true perspective.

CONSUMER CREDIT IN THE PURCHASE OF GOODS

Purchases on Open Account.—It is variously estimated that nearly 50 per cent of the retail stores grant the charge-account credit privilege to consumers, and that the volume of such business runs into more than $8 billions a year. The reasons for such wide use of the charge account are analyzed in the chapter immediately following. Even stores which have attempted to capitalize on their cash selling policy, like R. H. Macy & Co. of New York, have found it necessary to offer consumers some kind of service along this line by permitting customers to open a "deposit account" with the store. By this plan, the store, under the supervision of the state banking department, receives interest-bearing deposits from its regular customers. When a purchase is made by such a customer, it is charged against the deposit account, and a monthly statement is rendered, itemizing the purchases and showing the unexpended balance. Many stores formerly selling entirely for cash have since adopted the credit policy. In this group of stores may be mentioned the chain grocery stores in certain sections of the country and the growing number of gasoline filling stations which solicit charge-account business.

Purchases of Goods on the Instalment Plan.—The volume of such purchases by consumers has shown vigorous growth during this century, and especially in recent years, as shown in Chap. VII. It runs into

several billions a year and approximates 12 per cent of all retail store sales. Instalment credit is not limited to the field of retailing, for it has also been widely adopted in the purchase of services, professional and other. Here, too, some businesses refrained for many years from adopting the instalment-credit principle but have found it necessary to resort to it, sometimes by the backdoor method. A case in point is again Macy's department store, which early in 1937 decided to sell goods on the instalment plan through the medium of the Morris Plan Bank.

Department stores selling on the instalment plan usually carry their own paper, partly because they are able to finance the consumer's purchases and partly for the sake of the advantages they derive from the procedure. It enables the store to retain the charges which would otherwise go to a financing agency, part of which is net profit on the financing operations. It gives the store an opportunity to bring the customer into it at intervals to make payment and thus develop good will and pave the way for additional business. Besides, when an outside financial organization has to decide what risks it will accept, it automatically limits the store's market. There are also other retailers besides department stores who choose to care for the financing of consumers' purchases, but most of the dealers are not strong enough financially to perform this service.

Sales Finance Companies.—One of the effects of instalment credit has therefore been the rise of a new type of financial institution in the form of the sales finance company. The first such organization in the automobile field made its appearance in 1915, when the Guaranty Securities Company was formed to render service in the sales of the Willys-Overland dealers.[1] The new financial middleman has grown to such proportions that in 1925 it was estimated there were no less than 1,400 sales finance companies in the United States, although the bulk of the business was probably done by a relatively small percentage of these firms.[2] Through keen competition, lax methods of management, and mergers, the number of such companies has since been greatly reduced. A good share of this business is now in the hands of four large organizations, *viz.*, the General Motors Acceptance Corporation, the Commercial Credit Company, the C.I.T., and the Universal Credit Corporation. Of the last two companies, the Commercial Investment Trust Corporation is the holding company.

While some of the leading finance companies operate principally in the automobile field, some companies specialize in carrying other products, and an increasing number of them handle, besides automobiles,

[1] GRIMES, W. A., "Financing Automobile Sales," p. 12, McGraw-Hill Book Company, Inc., 1926.

[2] *Ibid.*, p. 79.

radio sets and many other commodities. Such a combination of financing different products helps the finance company to iron out the fluctuations in the requirements for funds incident to automobile financing.

Prior to the organization of finance companies, the bulk of motor cars and trucks were sold to consumers strictly on a cash basis. The remaining automobiles were disposed of on credit terms, involving a conditional bill of sale or a chattel mortgage. The promissory notes given by the purchaser were discounted by the ordinary commercial banks for the dealers. Commercial banks as a whole were reluctant, however, about rendering this service to automobile dealers. A commercial bank must so regulate its loans and discounts that they will mature with regularity and evenly throughout the year. Long-time notes, therefore, tend to disturb the stability of the bank because its discounts are in less liquid form. Besides, the funds demanded for the purpose, especially when instalment selling and buying spread into other lines of business, greatly exceeded the financial resources of many local banks. Many keen business men at once realized the possibility of adding to their wealth by extending a financial service to purchasers of high unit-value goods in a way which would preclude the necessity of paying the full purchase price in a lump sum. Thus the finance company came into existence to supplant the commercial banker in this particular type of financing, dealing at first with the retailers and later with ultimate consumers as well. The scope of their activity and method of operation are reserved for treatment in Chap. XXVI.

PHILANTHROPIC AGENCIES

Advances by Relatives and Friends.—There is always a certain amount of lending taking place between members of the same family and between friends. In times of economic stress and unemployment, it may assume large proportions and prove unusually burdensome on the lender and far from satisfying to the borrower. Sometimes such loans are placed on a business basis, a promissory note may be given and even some security offered, but this basis is frequently more apparent than real. Few relatives and friends enforce payment of the principal, let alone payment of interest charges.

Special Loan Funds.—Employers sometimes set aside special funds out of the company's treasury for the benefit of employees who are in need of temporary assistance. Student funds are maintained by many colleges and universities to help deserving students in emergencies. A number of philanthropic organizations, fraternities, and church societies have also provided funds for such purposes. Very often, however, the students themselves contribute to funds for loans to be repaid after

the borrower has graduated and established himself. On such loans no interest is charged and quite frequently no principal is collected. Consequently, many of them take the form of outright contributions. Then there is a host of free loan societies of one kind or another making loans as small as $5 and as large as $500. The average loan, however, is said to be less than $50. Loans made by such organizations are usually repaid, and the funds are said to have a great velocity. In addition, there are special funds provided by philanthropists, such as the Benjamin Franklin Fund and the Provident Loan Society of New York, formed in 1894.[1]

Remedial Loan Societies.—These organizations, which operate in some 20 cities, make loans on endorsed notes, pledges, or chattel mortgages. The average loan is said to be around $100, and about 500,000 persons borrow from such organizations.[2] The rates charged range from 12 to 36 per cent per year, depending partly upon the society's policy but largely on the nature of the security offered and type of loan. Usually, the rates are lower than those charged on similar loans by commercial lenders. The number of such societies is so small, however, and their funds are so limited that little assistance can be expected from such a source by the majority of consumers in need of financial aid.

COOPERATIVE OR MUTUAL AGENCIES

There are a number of mutual aid associations of a strictly informal type, especially among the yet un-americanized immigrants, for which no data can be secured. There are also some employer-employee mutual savings and lending organizations that belong in this classification. The two major types, however, are the so-called "aktsias" and "credit unions."

Aktsias.—These are voluntary associations organized by members of the foreign population in some of our larger cities for the purpose of selling shares to members which are used, when necessary, as a pledge for a loan from the society. At times loans are made on endorsed paper without any collateral. Each member must have a minimum number of shares prescribed by the society. Expenses are small, since the services are donated and the work is done cooperatively. Rates charged on loans vary from 18 to 30 per cent a year. As the foreign population becomes Americanized and better sources of consumer credit are made available, the aktsia (sometimes called "axia") type of association tends to disintegrate.

[1] For a more detailed statement of loans made by philanthropic agencies, see M. R. Neifeld, "The Personal Finance Business," pp. 29–34.

[2] CLARK, E., "Financing the Consumer," p. 30.

Credit Unions.[1]—These are cooperative organizations which lend savings of members to some of the members of the group. To accept deposits and to charge rates higher than those charged by commercial banks, credit unions must operate under special laws. Credit-union legislation has been enacted by 41 states and the District of Columbia. These laws give them power to receive deposits, to make loans to members "for provident or productive purposes," to make investments in certain kinds of financial institutions, and to borrow money up to 50 per cent of their assets. Every member must subscribe for at least one share, pay the initial instalment on it, and a small entrance fee. In June, 1934, Congress passed the Federal Credit Union Act for the purpose of developing thrift and providing a loan service. The act was placed under the supervision and administration of the Farm Credit Administration, apparently on the theory that the need for depositories of small savings is greatest in rural areas where no or few banking facilities are present and where there is also urgent need for small loans, although the greatest development of such unions has taken place in the cities. Under this law, credit unions can be formed in all states, even in those which have no special enabling legislation. Prior to the enactment of this law, there were approximately 2,400 credit unions, and now there are in the neighborhood of 3,000 such organizations. Some enthusiasts have placed the number of credit unions at 4,000 and the membership around a million.[2]

The majority of the loans made by credit unions are around $50. For loans up to this amount no security other than the borrower's promissory note is required, and the pledge of union shares owned at the time. Loans of larger amounts require endorsers or other security, and such loans may be made up to $200 under the Federal law. The maximum period for repayment is 24 months and the interest charge on a loan must not exceed 12 per cent a year on the actual amount of money in the borrower's hands.

Several advantages are claimed for the credit-union plan of saving and lending. First, there is the low cost of operation. Office space is donated, management services are given by members free of charge, and the unions are exempt from all taxes except on real estate. Second, because of the intimate knowledge of borrowers, losses are very small. Third, the return on capital to shareholders is limited to not more than 6 per cent a year. Fourth, the rates charged by credit unions are much lower than those charged on similar loans by most commercial lenders, being limited to 1 per cent per month on the unpaid balance. Fifth, there is the group of advantages the members derive from learning to

[1] For a comprehensive and detailed presentation of the subject, see M. R. Neifeld, "Cooperative Consumer Credit."

[2] FILENE, E. A., "Credit Unionism," *The Jeffersonian*, p. 3, March, 1936.

manage financial affairs and carrying out the cooperative ideal which they often hold.

From this it must not be implied that the future of credit unions is so bright that they will in time supplant other loan agencies. These unions operate best for groups with a common bond and those that are closely knit. To insure success, participants must all be members of the same church, lodge, club, labor union, teacher association or group, residents of the same neighborhood, employees of the same governmental bureau or department, or employees of a single business firm or industrial plant. Second, a credit union must have at least 50 members in order to operate with a reasonable degree of efficiency and to provide sufficient funds for lending. It is estimated that four fifths of all employers in this country have less than 50 employees each. This at once limits the organization of unions among employees of industrial and commercial enterprises. Third, they do not seem to operate in harmony when the membership is much in excess of 200. This limitation, together with the fact that Federal unions are not permitted by law to accept deposits and credit unions generally cannot readily secure funds by borrowing, enhances the difficulty in obtaining the necessary capital for large operations. Finally, credit unions have not as yet learned to extend credit safely without sacrificing the secrecy which small borrowers ordinarily seek.

COMMERCIAL AGENCIES IN THE SMALL-LOAN BUSINESS

Pawnbrokers.—Pawnshops make loans on pledges, lending from 70 to 90 per cent of the auction value of the chattel pledged. Except for shops that specialize in jewelry, the average loan is considerably below $10. This is sometimes the only way of securing needed cash for people without an assured income or a good credit standing. The alternative may be to borrow on pledge from a remedial loan society, if one is present in the community, where a larger amount can be obtained on the pledge and a lower rate is charged for the loan.

The pawnshop method of borrowing is not without its advantages under certain conditions. No promise is made to pay the amount borrowed; the pledge is virtually sold with an option to repurchase it. In case of nonpayment, no risk is assumed other than loss of the pledge. The borrower is not pursued by collectors, nor is he in danger of having his wages attached. On the other hand, the rates charged are frequently exorbitant, varying from 24 to 120 per cent per annum, with 36 per cent being more or less common in the large cities. Furthermore, if the chances of redeeming the pledge are slight, much more can be secured by selling the article outright.

Industrial Banks.—Probably the earliest of the so-called "industrial banks," were those operating on the Morris Plan. Established in 1910, these banks have grown in number and strength so that they now operate in approximately 150 cities. They have attempted to imitate commercial banks by retaining the word bank in their name and by making loans at a discount on the security of two co-makers or endorsers. These institutions also accept deposits and are members of the American Bankers Association. Although they specialize in making loans on notes having two co-signers, they also finance conditional sales transactions and in recent years have branched out into other fields. A number of stores which do not wish to carry any or certain kinds of customers who desire to buy goods on the instalment plan have effected arrangements with the Morris Plan Banks to cash their sales to such customers and have the customers finance the transactions through the bank.

In view of the success of the Morris Plan Banks, many other industrial banks of this type have come into being. Most of them operate very much like their predecessor, except that they may not in some states be permitted to accept deposits or sell investment certificates. Funds must then be secured through the sale of stock or through borrowings from commercial banks and other financial institutions. Thus, the other banks have been unable to obtain the desired amount of money or the cheap funds which the Morris Plan Banks have been in a position to secure through deposits. Nevertheless, many of them have grown and prospered, indicating a definite field for this type of financing.

In Morris Plan Banks loans may be made up to $5,000 and in other industrial banks loans up to $1,000 are frequently allowed, but in actual practice the loans are seldom in excess of $500. Repayments are made monthly, semimonthly, or weekly, and may extend for as long as two years, although they are normally limited to one year. The usual charge is 6 or 7 per cent, and 2 per cent for the investigation, the charges being based on the full amount borrowed.

The principal advantages of borrowing from industrial banks on the signature of the borrower and co-makers are the relatively large sums that can be borrowed from such sources and the relatively low rates of interest charged on the loans. With the exception of commercial banks, there are practically no other agencies from which amounts in excess of $300 can be borrowed by consumers at reasonable rates. Attention must be called, however, to the fact that the rates charged are not so low as they appear on the surface. In the first place, if the total charge is 9 per cent, including the cost of investigation, a borrower who signs a note for $100 receives only $91. When computed on the basis of the actual amount received, he rate is 9.9 per cent. Second, the borrower is required to make regular payments, sufficient to pay back the loan at maturity. Thus if the loan

is to be repaid in 12 months, each month a deposit must be made of $8.34, which means that the borrower pays interest on the amount already paid back. By applying the formula presented in Chap. VII, the rate of charge becomes 18.3 per cent in the instance cited rather than 9 per cent. In some cases, the rates have been as high as 34 per cent per annum, but the usual rate charged by industrial banks figures around 17 per cent, which is much more reasonable than the rates of other commercial agencies.

The requirement of one or two co-makers and endorsers from among the borrower's friends, relatives, business associates, or fellow employees, has proved a real stumbling block. Some would-be borrowers cannot get acceptable endorsers, some do not wish to ask such a favor unless they can reciprocate it, and others are reluctant to reveal their financial embarrassment to friends and relatives. For this reason, some of the industrial banks now make character loans on the borrower's signature alone, provided he is deserving of the consideration. Another weakness from the standpoint of the consumer is the insistence of these lenders upon prompt payment. Certain banks do not hesitate to turn an account over to an attorney for action if payments become overdue on two successive instalments.

In recent years, the industrial banks have branched out and invaded other fields. In addition to character or signature loans, they also make loans now on collateral, on which the charges are smaller, usually amounting to a quoted rate of 7 per cent on a $100 loan which is actually a little over 13 per cent per annum. They also make automobile-purchase loans as well as loans on owned cars, using a lien on the automobile as collateral. Some industrial banks have made loans, under the Federal Housing Act, for home improvement, and others have gone into wholesale financing by discounting instalment paper held by merchants.

Personal Loans by Commercial Banks.—Ever since their inception many commercial banks, particularly in rural areas and small cities, have been making character loans to individuals. These loans may have been secured or unsecured and, like regular business loans, have been discounted at the usual rate. Sometimes a somewhat higher rate of interest has been charged on such personal loans, especially when unsecured or when made for a small amount. Even today a considerable amount of business is done by commercial banks along this line, but loans of this type are restricted to persons of high integrity, an assured income, and a good all-round credit risk. Banks are motivated to engage in this kind of business by unused capital, available plant and equipment, and a desire to build good will among their business customers and within the community in general.

About the middle twenties, commercial banks began to experiment with the idea of establishing separate personal loan departments or other-

wise make personal loans on a basis comparable to that used by industrial banks, especially of the Morris Plan type. Through such departments, endorsed notes up to $2,000 are discounted at 6 or 7 per cent plus a 2 per cent charge for handling and investigation, and borrowers are permitted to repay the loan in monthly or weekly instalments. The number of commercial banks so organized to make personal loans on character and income was very small, however, until August, 1934, when the National Housing Act was passed. Under the impetus of Title I of this law about one half of the 14,000 banks began to make personal loans for home modernization, including the purchase of certain household appliances. Although that part of the Act expired in March, 1937, most of the banks are continuing to make such loans on their own and without government insurance, but the amount of such business has declined considerably. In recent years a number of commercial banks have also provided facilities for financing the purchase of automobiles on which they take a chattel mortgage. This marks a change in bank policy, substituting a "*borrow* to buy" appeal for that of "*save* to buy."

The operations of commercial banks in the personal loan business are subject to the same advantages and limitations as are those of industrial banks. They are further handicapped by the costliness of handling small loans, for their machinery is not geared for this kind of business. Consequently, they must discourage personal loans under $300 if they are to make small-loan business bear its proportionate share of the cost incident to operating the bank. It is quite likely that when business opportunities expand, calling for more bank loans, and when commercial banks develop an accounting system that will show the exact costs of operating a personal loan department, fewer commercial banks will enter the field (some of them may even withdraw from it) but engage in it indirectly by supplying funds to the various finance companies in the sales and personal phases of the work.

Illegal Lenders.—Unlicensed lenders, commonly referred to as "loan sharks," operate in all states, but abound and do a thriving business in those states which have failed to enact small-loan legislation or in states which have enacted defective laws and set the maximum rates too low to attract regular small-loan companies. In the latter two classes of states, illegal lenders are the only source available for a large majority of wage earners in need of financial assistance. While they accept all kinds of security, such lenders favor a wage assignment, especially in states where garnishment laws fail to limit drastically the amount that a creditor may attach.

While some of the unlicensed lenders may attempt to supply a need at a reasonable rate, most of them have been found to be unethical and outside the law. The rates charged are exorbitant, ranging from 10 per

cent a month and up, with 20 per cent per month being rather usual. On an annual basis, the rates vary from 120 to 1,200 per cent, with a usual rate of about 240 per cent. Interest payments are being collected indefinitely, so long as the principal remains unpaid. But, worst of all, it is the aim of loan sharks not only to get a person in debt but to keep him there. This is accomplished by urging the borrower to renew the loan, by using various so-called "legal devices" to collect more than can be paid, and by having the loan, when unable to pay, refinanced by a fictitious company owned by the same lender so that a heavy refinance charge may be collected in addition to the usual rate.

Personal Finance Companies.—Consumer credit is probably as old as man. It was no doubt used in primitive times when an unsuccessful hunter borrowed some food from another member of his tribe who was more fortunate. Throughout the ages it must have been used to meet a temporary shortage in life's essentials or to care for an emergency that has suddenly arisen in the life of an individual or his family. Money lending to individuals in small amounts also has a long history. Biblical accounts of money lenders are a matter of common knowledge. Through the centuries money lending has continued, but as time went on and the modern, complex economy replaced the older and simpler methods of life, the demand for cash loans grew by leaps and bounds while facilities to serve the consumer's needs lagged behind and lenders for the most part remained primitive in their treatment of borrowers. The plight of our wage earners and other consumers of small means attracted the attention of many socially minded persons and of certain institutions. Among the latter the leading one was the Russell Sage Foundation, an organization philanthropically endowed in 1907 to work "for the improvement of social and living conditions in the United States." A comprehensive investigation of the small-loan field was begun at once and many bad conditions were uncovered, including inadequate facilities for small loans and numerous abuses on the part of existing commercial lending agencies. After a nine-year survey of the consumer credit situation, this Foundation in 1916 drafted what has since become known as the Uniform Small Loan Law which has since been revised six times to keep abreast of the times. The Foundation has continuously urged this law for adoption by the several states. This type of legislation gave birth to the modern personal finance company. In the meantime, credit unions and state industrial banks also came into the picture to fill in part of the gap in the consumer credit structure.

The Uniform Small Loan Law.—Largely through the effort of the Russell Sage Foundation and the many social, civic and welfare organizations and leaders that have joined the Foundation's endeavor to secure the enactment of legislation, 36 states enacted small-loan laws. Of these,

however, only 26 so far adopted the principal features of the Uniform Small Loan Law. These states embrace about 77 per cent of the country's urban population.

In the main, the law provides for the licensing of agencies which are to operate under strict state supervision. Loans may be made without collateral or endorsers. Not more than $300 may be loaned to an individual. The charges must not exceed 3½ per cent a month, simple interest on unpaid balances. For some states a maximum of 3 per cent per month has been recommended. No fines, fees, or other charges are allowed. To obtain a license under this law an agency must have at least $25,000 in liquid assets and must agree to pay an annual license fee of $100. The Foundation was especially careful in recommending a rate that is high enough to attract commercial capital into the enterprise and warned against rates being set too low. It also recommended simple arrangements so that the various terms may be stated in understandable language in each contract. The borrower must receive a statement of the loan, showing the amount, maturity, the rate of interest, and security. He may prepay all or any part of the loan on any payment date. Some states, while embodying most of the principal provisions of the recommended law, have deviated from it in certain respects.

Growth and Present Status of Personal Finance Companies.—Since 1916, the personal finance business through licensed lenders has experienced phenomenal growth. In July, 1937, there were 3,553 licensees in operation,[1] with aggregate annual loans of about $500 to $600 millions, if it is assumed that the outstandings shown in Table III turn at least twice a year, which seems to be in line with the experience of the leading organizations in the field. These companies are said to serve more than 2,500,000 families.[2] Assuming four persons to the average family, it would seem that about 10 million persons, or one thirteenth of the entire population, are in any one year directly affected by the service of these organizations.

As in other lines of business and finance, the chain method of operation has been adopted in this field. The two largest organizations in the personal finance field are the Beneficial Industrial Loan Corporation, operating also under the name of Personal Finance Company, and the Household Finance Corporation. The Beneficial group loaned $103,855,567 in 1936, and at the end of that year had 360 offices in 280 cities. The Household Finance Corporation loaned $100,855,787 in 1936, and had 222 offices in 143 cities.[3] Not only do these principal companies

[1] "Roster of Personal Finance Companies in the United States," American Association of Personal Finance Companies, Sept. 1, 1937.

[2] ROBINSON, L. N., and NUGENT, R., "Regulation of the Small Loan Business," pp. 143–162.

[3] Moody's Manual of Investments, 1937.

absorb a substantial part of the business done by personal finance companies, but they have, together with many so-called independents, also taken the leadership in the progress recorded to date.

The type of borrowers served by personal finance companies is illustrated by the data in Table IV based on the experiences of the Household Finance Corporation with 335,788 loans during 1934 and 614,737 loans during 1936 (taken from the company's annual reports).

TABLE IV.—OCCUPATIONS OF BORROWERS FROM PERSONAL FINANCE COMPANIES

Occupation	% of all borrowers	
	1934	1936
Skilled and semiskilled laborers	35.26	39.63
Office and clerical workers	18.73	19.10
Professional persons (except teachers)	2.52	9.00
School teachers	8.73	
Owners-managers	11.00	9.42
Managers, superintendents and foremen	10.34	10.03
Sales persons	6.54	5.86
Unskilled laborers	5.01	5.39
Unemployed recipients of independent incomes	1.26	1.25
No occupation given	.61	.32
Total	100.00	100.00

From 75 to 80 per cent of the loans are apparently for the purpose of paying family debts already contracted. The specific uses made of the money thus borrowed is illustrated by the data shown in Table V and taken from the experiences of the same company and from the same sources.

It is probable that when a borrower says that he needs the money for clothing, for example, he may intend to buy clothes with the funds rather than pay an already contracted clothing bill. However, since such articles can generally be bought on credit from the store, the presumption is that when one borrows for clothing it is for the payment of a debt already incurred. Nevertheless, the data on the reasons for borrowing, while they cannot be taken at par, may be deemed approximately correct.

Advantages and Disadvantages.—When borrowing from a licensed personal finance company, the borrower needs no co-makers. His own signature, with perhaps that of his wife, suffices. Secrecy is maintained throughout. Chattels on furniture or wage assignments, when obtained as security, are seldom enforced. Some companies no longer take wage assignments, and it is probable that others will follow this example. Relatively kind, human treatment now characterizes the business.

TABLE V.—REASONS FOR BORROWING FROM PERSONAL FINANCE COMPANIES

Reason for borrowing	% of all loans	
	1934	1936
Medical, dental and hospital bills	16.93	17.03
Miscellaneous debts (to consolidate)	14.71	9.12
Tax bills	7.98	5.32
Fuel bills	7.24	6.70
Clothing	6.32	9.86
Real estate mortgage and interest	5.19	4.46
Repairs	4.45	4.54
Furnishings	4.17	6.39
Insurance	3.92	2.74
Rent	3.61	3.27
Automobiles	3.43	4.60
Food	1.66	1.74
Funeral expense	0.81	0.81
To pay debts	80.42	76.58
Business needs	5.74	6.00
Travel and vacation	3.71	5.30
Assist relatives	2.77	4.94
Education	2.10	2.02
Moving expense	1.74	2.07
Miscellaneous and not reported	3.52	3.09
Total	100.00	100.00

Except for the industrial and commercial banks, there are practically no agencies other than licensed personal finance companies from which character loans may be obtained for as large an amount as $300. The leading personal finance companies aid borrowers in budgeting their expenses to make sure that they will be able to extricate themselves from their financial difficulties. In this connection, some of them have taken the leadership in educating the consumer on buying so that she may get her money's worth and live within the family income. Considering the type of loan and character of the service rendered, the rate seems reasonable, as will be shown in detail in Chap. XXVI. The larger companies operating in the large centers of population, where the volume permits it, usually charge lower rates than either allowed by law or recommended by the Russell Sage Foundation. To this there are two exceptions: in the states of Indiana and Wisconsin the rates are set by the banking commissions and the companies have no discretion. There is also a definite trend to limit the number of interest payments on any one

loan. Finally, the careful state supervision to which such companies are subjected assures fair treatment even when a licensee should be prone to take advantage of the borrower.

Like other consumer-financing agencies, personal finance companies at times make loans to undeserving risks, which increase their losses and costs of operation. They may also tend to overload a borrower by extending a larger amount than warranted. Others may attempt to make habitual borrowers by refinancing loans when they are but partly paid. All of these are abuses that the better companies are trying to eliminate and which are not inherent in the personal finance business. As a matter of fact, most such organizations make loans in a way that not more than a few per cent of the monthly income of the borrower will be required to take care of the instalment, covering both principal and interest on the loan. Most of these companies are constantly on the alert to rid their business of the abuses formerly prevailing in the consumer cash-credit field.

ADEQUACY OF CONSUMER CREDIT FACILITIES

From the consumer's standpoint adequacy may be judged by the availability of credit when needed, at reasonable cost, and on terms and conditions which the consumer can meet. On this basis there would seem to be ample facilities for people who are justified in buying on a charge account. Plenty of stores offer the service, it costs nothing more than if purchases were made for cash at the same stores, and the terms are simple and can be met by regular charge customers. As far as instalment credit is concerned, it is believed to be altogether too ample, many grantors are too lenient, a growing number of vendors are offering goods on that basis, and the cost is being constantly reduced, although much still remains to be done on this score.

Such is not the case, however, in the cash-credit area. For loans considerably under $100, much improvement has been made in recent years through the growth of credit unions, but it is doubtful whether this device will obviate the necessity for pledge loans for very small sums on the part of persons who are not eligible to join a credit union. Pledge loans, therefore, should be regulated more strictly by the government to curtail some of the major abuses. For sums in excess of $300, facilities are limited, but increasing opportunities may be found in the personal loan departments of commercial banks and in many of the industrial banks. For this type of service there is a legitimate place, which it appears can be best rendered by industrial banks that specialize in it without the expensive machinery of the commercial banking institution.

From the experience accumulated to date, it would seem that the need is probably greatest in the loan brackets of $50 to $300. The average

size loan of the leading personal finance companies seems to range from $150 to $175. Much progress has already been made in curtailing their illegal activities through the enactment of enabling legislation making possible the operation of licensed small-loan companies. Even in the 26 states which have fairly workable legislation, considerable improvement can be made in the laws to put the business on even a higher level. Certainly, there is urgent need for such legislation in the remaining states. Such legislation, wisely enacted, may go far in mitigating some of the perplexing financial problems of millions of our families and in encouraging the development of legitimate small-loan companies that even now fill an important gap in our credit structure.

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Questions and Problems

1. List the various classes of credit purchases and types of borrowing comprised in consumer credit.

2. Are the reasons for buying goods on credit and borrowing money, on the part of consumers, identical, or do different sets of motives prompt them to act in each case? Explain.

3. You are assigned the task of measuring the total volume of consumer credit, for which you are given a limited appropriation. How would you go about it? If the appropriation were exceedingly liberal, what would be your method of approach? Explain in detail.

4. Are the estimates of consumer indebtedness shown in Table III liberal or conservative? Give reasons for your conclusion.

5. If estimates of consumer credit and consumer debt are deemed inaccurate, why make them? Is there any purpose served by inaccurate data on this score?

6. Name and classify all sources of consumer credit, and indicate their relative position in the credit structure.

7. If a consumer wished to borrow on character or against income an amount under $50 or $60, what sources could he use? What sources would be available to him if he wished to borrow $200? Suppose he had no assured income, could he still obtain the needed funds?

8. Why are Morris Plan and similar institutions called "industrial banks"? Trace the development of these organizations to date and indicate their possible future.

9. Define or explain each of the following terms: character loan; co-maker; pledge loan; the Uniform Small Loan Law; aktsia; credit union; automobile loan; loan shark; sales finance company; personal finance company.

10. What forces gave rise to the licensed personal finance company and what are the major features of their operation?

11. Arrange in tabular form the rates charged by the different types of lenders and explain the differences.

12. In what ways is the licensed personal finance company superior in serving the needs of consumers to other agencies making similar-sized loans?

13. If you were to draw up a platform for the improvement of the consumer credit structure, what planks would you put in that platform and why?

CHAPTER VI

THE RETAIL CHARGE ACCOUNT

The retail charge account still represents the major part of consumer credit, despite developments in recent years along other credit fronts, especially of the instalment type. It constitutes the credit a merchant extends to an individual or his family when goods are purchased by the latter for use or consumption and not for sale. Technically, it is the power which the individual or his family uses in obtaining goods and services for consumption purposes in exchange for a promise to repay an equivalent at a future time. In a broad sense, this type of credit includes extensions to consumers by manufacturers who sell direct and by various professional and service groups such as doctors, dentists, lawyers, beauty parlors, garages, and undertakers. For our purposes the discussion in this chapter will be confined, however, to a consideration of retail credit of the charge-account type as extended by a retailer to an ultimate consumer who buys goods for personal use rather than for sale.

Significance of the Retail Charge Account.—Although the retailer is the one primarily and directly interested in this form of credit, yet wholesalers, functional middlemen, and manufacturers are indirectly, though not less vitally, concerned with it. The success in credit granting along the entire chain of distribution depends ultimately upon the payments by consumers to retailers. Only prompt payments to retailers enable the latter to cancel their obligations incurred in the purchase of goods from wholesalers, who, in turn, are then in a position to settle their accounts with the manufacturers or functional middlemen from whom they bought their stocks of merchandise.

As a corollary of this it naturally follows that, should the ultimate consumer fail to meet his obligations, the consequent weakness of the retailer will invariably be reflected all along the various links in the chain of distribution. When such a situation becomes accentuated, the whole credit system is impaired.

It is quite obvious from the foregoing that a large part of our credit system is built around retail credit. The wholesaler grants credit to the retailer in order to enable him to meet the demands of the consuming public. In his turn, the wholesaler demands credit extensions from his sources of supply, whatever they may be. Finally, manufacturers must either have adequate financial resources of their own or else resort to the

aid of functional middlemen, such as brokers, commission houses, or factors. In addition, all of them enlist the aid of the financial specialist—the commercial banker.

Retail Credit Much Demanded.—Few reliable data are available showing the extent to which credit of the charge-account type is being used. According to the Bureau of the Census, of the $33 billions of sales reported by retail establishments for the year 1935, no less than $7,041 millions represented sales on open account and $3,599 millions consisted of sales on the instalment plan.[1] This means that 32.2 per cent of all retail business was on credit, and, of the latter, open-account sales constituted 66 per cent, or two thirds, of all credit extended by retail stores. Thus the retail charge account is still the dominant form of retail credit, despite the recent phenomenal growth in instalment business. For 1936, it has been variously estimated that retail credit sales rose to 34 per cent of all retail store volume, the same as in 1929, and that open-credit sales amounted to $8 billions. The census figures do not show, however, the *total* amount of business transacted by means of charge accounts, because they do not include the credit business of the various service establishments or of the professions. Neither do the data from the above source indicate how many of the 1,653,961 stores in this country extend credit to their customers. For this reason, credit statistics by kind of business as presented by the Census of Business lose much of their meaning. From another source, however, it is possible to determine how widely the charge account is used in different kinds of business. According to this source, approximately 90 per cent of the business done by those plumbing and heating establishments that extend credit privileges is of the charge-account type, and the same is true of about 74 per cent of the business of coal dealers, 64 per cent of the business of women's specialty stores, 56 per cent of the grocery store trade, 54 per cent of the hardware trade and of men's clothing, respectively, and nearly 43 per cent of the department store business. On the other hand, only about 18 per cent of the business of household appliance dealers selling on credit is on the charge-account basis, for the bulk of such business seems to be on the instalment plan. Only 21 per cent of the business of furniture stores selling for both cash and credit is transacted by means of charge accounts, and about the same proportion obtains in the sales of automobile dealers.[2] Moreover, the trend seems to be for the larger stores to sell a proportionately greater amount on credit of the charge-account type. For example, department stores doing less than $100,000 business

[1] Census of Business: 1935, Retail Distribution, Vol. VI, p. 11, U.S. Department of Commerce, May, 1937.

[2] LaCrosse, H. T., "Retail Credit Survey, 1936," Domestic Commerce Series, No. 98, U.S. Government Printing Office, 1937.

a year reported about 25 per cent of their business on open credit, and this percentage increased until it reached 47.4 per cent for department stores with an annual volume of $5 to $10 millions. After that point there was no definite correlation one way or the other.[1]

It should be noted that in the estimates of the total percentage of credit business cited in Chap. I, checks were included among the credit instruments, so that all transactions involving payment by check were necessarily regarded as credit transactions. In the percentages of credit business discussed in the paragraphs immediately preceding only strictly credit transactions were considered. The merchants reporting generally regarded checks as cash.

ARGUMENTS FOR RETAIL CREDIT

Despite the obvious growing demand for retail credit on the part of consumers, it is sometimes argued that, from the standpoint of society at large, it is doubtful whether retail credit is necessary. Even some retail merchants themselves occasionally doubt the feasibility of such a policy. Excellent evidence of an unfavorable attitude toward retail credit granting is presented by pointing to the enormous growth of stores since 1910, usually of the chain type, based on a "cash-and-carry" system. The development of supermarkets in more recent years is another indication of attempts to do away with credit as well as to eliminate other services, such as delivery and sales help.

While the validity of some of these arguments cannot be denied altogether, it is true, nevertheless, that the strongest arguments favor the adoption and use of credit. No one will deny the possibility of successfully operating a store on a cash basis under certain circumstances. It must be conceded, however, that the pendulum is swinging in the opposite direction, and that even the chain stores are realizing that the lack of credit service is a decided limitation to their expansion and many of them are now selling on a credit basis.

The arguments in favor of retail credit may be arranged in two groups according to the point of view. From the standpoint of the merchant it is argued that:

1. Credit Ties Up Trade.—It makes regular customers. Patrons with charge accounts usually give their entire trade in a given line to a limited number of stores. Cash customers are everybody's customers. A credit customer, on the other hand, as a rule trades regularly in the store with which credit connections have been established. At least, the first choice is given the institution in which a charge account is had. Thus credit makes for repeat business.

[1] *Ibid.*, p. 40.

2. Credit Sales Are Larger on the Average.—Cash customers are constantly on the lookout for startling bargains. They are attracted to a larger extent by advertising, are interested in a larger measure in price, and generally shop around more. This group constitutes the class of habitual bargain hunters, who, on the average, muss up larger quantities of merchandise, flit from store to store, and buy less per person than do charge customers. With credit customers, price does not restrict sales, and the average sale is larger.

3. Credit Customers Buy More.—On the average, it is believed, customers having charge accounts buy more freely and are somewhat more extravagant. They do not for the most part realize the value of money, because of postponement in payment, to the same extent to which cash buyers do.

4. Credit Develops Confidence.—By trusting goods to a customer, the store, in turn, gains the confidence of the buyer. Confidence breeds good will, without which no merchant can claim success. A credit system also insures permanency of the store in the community. A merchant of a dishonest character will not trade on a credit basis. On the other hand, the straightforward retailer, by dealing squarely with his trade, does not fear that his customers will refuse payment for value received. Goods can be sent on approval, and sales may also be increased through displays and suggestions which are more nearly taken at par by credit customers.

5. Credit Attracts Better Trade.—Contrasted with cash stores, businesses selling on credit appeal to a better type of trade which is interested primarily in service, quality, and style, and is only secondarily concerned with price. Cash stores usually attract the poorest and cheapest trade and become known as cheap stores. Most of the urban department stores operating purely on a cash basis are of this type.

6. Credit Irons Out Business Peaks.—Credit makes for a better distribution of business volume. Cash trade tends to peak on certain days, such as Saturdays and preholiday periods, when wages or salaries are obtained and cash is readily available. Credit customers, on the contrary, buy whenever goods are needed, irrespective of their possession or lack of money at the time.

Peaks are costly. Because of them, larger inventories must be carried regularly, and the selling problem becomes more complex. Excessive clerical help must normally be carried on the payroll and many "extras" must be kept in touch with. In support of this argument, it may be stated that, according to investigations conducted by the author, department stores selling on both cash and credit report that on Saturdays the increase in volume of business comes primarily from cash purchasers and that no noticeable variation is observed in the sales to credit accounts on

such days. Credit thus tends to prevent concentration of sales and to iron out the peaks in business.

7. Credit Reduces Complaints.—Failure to deliver purchases promptly does not tend to arouse any suspicion on part of credit customers, whereas purchasers who have paid in advance are likely to get disgruntled and panicky under such circumstances, and complaints are immediately registered to that effect. The assumption on which this argument is based is that consumers lack confidence in a store which insists upon payment for the goods in advance, since only dishonest merchants refuse to grant credit. It is obvious that this line of reasoning is not entirely sound. Credit may be denied because of a number of reasons. The particular credit risk may be inferior, or the store may operate on a purely cash basis for economic reasons, as will be indicated in the following pages.

8. Credit Sales May Be More Economical Than C.O.D. Sales.—To begin with, when sales are on a C.O.D. basis, a special system of handling them must be provided in the delivery department. They must be segregated from the others and properly accounted for. Additional clerical help is necessitated, and often a separate C.O.D. room is maintained. Moreover, when the customer is not at home at time of delivery the merchandise must be taken back and "sent over" again, thereby bringing about duplication of effort. If the customer is at home, additional time is consumed in making collections, especially when she insists on examining the goods prior to making payment.

9. Credit Is a Customary Convenience.—People are accustomed to receiving credit and, to be successful, a merchant must meet the demands of his trade. Purchases are frequently made by different members of the family, while payment is made by the one who has control of the financial end. Credit makes such practice possible. Again, some persons are paid at definite intervals—wage earners and many clerks receive compensation weekly—while the salaried group ordinarily receives payment on a monthly basis. These individuals are compelled to wait for their earnings, and they justly feel that retailers from whom they buy should do likewise. Moreover, many wage earners live from hand to mouth, especially during periods of stress and unemployment, and, consequently, possess no ready cash with which to pay for purchases until pay day when wages are received. Similarly, in farming communities, consumers are frequently compelled to wait for cash until the crops are harvested and marketed. When prices are depressed and unsatisfactory, the period of waiting may be considerably prolonged until resumption in buying on a large scale commences.

Then, too, customers who are able to pay cash are unwilling to do so because of the inconvenience incident to carrying around money at all

times to pay for purchases, especially when purchases are small and frequent. Credit also makes it possible to place orders by telephone and to depend upon the merchant to make delivery and leave the goods even in the absence of the purchaser. This, of course, applies only to stores which also render telephone and delivery services. Finally, home accounting is simplified and facilitated by the credit system. Periodic payments are easily kept track of and the housewife can manage the home on a budget plan. To be sure, when cash stores render a receipt each time a purchase is made the same object could be accomplished, though with slightly greater difficulty. However, as yet, few cash stores are following the practice of rendering such receipts.

10. Increases Sales.—Credit as a volume builder is well recognized by most merchants today. This net result is achieved through the various advantages previously enumerated. Moreover, such larger volume is obtained from regular customers with whom dealings are usually more pleasant and profitable.

When viewed from the standpoint of social welfare, it is claimed that:

1. Credit Improves Quality of Merchants.—Credit rests essentially on confidence. Confidence in customers arises out of an intimate knowledge of the trade. A knowledge of his clientele facilitates the rendering of merchandise and services on the part of the merchant in accordance with the requirements of the community. Buying can be done more scientifically and merchandise plans accurately drawn up. It should also be remembered that credit customers regularly and steadily patronize the store in which they have a charge account. Their needs can, therefore, be more readily anticipated and future requirements more easily forecast.

2. Credit Improves Quality of Selling Service.—A knowledge of the idiosyncrasies of the different customers on the part of the salespeople makes it easier for them to serve the trade and sell satisfaction and good will. Charge customers are regular customers and clerks learn to know them and serve them accordingly. At least some cash stores are cold and impersonal. It must be admitted, however, that poor clerical service is not inherent in a cash policy, although it almost invariably accompanies it, primarily because cash stores generally make a price appeal which is possible only through various kinds of savings in the buying as well as in the selling aspect of merchandising.

ARGUMENTS AGAINST RETAIL CREDIT

1. Credit Increases the Cost of Doing Business.—Even credit stores will admit that it is impossible to operate on a credit basis without some loss. The loss from bad debts is inevitable and may be caused by human or external factors beyond man's control. The debtor may be dishonest and unwilling to pay, or external events may occur, such as a failure of

crops, accidents, general business depressions, the effect of which is to reduce his ability to meet his obligations. To the extent of such loss, the retailer is called upon to support some people with necessities and sometimes luxuries. He, in turn, seeks reimbursement from the public whenever permitted by competitive conditions. This is accomplished by adding the amount of loss to the selling price of the goods. In addition, the expense incurred in maintaining a credit department and an adequate personnel to care for both credit granting and collections must necessarily be added to the normal cost of operation. When sales are made for cash, interest is saved on borrowed money, credit and collection expenses are eliminated, bad debts are avoided, and bookkeeping expenses are reduced.

Unfortunately, there are no reliable data showing how much it costs a store to operate on a credit basis. The single largest item of expense is in the operation of the credit office. It covers salaries and wages of the credit and collection personnel; maintenance, including a reserve for the depreciation of equipment; rent for the space occupied; supplies; and a prorated share of the overhead. In the majority of the larger stores, this item of expense may range from 2 to 4 per cent of credit sales. A second item of considerable import is the interest on the average receivables. If computed at the rate of 6 per cent per annum, this cost is deemed to be around 1 per cent of credit sales, but it is questionable whether a 6 per cent rate should be charged since not many businesses, particularly the smaller ones, earn such a rate on the capital invested in the business in addition to the compensation of proprietors. A third major item of expense is the loss from bad debts, which, like all other expenses of credit granting, varies with different kinds of business, but in general is around 0.5 per cent. Finally, there is the cost of credit information and collection expenses in the form of fees to attorneys and collection agencies. This amount may vary from 0.3 to 0.5 per cent. Thus the total cost of operating on a credit basis may range from 4 to 6 per cent of credit sales.

It should be noted that the various items of credit-granting expense, including bad-debt losses, have been expressed in terms of credit sales rather than total sales. There are several reasons for this. Such expenses are incurred only on credit sales, hence should be expressed as a percentage of the business for which they are incurred. Second, it facilitates comparison with other enterprises similarly operating regardless of the credit to total sales relationships. Third, it facilitates comparison of expenses from year to year in the same establishment even though the proportion of credit business to total sales has changed.

Credit stores, however, claim that the expense incident to credit granting is not unlike that incurred in advertising. An expense is not an expense in the true sense when the gross profit attributed to it exceeds the amount expended for the purpose. Although the losses in well-regulated

retail establishments incident to bad debts and failing accounts may sometimes run as high as 1 per cent, the consequent increase in volume of business and corresponding net profit more than offsets the amount of loss.

2. Cash Customers Pay for Bad Debts.—It is frequently argued that cash customers as well as those who pay their bills promptly are penalized and that they are caused to pay for credit losses. These classes of customers are charged the same prices as poor-pay customers, and, since the prices in a store operating on both a cash and a credit basis are necessarily higher on account of losses from bad debts, the former are penalized and unduly taxed.

On the other hand, cash customers shop around considerably, buy less and in smaller quantities, and in many other ways raise the cost of operation, while credit trade rolls up volume—so essential to economical operation of a retail institution.

3. Credit Leads to Extravagance and Recklessness.—Charge accounts induce people to buy more and to live beyond their means, arguments to the contrary notwithstanding. Nevertheless, extravagance could be curtailed by proper education regarding the use of a credit system. Besides, cases abound of wage earners who spend all of their weekly income at one time, extravagantly and carelessly, and go without necessities until the following pay day. Thus, extravagance is not practiced solely by persons purchasing on charge accounts.

4. Credit Ties Up Capital.—Charge accounts require a larger capital investment. A merchant who wishes to engage in credit granting must possess more capital to secure a given volume of business than a merchant who operates on a cash basis only. Capital turnover is decreased accordingly, but it is believed that the additional funds are well invested. More trade is secured, and economies from large-scale operation are gained which more than offset the interest cost of the additional investment.

5. Credit System Invites Complaints.—Many credit customers feel their preferred position and take advantage of it. More goods are returned, many complaints are registered as a result, and adjustments are asked for. Some of them even act occasionally as if they owned the store. In justification of this position, credit stores claim that credit customers, because of their concentration of purchases and savings effected thereby, are entitled to more attention and greater consideration. Besides, most complaints are not unreasonable and an up-to-date merchant aiming at a maximum of service should welcome them, irrespective of their origin.

FACTORS DETERMINING CASH OR CREDIT POLICY

Class of Trade.—In considering the question of a cash versus credit policy, a retail merchant must not confine himself entirely to an analysis

of the advantages and disadvantages of the two alternatives. A number of additional factors must be carefully scrutinized and appraised. It is a matter of common knowledge that a retail storekeeper has the choice of emphasizing one or more of three types of appeal to the consuming public. He may emphasize price, quality, or style, in addition, of course, to stressing the reputation and superior service of the store. In choosing the price appeal, a merchant automatically eliminates that class of trade which is only secondarily interested in price, namely, those strata of society falling within the medium and higher ranges of income. Obviously, a store emphasizing price attracts the trade of the lower social stratum, as judged by the size of income, and, in addition, gains the trade of the habitual bargain hunters.

When the emphasis is shifted from price to quality or style, the appeal is automatically directed to a class of trade primarily concerned with the appearance or quality of the goods, and only secondarily interested in price. These customers require services of which credit extension is a significant form, and are willing to pay for them, provided the additional cost is not unreasonable. Under these circumstances, it is advisable that a merchant meet the demand of the trade to insure his own success.

Line of Goods.—Another factor in determining credit policy is the line of merchandise handled. Goods within lower ranges of price lend themselves more readily to a cash system. It is customary to pay cash for relatively small purchases. This fact may partially account for the phenomenal success of chain stores dealing in lines of merchandise falling within the lower price ranges. Ready cash to pay for large purchases is frequently not available, and it is customary to have such purchases charged. Groceries and drugs are examples of the former, while furniture, clothing, automobiles, washing machines, and the like characterize the latter type of merchandise ordinarily purchased on time.

Competitive Conditions.—A third factor consists in the nature and keenness of competition. To the extent to which consumers' goods become standardized and nationally advertised by manufacturers is the nature of price competition on the part of retailers diminished in importance, save when articles are used as loss leaders in featuring bargain sales. The tendency then is for retail dealers to shift the basis of competition from price to service or quality, as in the case of private brands. Credit granting is one of the most important forms of service. Hence, retailers resort to it as a means of meeting competition, especially from chains and other stores granting the credit privilege. The keener the competition in a given community the more likely are the stores to feature credit service as an attraction.

Sectional Preferences.—Then, too, sectional preferences and the character of community incomes must not be overlooked. It is com-

monly known that in the South credit is more freely sought than in other portions of the country. The same applies to mining and farming communities, where ready cash is scarce between pay days and crops, respectively. In establishing a retail institution, local preferences should be duly considered, thereby avoiding the danger of adopting a policy that would necessitate running against the current.

Size of Community.—Again, the size of town in which the store is located must be given adequate consideration. In a large city there is always room for a limited number of cash stores. In these communities are to be found all classes of people with varying desires, ambitions, and incomes. Since cash stores primarily appeal to the trade of persons with limited incomes and bargain-hunting instincts, large cities should be sought, for in them reside sufficient numbers of such people to suport a few of these stores properly. In smaller communities cash policies should be adopted only after great hesitancy.

Capital Commanded.—The capital commanded by the store is a most significant factor in the determination of a cash or credit policy. Concerns with limited financial resources should either be satisfied with a limited volume of sales or else operate on a cash basis, for, to roll up a certain volume of business, more capital is required when trading is done on a credit basis. In addition to merchandise inventories, customers must be carried on the books, thereby tying up more capital in the enterprise.

CARELESSNESS IN RETAIL CREDIT GRANTING

There is doubtless more carelessness in retail credit granting than in any other class of credit granting, although much progress has been made within recent years. Especially is this true of the large number of unit stores of the neighborhood type. For example, the larger stores usually lose a smaller percentage in bad debts, even though they sell a large proportion of their goods on credit. This is due primarily to the greater efficiency with which they perform the credit function. That much improvement in the administration of credit and collections can be brought about in the smaller stores is apparent from a mere statement of the principal factors responsible for their present condition. These factors are:

1. The increased keenness of competition causes many retailers to strive to outdo their competitors in volume of business, usually at the expense of quality. To secure the desired volume, many customers must be attracted to whom credit is extended rather liberally. Outwardly, the business shows evidence of prosperity. Inherently, it is based upon a false foundation, whereby standards of credit are debased and the whole credit system demoralized.

2. Undoubtedly, the most important cause of the neglect to live up to established and well-recognized sound standards of credit is the failure to keep posted on the exact condition of the business because of a lack of proper books of account. Without them, the merchant is ignorant of actual conditions; he does not know the cost of doing business, the amount of credit losses, collection expense, and the extent to which these cut into the net profit, if any is available.

3. Many retailers usually trust most customers at least once. A buyer may ask for credit "until next week," or "until he has sold his crop," etc. In all of these instances the date of payment is indefinite. In other instances the fault lies with the retailer, who fails to set a definite date for settling accounts and to insist upon prompt collections. At first, partial payments may enter into the account and, finally, the total amount lapses into slowness and collections are made difficult.

4. Some merchants are timid in making the investigations necessary to determine the character of the credit risk for fear that customers may resent such inquiries, thereby resulting in a diversion of trade to stores of competitors. The fear of driving away trade thus prevents them from establishing retail credit on a sound basis. It is true that many customers feel humiliated when what they regard as "strictly personal" matters are encroached upon.

5. Many merchants lack adequate facilities for obtaining credit information. Few retailers cooperate to the extent of exchanging information concerning applicants for credit. Manufacturers, jobbers, and bankers have numerous sources from which accurate and reliable information concerning the credit standing of customers may be secured. Not so with the smaller retail merchants. Few of them as yet claim membership in credit bureaus. The larger retail organizations, including department stores and the better class of unit stores in the shopping districts, generally take advantage of these services and, consequently, their credit granting is more scientific and, on the whole, much more satisfactory.

6. Easy credit from wholesalers and manufacturers frequently causes the retailer to be more lenient than he should be in extending credit to his customers. It is not unusual for a wholesaler to sell his goods on credit to retailers who are financially weak and incompetent, as business men, and to carry such accounts long beyond the credit period. Once such accounts have been opened, it becomes necessary to nurse them along for years with a consequent loss to the creditors and to the merchants themselves. Being more experienced than the average retailer, the wholesaler or manufacturer will often serve the best interests of the retailer, as well as his own and those of society at large, by refusing credit when circumstances justify such a step.

Effect of Careless Retail Credit Granting.—To begin with, the retailer himself is directly and most unfavorably affected by a failure on the part of customers to meet their obligations. To him credit is often a cause of recklessness and liquidation. If many retail dealers fail because of lack of realization in their false hope of getting pay in the future, the jobber is equally affected, partly through losses from bad debts incurred in selling the retail trade on time, and partly through a decrease in sales. Purchases from the jobber are sometimes decreased because of the higher prices charged by retailers in an attempt to cover the losses incident to extravagant credit granting. The honest consumer who pays his bills promptly, as well as cash customers, are thus penalized. As prices rise, other things being equal, sales necessarily decrease, though not proportionally. The effect of unwise and improper credit granting by retailers thus extends even beyond the wholesaler and, indirectly, affects the manufacturer, broker, commission house, and banker.

Possible Remedies.—To be successful in a credit business, a merchant must make a careful study of local business and economic conditions, carefully select his risks, secure and thoroughly examine an adequate quantity of credit information, constantly watch the progress of accounts, and insist upon prompt payment. To make his business more efficient, a retailer should keep adequate records giving information as to operating expenses, losses from doubtful accounts, and the like. An accurate knowledge of facts would prevent many a merchant from unconsciously plunging into questionable selling campaigns and extending credit unwisely. The establishment of a customary method of procedure in making inquiries of customers would help to overcome the general resentment on the part of credit seekers, and the information would come as a matter of course. Both consumer and retailer need to be educated to the standards upon which sound credit should be based. Finally, cooperation among retail credit grantors should be fostered. They should be made to realize that only through cooperative effort will the maximum efficiency in the management and operation of a credit business be attained.

A growing number of cities are adopting a so-called "community credit policy" which requires, among others, that all accounts should be cleared through a credit bureau before opening, that all application forms should be uniform in wording and should contain certain essential items of information, that all statements should state the terms on which the merchandise is sold by the store, that a service charge of a stipulated amount should be added for each month a charge account remains past due, and that certain collection measures should be taken as provided for in the rules of the organization. Other rules that may form a part of the community credit policy may relate to terms to be used in the sale of certain articles on the instalment plan, to the handling of "chronic

returners," and to conditions under which accounts on the books should be suspended.

To facilitate credit granting on the part of retail merchants, a mutual charge-account service has been established in some communities. This is illustrated by the Retail Service Bureau System in Seattle, Wash.[1] According to this plan, the Bureau enters into a contract with merchants through which the merchant agrees to honor charges of the Bureau's purchase-card holders. One credit card, for a certain amount, is then issued to the consumer who applies for it, if he is deemed worthy of credit, which is presented to any of the merchants on the RSB list. The Bureau cashes the merchant's sales invoices daily, thus furnishing him with ready funds and freeing him from the business of credit granting, billing, statement mailing, and collection. The consumer, on the other hand, receives one itemized statement each month direct from the Bureau in which all purchases from affiliated stores are listed and payment is expected by the tenth of the month on purchases made during the preceding month, just as in any open account of the monthly type. If a card holder wishes to carry over all or part of the amount for another month, arrangements can be made to that effect and a service charge of 1 per cent per month is made for the privilege. Arrangements can also be made with the Bureau to cover instalment purchases. Large stores with adequate capital and well-organized credit departments will find this kind of service more or less duplicatory and unnecessary, but for the smaller establishments with limited capital it should fill a real need.

In some communities this plan is used in modified form whereby purchasing orders of various denominations, totaling a certain amount as justified by the condition of the credit risk and his requirements, are issued to the consumer. These orders are honored by affiliated merchants and payments are made by the purchaser directly to the mutual charge-account service organization in stipulated amounts at stated intervals until the full amount has been repaid. For amounts larger than $100, an initial payment of $20 is usually required of the consumer, but in no case are there any service charges or interest except for past-due amounts, the affiliated merchants advancing the necessary funds for the operation of the system.

In some cities the merchants cooperate by suspending slow and undesirable accounts and other stores refusing to accept them on a credit basis. In others, periodic attempts are made to educate consumers to pay their debts to the merchants. Special campaigns often feature such programs. But no matter how much is being done cooperatively no individual credit grantor can escape personal responsibility for the bad practices that have grown about the retail-credit system, and it behooves

[1] "A New Retail Credit Plan," *Domestic Commerce*, Sept. 29, 1936.

firm to make strenuous attempts to remove them and to establish credit on a sound basis.

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Questions and Problems

1. Show by illustration how retail credit affects the credit secured from wholesalers and manufacturers.

2. Department store A has a volume of credit sales equal to 60 per cent of its total annual business, while the credit sales of department store B are only 35 per cent of its total sales volume. From the standpoint of credit management, which of the two stores is probably the more successful? Why?

3. What is involved in the statement that "credit is a customary convenience"? Is this a primary or secondary argument in favor of credit?

4. Does credit business tend to increase or decrease complaints from customers? What are the reasons for your answer?

5. What effect does credit business have upon Saturday sales of stores operating on a credit basis? Why? Is such an effect desirable?

6. In determining the costs of operating on a credit basis, what items should a store consider? Should such costs be expressed as a percentage of credit sales or total sales?

7. "Credit leads to extravagance and recklessness." What is the answer to this objection, if any?

8. J. Brown plans to open a store in the near future. One of his problems is to decide whether to operate on a cash basis or to adopt a credit policy. He seeks your advice. What would you recommend?

9. To what specific things may the carelessness of many retailers in credit granting be attributed? What remedies would you suggest?

10. "Cash customers pay for bad debts." If this is true, show that they are really benefited thereby.

11. How do you account for the fact that, as a rule, the loss from bad debts in a large store is a smaller percentage of sales than that of a small store?

12. In a period of business depression would you expect that, on the whole, the percentage of retail business done on credit would be more or less than in so-called "normal" times? Explain.

13. Retail stores selling for cash and open credit do not distinguish in the prices charged credit and cash customers. Is this practice justified or should such a retailer operate on a dual pricing system? Why?

14. What specific advantages does a retail merchant derive from the extension of credit to his customers? Would you recommend that most or all merchants operate on a credit basis in order to derive the same benefits? Explain.

15. In what ways may retailers in a community cooperate to the end of making retail credit business more sound? Does such cooperation relieve the merchant of individual responsibility? Explain.

CHAPTER VII

INSTALMENT CREDIT

Meaning of Term.—Instalment credit is but one kind of consumer credit. In reality, it is broader than that, for it is used to a considerable extent in the wholesale financing of automobiles and in the purchase of goods for industrial consumption. In this chapter, however, the subject is treated as a phase of consumer credit where it has found its field of greatest usefulness. When applied to the purchase of merchandise or service it differs from the ordinary type of retail credit in just one respect. Instead of paying the full amount of the bill at the end of a given period of time, when instalment credit is used the purchaser is asked to pay his obligation in fixed portions or instalments at stated intervals as agreed upon at the time the sale is consummated. In other words, an instalment sale is one in which part of the price of the goods is usually paid at once in cash or its equivalent, the balance being paid in fixed amounts at stated intervals. The transaction is simply one of credit, and has no essential differences in its nature from any other credit transaction.

The subject of instalment credit has often been approached from the standpoint of selling, buying, or financing. It is this difference in point of view that is responsible for the many names given to the plan, some of which are confusing, misleading, or anything but descriptive of the actual process. A few of the more familiar names which may be seen flashed before the public in newspapers and magazines are instalment selling, instalment buying, credit merchandising, time sales, deferred payments, partial payments, easy payments, and the "sugar-coated" budget plan. It is true enough that the process of selling on the instalment plan has its merchandising or selling and buying aspects, and that both buyers and sellers are vitally interested in it; the former regards it as a buying facility, and the latter as a sales stimulant. Nevertheless, it is the credit arrangement and nothing else that distinguishes this type of transaction from other types. It is for this reason that the term "instalment credit" has been chosen as the most suitable designation of the economic process in which payments for goods or services are made in fractional amounts instead of in a lump sum.

Origin of Instalment Credit.—There is nothing new about instalment credit as a business practice. In fact, it is a very old device, probably as old as credit itself. It is even older than Christianity, and has been

practiced on a limited scale in connection with marine insurance by the Babylonians and Phoenicians.[1] In Rome, according to Plutarch, Crassus, who was a contemporary of Julius Cæsar, amassed a fortune by buying up houses during periods of great conflagrations, rebuilding them and selling them on the instalment plan. The present type of instalment selling was introduced in England in 1828 by the Countess of Blessington, who, on her return from Paris, where it was apparently practiced by the store of Dufayel, suggested it to a firm of cabinet makers.[2]

Evolution of Instalment Credit in the United States.—In the United States, the instalment method of operation is also quite an old practice. It was introduced in New York as early as 1807 by the founder of the firm of Cowperthwait & Sons. It was first applied to furniture and later spread to other articles. The building and loan associations which operate on this basis have been in existence for nearly a century. The Singer Sewing Machine Company adopted the plan about 1850 and has carried it to very large proportions. In the piano business, the instalment plan has been used since about 1875, and is now considered the prevailing practice in that field. The same is true of sets of books which were thus sold for a long time by itinerant book agents. Many other lines of merchandise, including jewelry and reapers and binders, have been sold on the instalment plan for many years.

Reasons for Present-day Importance.—While the instalment method of selling is an old practice, it has never received as much attention or aroused so tremendous an interest on the part of the public as in the past two decades. This may be accounted for in several ways. In the first place, never in the history of credit has the instalment plan occupied the prominent position which it now holds in the business field. It experienced little growth until after the World War. This phenomenal development received its greatest impetus when it was adopted by the automobile industry which still claims a substantial proportion of the total volume of instalment business. Second, the amount of such business is still growing rapidly, in absolute amounts and in proportion to total retail business.

In the third place, this method of merchandising is used more widely than ever before. Many more different commodities are sold on the plan. Fourth, its use has even spread to the sale of so-called "soft" goods. Finally, instalment credit is no longer restricted to the poorer classes of people. It has now become a perfectly respectable device to be used by the highest classes of our population and has been adopted by many of the best stores.

[1] SELIGMAN, E. R. A., "The Economics of Instalment Selling," Vol. 1, p. 10.
[2] *The Columbus Dispatch*, Jan. 26, 1926.

It is these significant changes that have proved alarming to the critics who rise in arms against the plan, largely because they cannot understand it, and partly because the device has been greatly abused.

Volume of Instalment Credit Business.—Prior to 1929 no reliable data were available on which to base satisfactory estimates of the volume of business conducted on the instalment plan. For the year in question, on the basis of data obtained on the subject for five states, the Bureau of the Census estimated the volume of instalment sales in the retail field to be $6½ billions, or approximately 13 per cent of total retail store sales.[1] The comparable figure for 1935, based on more adequate statistics, showed the instalment sales volume to be $3,599 millions, or 10.9 per cent of all retail store sales.[2] On the basis of an inquiry which resulted in satisfactory data from 1,920 credit-granting stores, an increase in instalment sales of 25.4 per cent was reported for 1936 over the previous year.[3] When this 25.4 per cent increase is applied to the volume of instalment business reported for 1935, it would appear that the corresponding volume for 1936 was around $4½ billions, or about 12 per cent of the estimated retail sales for the year. To this must be added, however, the large amounts borrowed from banks and other financial institutions, partly through the cooperation of government agencies, to finance the purchase of commodities that would normally be bought on the instalment plan. Since such a practice was little followed in 1929, it is reasonable to assume that as a percentage of total retail store sales the volume of instalment business transacted in 1936 was somewhat greater than that estimated for 1929, even though the absolute dollar volume was still below the figure for the former year. This means that approximately 35 to 40 per cent of all retail credit sales are of the instalment type.

Growing Importance of Instalment Credit.—The rapid growth in the volume of business on the instalment plan is exemplified by what has been taking place in the department-store field. According to the reports submitted by department stores to the U.S. Bureau of Foreign and Domestic Commerce in connection with its surveys of retail credit, instalment credit sales were but 4.4 per cent of their total volume in 1925 but increased to 4.9 per cent for 1927, 5.5 per cent for 1932, 6.9 per cent for 1934, 7.8 per cent for 1935, and to 9.1 per cent for 1936. The conservative nature of the figures secured by the sample method in these surveys

[1] Fifteenth Census of the United States: 1930, Distribution, Vol. I, Retail Distribution, Part I, p. 27, U.S. Government Printing Office, 1933.

[2] Census of Business: 1935, Retail Distribution, Vol. VI, p. 23, U.S. Department of Commerce, May, 1937.

[3] LaCrosse, H. T., "Retail Credit Survey 1936," p. 6, Domestic Commerce Series, No. 98, Bureau of Foreign and Domestic Commerce, U.S. Government Printing Office, 1937.

is demonstrated by the fact that the Bureau of the Census reported for 1935 instalment sales by department stores to be 9.7 per cent of their total volume. In various other studies large increases in instalment sales of the various types of stores that engage in the practice have been reported year after year, especially since 1933. Not only that, but the number of stores that have adopted the instalment plan of merchandising is steadily growing. A survey of representative department and furniture stores revealed the fact that most of the stores reporting engaged only recently in the sale of certain items on the instalment basis. Although nearly 70 per cent of the department stores involved were selling electric refrigerators on deferred payments at time of the survey, only 2.1 per cent of them sold that merchandise on such a plan 10 years prior to that time. Similarly, but 3.8 per cent of the furniture stores replying on this point were selling this type of merchandise 10 years prior to the survey, although when the survey was conducted 68 per cent of such stores were selling electric refrigerators on instalments. Even furniture was sold on deferred payments to a smaller extent 10 years ago than now, the percentages being 64.1 and 90.5 respectively for furniture stores, and 24.2 and 54.8 per cent, respectively, for department stores.[1]

Wide Use of Instalment Credit.—In the late twenties it was estimated that about one half of all instalment sales at retail were represented by automobiles. Since that time a smaller and smaller proportion of the instalment business has been represented by motor vehicles, so that in 1935, according to the Census of Business data, motor-vehicle instalment sales approximated a billion dollars which was about 25 per cent of all instalment sales reported by the same source. This means that the growing volume of instalment business, especially since the depression, had come from the sale of many other items of merchandise on the instalment plan. An idea of the large variety of goods now sold on deferred payments may be gained from an examination of the long list of commodities handled by the larger finance companies. In this list will be found automobiles, adding machines, automotive equipment, barber supplies, cleaners, all kinds of machinery and electric motors, furniture, hotel equipment, incubators, kitchen equipment, musical instruments, office and physicians' equipment, pianos, portable houses, pumps, radios, refrigerators, oil burners, ships and tugs for inland waterways, store fixtures, stoves, ranges, furnaces, time clocks, washing machines, and many others.

It has been variously estimated that the instalment plan is used in connection with 70 per cent of the sales in household furniture; 75 per cent of the radio sets; 90 per cent of the washing machines, pianos, sewing machines, and mechanical refrigerators; 85 per cent of the vacuum

[1] KAYLIN, A., "Instalment Selling," p. 1, Fairchild Publications, 1935.

cleaners; 70 per cent of the gas stoves; and more than 25 per cent of the jewelry. From the standpoint of the kinds of stores, it is reported that 59.9 per cent of the sales made by motor-vehicle dealers are of the instalment type, and the same is true of 16.5 per cent of the sales of furriers and fur shops; 17 per cent of the sales of family clothing stores; 48.7 per cent of the sales of the furniture stores; 54.9 per cent of the sales of household appliance and radio stores; 22.8 per cent of the sales of heating and plumbing equipment dealers; 24.3 per cent of the sales of all jewelry stores; and 20.7 per cent of the sales of all bookstores.[1] Since in each of these categories there are stores which do not as yet sell on the instalment plan it means that those stores that have adopted the plan are doing a large share of their business on that basis. Thus, according to the Retail Credit Survey for 1936, furniture stores selling for cash and instalment only reported 93.3 per cent of their business on the latter basis. The same was true of household-appliance dealers selling for cash and instalment only to the extent of 96.6 per cent, of jewelry stores to the extent of 81.4 per cent, and of men's clothing to the amount of 96.9 per cent.

Selling "Soft" Goods on Deferred Payments.—In recent years the instalment plan has been extended to the sale of nondurable or so-called "soft" merchandise such as is handled by department stores and ready-to-wear shops. It includes men's and women's wearing apparel, blankets, linens, piece goods, toilet goods, and smaller articles of home furnishings. Fur coats have been sold on instalments for some time because they are among the durable items and of a rather high unit value. Even men's clothing may be classed at least among the semidurable items. Household articles have for many years been added on to a regular deferred-payment contract of durable goods but have not generally been sold separately on instalments. A radical change on this score is to be noted, especially among department stores. Under some of their so-called "store-wide" plans all items, irrespective of their unit value or durability, can be purchased on deferred payments. Approximately 72 per cent of the department stores covered in a survey by the National Retail Dry Goods Association reported to sell soft merchandise on the instalment plan.[2] This change in policy, coupled with the addition of furniture departments and departments handling goods normally sold on instalments, has been responsible to no small degree for the marked increase in their instalment sales, both in absolute dollars and in proportion to total volume.

[1] Census of Business: 1935, Retail Distribution, Vol. VI, p. 23.

[2] Report on Instalment Selling—Policies and Practices, by B. S. Wright, presented at the Third Annual Convention of the Credit Management Division of the N.R.D.G.A., at Chicago, June, 1936.

The wisdom of such a policy, at least from a long-run point of view, has been hotly debated. When Montgomery Ward adopted the store-wide policy for both store and the mail order divisions of its business, late in 1934, the step was generally regarded as radical. Their policy stipulated, however, that the initial order be at least $20 and that subsequent purchases be not lower than $5 each. As a result of this policy, the stores of the company have shown a large increase in credit accounts, and many other stores have followed their leadership.[1]

The chief merits in selling soft goods on instalments lie in the sales-building results of the liberal credit policy, smaller returned goods percentages reported because buyers on that plan are apparently not so discriminatory as regular charge customers, an improved position of charge accounts since those who cannot pay in accordance with regular terms are transferred to the deferred-payment plan, and the fact that certain rejected charge accounts can be accepted as customers on the instalment basis. On the other hand, soft merchandise is not subject to repossession, for it has little or no resale value. Since the merchandise is highly perishable, the customer must pay for goods no longer in existence. Furthermore, the plan of selling soft goods on deferred payments is said to be a habit-forming drug dangerous to both the store and the customer. It is easy both for the former to oversell and for the latter to overbuy. Such business is often done at the expense of the store's cash volume and may prove demoralizing to the regular charge account customers by transferring the poorer ones to the instalment plan and thus giving them essentially greater privileges. Finally, it is said to attract an inferior class of credit risks.[2]

Wide Acceptance of Instalment Credit.—The instalment plan is no longer confined to the cheaper retail stores selling goods on the "$1 down and $1 a week" plan. It is now fully as respectable a method of doing business as any of the other methods in existence, so long as it is practiced in accordance with sound business principles. It is no longer regarded *contra bonos mores.* Even many of the social registerites indulge in it, and some of the most expensive automobiles, airplanes, and yachts are so bought.

Instalment Credit in Disguise.—Many attempts have been made to sugar-coat the instalment method of merchandising, especially on the part of the more reputable stores. The budget-purchase plan has long been used for this purpose. Then came the 10-pay plan (10 weekly payments)

[1] BASKIN, J. M., "Ward 'Goes Over' with Part-pay Plan, after One Year's Operation," *Retailing* (executive edition), Nov. 18, 1935, p. 2.

[2] For some of the experiences of department stores with this plan, see J. A. Hagios, "The Spread of 'Installment Selling' of Soft Merchandise," *The Bulletin of the National Retail Dry Goods Association*, November, 1935.

in men's clothing. The Three Payment Plan now in use in many men's stores and women's specialty shops, whereby purchases can be paid for in three monthly instalments instead of paying the full amount in 30 days, is another innovation. As a matter of fact, some of these stores are offering the customer several alternatives. For example, if a customer purchases merchandise valued at $41.50, a down payment of $6.50 is required, and the remaining $35 may be paid in three equal monthly instalments, in six semimonthly payments, or in 12 weekly payments. Under such a plan no interest or carrying charges are added, since the plan is designed primarily for good charge customers in order to enable them to buy higher priced garments, but it often results in pyramiding by adding on to the balance through additional purchases before the entire amount owed has been paid.

One of the popular devices now in use is the Letter of Credit Plan, whereby the customer is tendered a purchase order resembling a bank draft, authorizing him to buy up to the amount specified on the face of the instrument. When a purchase is made, the sales clerk notes on the back of the letter of credit the amount, subtracts it from the balance, and then sets down the amount still "open to buy." When the limit is reached the letter of credit is withdrawn by the store and another issued in its place. A modification of this system is to be found in the "Purchase Certificate Plan," the "Budget Plan Plate," and the "Coupon Book Plan." Each of these is issued in certain denominations and the proper amount is punched or withdrawn each time a purchase is made. Other fancy devices to disguise deferred-payment merchandising are the "Planned Charge Account," the "Junior Charge Account," the "Christmas Budget Account," the "Credit Bank Account," and the "90-day Charge Account Service."

ADVANTAGES OF INSTALMENT CREDIT

Facilitates Enjoyment of Life.—The phenomenal growth in the use of instalment credit represents but an attempt on the part of business concerns to respond to the wishes and demand of the public. From the standpoint of the consumer, the instalment plan is desirable because it enables people to obtain, without delay, a great many commodities of high unit value and much usefulness, without the necessity of waiting or doing without them. The buyer is thus enabled to use the article while he is paying for it, and as a result can enjoy life more fully than would have been possible without instalment buying. Many individuals would never be able to own certain goods without this privilege, because of the difficulty or impossibility of accumulating a sufficient amount to pay for them in one lump sum. While it is theoretically possible to obtain desired

articles by saving the purchase price in advance of purchase, in practice it will be found very difficult for most people to do so.

From an economic standpoint, is there any reason why anybody should not have all of the comforts that he is able and willing to produce? If a person desires to keep from going hungry and is able and willing to produce food, why should he not be allowed to do so and appease his hunger? If mankind wants to go on wheels and go fast, why not give it the opportunity to buy all the necessary automobiles, so long as it is willing to work and pay for them? The instalment plan is nothing more or less than a practical means of helping people to satisfy their desires, their wants, and their aspirations.

Prevents Waste.—Instalment buying prevents possible waste. If it were not for this method of operation, many persons would, no doubt, spend their money foolishly on articles of temporary gratification instead of buying goods that last and the satisfaction of which is long remembered and enjoyed. It is very likely that much of the income which is now used in buying substantial goods, such as automobiles and electrical washing machines, would be expended for pleasures or goods that would give only immediate and temporary satisfaction. It is the consensus of opinion of authorities on the subject that frivolous purchases tend to be minimized as a result of instalment buying.

Encourages Thrift.—Instalment buying, statements to the contrary notwithstanding, tends to encourage thrift. It is an enforced form of saving. People will economize in order to be able to meet instalments when they become due but may refuse to economize for the mere sake of accumulating money. For example, a well-known automobile manufacturer insisted some years ago that his prospective customers first save the money and buy the machine after they had accumulated a sufficient amount to pay for it, but the plan has proved a complete failure. At the same time, other automobile manufacturers were exceedingly successful in selling their machines first and requiring that payments be made for them as they are put into use. "Pay as you ride," in the case of automobiles, and "pay while you play," in the case of pianos and other musical instruments, are very significant appeals, because they enable us to enjoy the use of the commodities while we can, and, besides, we can have the pride of possessing them, even though they have not been paid for in full. Few homes would be owned, indeed, if it were necessary to pay for them in full prior to obtaining possession. Yet few will deny the beneficial effect of home ownership, even on the time-payment basis.

The instalment plan is only another—and sometimes more effective—method of saving so that higher priced needs and comforts of life may be obtained. It provides the desired article first, and then encourages the

buyer to put aside a certain amount weekly or monthly in payment for it.

Lowers Prices.—The instalment plan enables people to purchase many commodities such as radios, automobiles, electrical appliances and similar goods for much less money than if this method had not been popularized. Through it the production of such articles has been stimulated and a larger volume made possible. Since most industries operate on a decreasing cost basis, mass production reduces the cost per unit materially, for the benefit of both cash and credit customers.

Lowers Prices to Cash Buyers.—Another advantage offered to consumers is that cash buyers pay lower prices. In the case of ordinary charge accounts, no discrimination whatever is made in favor of cash purchasers. The person who buys for cash must pay the same price as the charge-account customer. This is not true in instalment buying. Regardless of whether the basic price is a cash price or an instalment price, deviations are made in favor of the cash customer. Only the customer who buys on deferred payments is required to pay for the privilege, no other type of customer being forced to pay the cost of instalment financing and of carrying the accounts on the books.

Higher Standard of Living.—The instalment plan encourages a higher standard of living. It induces people to buy more goods and to satisfy many more of their wants and desires. It enhances culture, for it enables the poor as well as the rich to enjoy the better things in life. The better music and educational messages often heard over the radio are but one illustration of what has been made available through instalment credit to the masses of our population who would otherwise be deprived of them altogether. The instalment plan has aided people in securing higher standards of living, education, comforts, conveniences, efficiency, recreation and health. Not only that, but the added responsibility often causes them to do more and better work, for, in order to meet these instalments, they must earn more. It has proved a strong incentive to work, to produce, and to secure those things which tend to make people happy. So long as we assume a dynamic social order and steady progress, instalment credit contributes to a higher standard of living not only over a short period of time, but in the long run as well.

Increases Retailer's Volume.—That the instalment plan tends to increase the retailer's volume of business is no longer a matter of conjecture. Especially does it increase the demand for merchandise that is time and labor saving, health preserving, and pleasure giving. It brings customers to the store at frequent intervals to make their payments. Each of these calls gives the retailer an opportunity to make additional sales, until it becomes an endless chain with the payments for one purchase leading to still another purchase. That is why some of the stores

so urgently solicit instalment business and frequently offer leading articles even below cost just to enable them to bring customers into their stores and to open for them instalment accounts. A jeweler following this practice indicated that in a recent event of this sort every account opened by his store cost him $2 because of the special offer made on a leading article that was used as bait. As far as all retailers collectively are concerned, however, the instalment method of operation is beneficial only in so far as it tends to increase the consumer's purchasing power.

Other Advantages.—In addition to the distinctive advantages just outlined, instalment credit affords the same advantages as any other type of consumer credit. Furthermore, it helps to make for steady production, thereby furnishing regular employment. It is no longer necessary for a consumer to wait until he has accumulated a sufficient amount of cash to pay, in a lump sum, the full price of the article. A reasonable down payment will often be all that is necessary. Goods can thus be bought by a sufficiently large number of people to enable the plants to operate continuously and without serious interruption, avoiding sharp peaks and valleys in production. Finally, it is being used to liquidate slow-pay accounts and to finance equipment purchased by hotels, restaurants, business men, and industrial users.

OBJECTIONS TO THE INSTALMENT PLAN

Some very strong arguments have been set forth against instalment credit, and all sorts of predictions have been made as to its disastrous effects on the future of business. It is interesting to note, however, that those who use instalment credit are favoring it, but the critics and opponents are generally those who have never made any successful application of it, either because their lines of business are not suitable to such an arrangement or because it has not been managed properly and, hence, proved a failure. Some of the objections issue, of course, from economists and others who view the subject largely from a social standpoint.

Promotes Extravagance.—Among the most common criticisms of instalment credit is that it causes people to live beyond their means. Easy credit encourages extravagant living. This may take one of two forms. It may cause people to buy higher priced goods than they should purchase or to buy goods to which they are not entitled on the basis of their income at time of purchase. In other words, it promotes the consumption of luxuries. In the second place, it causes people to mortgage their future income, which is more or less uncertain, not necessarily through the purchase of luxuries as through temporary over-consumption in general.

What Are Luxuries?—On the score of luxuries, the question naturally arises as to what constitutes a luxury. How does a luxury differ from a necessity? Is the line of demarcation so clearly drawn that one can tell the difference? Is there any agreement that certain articles are luxuries? Furthermore, can one say with any degree of definiteness that a given article is a luxury to a given individual? Is it not true that what may be a luxury to one person may be an absolute necessity to another?

As a matter of fact, the development of our country has been so very rapid that the luxuries of yesterday are the necessities of today, and the luxuries of today may well become the necessities of tomorrow. On the basis of a comparison of our standard of living of today with that of 25 or 30 years ago, the bulk of our present-day commerce in consumption goods would have been regarded at that time as most extravagant and unessential. How many homes, for example, were then equipped with more than one bathroom, or even with a single bathroom, hot and cold water, telephones, electric lights, gas ranges, furnaces, in addition to the many articles so commonly used today, such as pianos, radios, electric washers, ironers, toasters, and other commodities too numerous to mention? To what extent did we then occupy skyscrapers with elevators, electric lights, and other modern conveniences? To what extent did we use in our daily business life such things as paved highways, automobiles, mail airplanes, typewriters, adding and billing machines, and many other labor- and time-saving equipment devices?

It is said that in 1895 only four automobiles were built in the United States. Compare that output with the 26,221,052 motor vehicles registered in the United States early in 1936 and with the production during 1935 in the United States and Canada of 4,119,811 cars and trucks.[1]

On the basis of these facts, how can one say what things are luxuries and what are necessities? Is it possible to say that luxuries should not be bought on time when it is almost impossible, *first*, to decide what is a luxury, and *second*, whether any given article is a luxury to a given person? Who is competent enough to sit in judgment on such matters, and will such judgment be accepted by the public? Of course, there are luxuries, and there is a tendency on the part of humans to spend more when they buy on credit and perhaps to indulge in luxuries, but to generalize on this subject and to go so far as to label certain goods as luxuries, as opposed to necessaries, is absurd except when applied to a specific individual under given conditions.

Temporary Overconsumption.—As far as overconsumption is concerned, the assumptions seem to be that a person's income is static, and

[1] "Automobile Facts and Figures," 1936 Edition, Automobile Manufacturers Association, 1936.

that instalment purchases are made on top of what would be normally bought in the absence of such plan. That neither of these assumptions is exempt from criticism is quite obvious. It may well be that the person who bought an expensive article on the instalment plan may justly expect an increase in his present earnings during the time he is paying for it. Again, it may be that he will so reapportion and redirect his purchases that less of certain other goods would be bought, with the result that even less income may be spent for all goods including instalment purchases. That such a shifting is not only possible but factual is apparent from the complaints voiced by manufacturers of shoes and men's clothing that serious infractions into their volume have been caused by the automobile industry.

Again, many buyers on the instalment plan have other resources, than their immediate income, which can be converted into cash if desired. Such persons by no means mortgage their future income in making purchases on deferred payments.

Hampers Thrift.—The instalment plan is also criticized because it is supposed to exercise a detrimental effect on thrift and savings. That this is not the case will be revealed from an examination of statistics on savings, life insurance in force, deposits, and similar data reflecting thrift.

Apparently instalment credit has interfered very little with thrift in one form or another. Even if it had interfered to some extent, it might still have been justified, for there can be just as much wasteful saving as there can be wasteful spending. It is possible to save too much just as it is possible to spend too much. Some authorities argue that if all that is being produced were consumed there would never be overproduction with its consequent business depressions. Of what avail is capital accumulation if it cannot be used to create consumable goods? What is needed is wise and intelligent saving just as we need wise and intelligent spending.

Instalment Credit Is Costly.—Probably the most serious objection to instalment credit is its costliness. In addition to losses from bad debts, high costs of collecting accounts are generally incurred, except in the case of the more reputable stores. When a customer buys on open credit, there is but one chance that payment will be delayed or not made at all. When he buys goods on instalments he has many more chances of becoming delinquent. When the terms call for payment in 10 or 12 instalments, there are 10 or 12 possibilities that payment will not be made on due date. This means that an elaborate collection machinery must be installed in order to enforce payment and to keep the consumer satisfied with the article he has purchased. For all practical purposes, an article may have to be resold several times in order to make the consumer keep it and pay the instalments. Then there is the cost of carrying the

account on the books and the expense in investigating the risk at the beginning. Despite all this, actual prices may be decreased, because the economies outlined in an earlier part of this chapter may more than offset the extra cost in handling sales on the instalment basis.

There is a crying need for accurate and complete data on the cost of operating on the instalment plan. Some credit managers place the cost of opening such an account at from $2 to $3 on the average, but such a figure does not include all costs incident to the operation on that basis. In such costs must be included the credit investigation, interest on the average outstandings, bad debts, payroll of credit and collection personnel —including bookkeepers and cashiers, attorney and collection-agency fees, supplies and postage, and interest and depreciation on fixtures and equipment. To determine the net cost to the vendor, carrying charges must be first deducted from these figures. There is no doubt that adequate knowledge of these costs would in time lead to their reduction and to better management.

Carrying Charges Are Exorbitant.—It is believed that very often consumers are charged more than is warranted by actual costs incident to carrying instalment accounts. This condition is made possible by the general ignorance of the public in figuring costs and percentages incident to such operations. The more reputable stores do not generally follow such a policy, but even many of them might reduce their charges were they forced to do so and were instalment credit management placed on a somewhat higher plane as it probably will be in the future.

A few illustrations will suffice. Some time ago a group of paint and building materials manufacturers announced a time-payment plan in which a 9 per cent financing charge was to have been made. When figured properly, the 9 per cent grew, however, to no less than 24.54 per cent. Briefly, the plan was as follows: The contracted price quoted to the owner of the house to be painted was to consist of the estimated cost of the job plus a 9 per cent financing charge. A cash payment of 20 per cent of the total quoted figure was to be paid to the dealer and the balance was payable to the finance company in 10 monthly payments.[1]

A little examination of the stipulations in the agreement revealed the facts that the 9 per cent charge was based on the total cost of the job and not on the amount actually borrowed, that the 20 per cent down payment was based on the total quoted figure and not on the cost of the job, that the 9 per cent charge was not a charge per year, since all payments had to be completed within 10 months, and that the financing charge was made on the total cost and not on the balances remaining each month. By computing the financing charge on the basis of the amount

[1] For a complete discussion of this case see R. COLE, "Indiscriminate Instalment Selling and Distribution Costs," *Printers' Ink*, May 21, 1925.

actually borrowed, after the 20 per cent down payment is deducted, the 9 per cent charge becomes 11.25 per cent. When the charge is converted into a per annum basis instead of a 10-month period, the 11.25 per cent becomes 13.5 per cent. But it should be remembered that the 13.5 per cent is but a nominal simple-interest percentage, which should be converted into the actual rate of simple interest by use of the following formula:

$$R = \frac{r(2n)}{(n+1)}.$$

In this formula, R is taken as the actual rate of simple interest charged, while r stands for the nominal rate of simple interest, and n represents the number of instalments.

The difference between the two types of interest is due to the fact that the principal borrowed is being reduced each time an instalment is paid. A contract to pay one twelfth of a given sum at the end of each month for 12 months is equivalent to a contract to pay the entire amount at the expiration of 6½ months. Thus, the service charge of 13.5 per cent in the above illustration becomes 24.54 per cent and may be expressed as follows:

$$R = \frac{13.5 \times 20}{(10+1)}.$$

This formula was first developed by the author in 1924. Another way of ascertaining the actual annual cost rate is to divide the credit charge by the average amount of credit extended for one year, by means of the following formula:

$$R = \frac{2(\text{ratio between 1 year and period or repayments}) \times (\text{total charges})}{(\text{original unpaid balance}) \times (\text{number of instalments} + 1)}$$

When payments are uneven, the formulas must be somewhat modified. For all practical purposes, however, they are useful short-cuts.[1]

Another illustration may be taken from the automobile field, since such a large proportion of cars is sold on instalment credit. The usual charge made by the leading finance companies is from 6 to 8 per cent per annum on amounts actually borrowed. In justice to the finance companies and others handling such transactions, it should be pointed out that the regular service charge in this field covers not only interest on the money lent, but also cares for all credit and collection expense, losses from bad debts, and all expenses involved in repossession, reconditioning. and resale of cars of delinquents. By the application of the formula, the

[1] For a more detailed discussion of such formulas, see L. R. FOSTER, "Instalment Credit Costs and the Consumer," *The Journal of Business*, Vol. VIII, January, 1935.

6 or 8 per cent nominal simple interest charge becomes, however, around 11 and 15 per cent, respectively, when expressed as an actual rate of simple interest.

Similarly, a 6 per cent charge as made by some of our department stores, when properly computed, exceeds 13 per cent per annum. Assume that the cost of the merchandise is $100, that the charge is 6 per cent, and that the merchandise is bought on a deposit or down payment of 20 per cent, the balance payable in 10 monthly instalments. Deducting the deposit from the amount of the purchase leaves a balance of $80, to which is added a charge of $4.80. If the charges were made against the unpaid balances only, there would have been a charge of 0.5 per cent for the first instalment, 1 per cent for the second instalment, and 5 per cent for the last instalment of $8 in principal which does not become due until after 10 months. On this basis, the total interest charge would have amounted to $2.20 instead of $4.80. It is thus easy to see that when $4.80 is divided by $2.20 and multiplied by 6 we obtain a figure of 13.09 per cent.

In order to verify this calculation one should resort to the formula first presented. The first step would be to determine the nominal rate of interest on a per annum basis. Since the 6 per cent was charged for a 10-month period at the rate of 0.6 per cent per month, the annual rate amounts to 0.6 multiplied by 12, or 7.2 per cent. When 7.2 per cent is converted into the actual rate of interest charged, according to the formula as shown below, we arrive at the same figure of 13.09 per cent:

$$R = \frac{7.2 \times 20}{10 + 1} = \frac{144}{11} = 13.09 \text{ per cent.}$$

In a study conducted in the state of Massachusetts it was found that, expressed in actual cost rates per annum, the average rate charged for financing new automobiles was 25 per cent, instead of the 6 or 8 per cent rate usually quoted. No less than 116 cases were discovered where the rates charged on financing various commodities exceeded 50 per cent per year on the average amount of credit extended; in 59 of these cases the rate was in excess of 100 per cent and in a few instances it was more than 500 per cent. Is there any wonder that the investigators have termed some of these rates as "exorbitant, unfair, ridiculous and possibly fraudulent"?[1]

Misrepresentation of Carrying Charges.—The high charges levied on instalment transactions are made possible at least in part by the fact that the terms are not clearly stated. Instead of quoting the actual cost rate per annum, vendors and finance companies have been quoting the

[1] "Report of the Special Commission Established to Investigate the Advisability of Providing for the Licensing and Regulation of the Business of Financing Purchases of Certain Personal Property," House Document No. 400, January, 1936.

nominal rate and often failed to indicate whether it applied to the unpaid balance or to the full purchase price of the article. While this fact has been pointed out by the author and others for some years past, it was not until December, 1936, that action was brought by the Federal Trade Commission against a number of the leading automobile manufacturers and several of the leading finance companies for advertising their new 6 per cent time-payment plan and referring to it as 6 per cent terms or as 0.5 per cent per month, when in fact the plan so advertised referred to a "plan of financing involving a 6 per cent interest charge on the full amount of the account originally financed from the date it begins to run to the date the account is closed regardless of the fact that the account is divided into and amortized gradually and regularly by monthly payments of equal amounts. For that reason, the said plan . . . involves the payment of interest at a rate much in excess of, or substantially 100 per cent greater than the 6 per cent" featured in the advertising.[1] As a result of this action, the several defendants agreed in April, 1937, to cease and desist from using the expression "6 per cent," "without equally prominent use, in direct conjunction therewith, of explanatory language which makes it clear that the said 6 per cent does not refer to or indicate 6 per cent per annum, simple interest."[2]

While the specific cases brought before the Commission have never represented any flagrant abuses in the instalment credit field, it is believed that the action taken will have a wholesome effect upon others engaged in interstate commerce. It will not affect, however, intrastate abuses of the kind unless special legislation is enacted similar to that now in operation in the states of Indiana, Wisconsin, and Utah and recommended for the state of Massachusetts, with the following provisions:

1. The licensing of retail sales finance companies (and perhaps also of the stores selling on the instalment plan but which do not use finance companies).

2. Sales finance companies to be regulated under laws similar to those that apply to small loan agencies.

3. The use of standard, clear forms of instalment sales contracts to permit a customer to know what he is paying and how these terms compare with those charged by competitors.

None of the laws or recommendations call for the establishment by legislation of fixed rates to be charged, on the assumption that complete knowledge of the rates when properly quoted will, through competition, make for lower and more reasonable rates and obviate the need for legislation to that effect.[3]

[1] Federal Trade Commission, Dockets Nos. 3000–3007 (complaints).

[2] *Ibid.* (stipulations as to the facts and agreement to cease and desist).

[3] See Massachusetts Report, p. 30.

Other Abuses of Instalment Credit.—Like any other relatively new device, instalment credit has been greatly abused. Both buyer and seller have been equally guilty of some of the abuses. There has been too much unsound buying, resulting in many repossessions, excessive losses, and reduced earnings. Purchasers sometimes buy goods without the slightest intention of paying for them. Other buyers are indifferent to the rates charged and make no attempt to understand the nature of the contract upon which they enter. Sellers, on the other hand, sometimes sell cheap goods at exorbitant prices, placing all emphasis on easy terms. Down payments have been lowered or eliminated, carrying charges have often been abandoned or reduced, the credit period has been unduly lengthened and other sound principles have been violated. Instalment vendors are constantly dipping into lower income levels, thereby attracting poorer credit risks and selling goods to people who cannot afford to buy them out of either current or future income.

Many, if not all, of the abuses just cited can be remedied or prevented through education and proper management, as will be shown in Chap. XXV. There are others, however, that cannot be thus handled. Among them are concealed and misrepresented charges; rebates and bonuses given by finance companies to dealers; extra charges or "packs" added by the dealer to the amounts required by the finance companies; special fees for delinquency, recording the instrument, and refinancing past-due amounts; hasty repossessions and "fixed" auction sales; taking extra security, such as wage assignments and endorsements of other parties; overcharging for insurance and failure to place insurance paid for by purchaser as well as requiring extra coverage; inadequate or no refunds for payment of unpaid balances before they are due; and one-sided legal protection provided for in the sales agreement. Many of these can be remedied through effective legislation and, better still, through a higher degree of integrity on the part of instalment vendors and finance agencies.

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Questions and Problems

1. In what respects does instalment credit differ from ordinary credit? Is it a phase of consumer, banking, or mercantile credit?

2. Inasmuch as instalment credit is an old device, how do you explain the tremendous and growing interest in the subject?

3. Is it wise to sell soft goods on the instalment plan? Discuss.

4. List five different ways or plans of instalment selling and describe each of them.

5. How does instalment credit affect prices?

6. Is instalment credit advantageous or detrimental to cash buyers? Explain.

7. What, in your opinion, are the two strongest arguments in favor of instalment credit? Give reasons for your choice.

8. "Instalment credit causes people to mortgage their future income and to overconsume." Analyze this statement and point out its weaknesses.

9. What effect does instalment credit have on:

a. Thrift?

b. Standard of living?

10. What are the strongest arguments against the use of instalment credit?

11. Mrs. Brown purchased $100 worth of perishable goods from department store X, consisting of ready-to-wear merchandise and some household supplies. The purchase was made on the Morris Plan basis, since the store had an arrangement with the Morris Plan Bank to care for such transactions. Mrs. Brown was required to pay down $10 and borrow $90 from the bank at the rate of 6 per cent per annum for the full amount borrowed. In addition, she had to pay to the store a service charge of 3.5 per cent of the purchase price of the goods. The loan was to be paid out in 26 weekly instalments.

a. In computing the cost of financing the transaction, what adjustments must be made for the proper calculation of the total service or interest charge?

b. What was the cost of financing the transaction, expressed in percentages per annum?

12. Mr. X purchased an electrical appliance for $89.50. The terms were: 10 per cent down payment, a service charge of 8 per cent on the purchase price, and the unpaid balance to be paid in 10 equal monthly instalments. Compute the amount of the service charge and the interest rate per annum. Can you justify this rate? On what grounds?

13. The Morris Plan Bank made a loan of $300. The cost of the loan was $27. The net amount received by the borrower was $273. Unpaid balance to be paid back in weekly instalments of $6 each. Find the cost of the loan as a percentage per year.

14. Mrs. Jones bought $23 worth of goods from one of the department stores. The terms of the transaction were: $3 down payment, balance to be paid in 4 monthly payments, and a charge of $2.50 for the privilege of making the so-called "budget purchase." Compute the actual cost of buying on this budget plan. Are these charges justified? Suppose that it can be shown that the store does not profit directly from the additional charge, would it then be justified? Explain.

15. A certain company advertised in its catalogue that purchases can be made from it on the instalment plan and gave the following illustration. If a purchase is made of $20 worth of merchandise, a 25 per cent down payment is required, $2 are added as a service charge, and the unpaid balance is to be paid in 3 monthly instalments. What was the actual cost to the consumer in this case, expressed in terms of simple interest per annum?

16. Is the high cost of instalment buying an inherent weakness? Can it be reduced? By what means?

17. It is claimed that instalment selling increases the retailer's volume of business and reduces his cost. As the extension of this type of credit becomes widespread, would this effect still obtain or would instalment credit operation result in a permanent increase in the retailer's cost of doing business? Explain.

CHAPTER VIII

THE CREDIT MANAGER

Consumer credit, in one form or another, has probably existed from the beginnings of civilization. Mercantile credit, too, can be traced to at least about the sixth and seventh centuries of the present era. Bank credit, while of more recent origin, also extends back a number of centuries. This, however, must not be taken to mean that credit management can boast of as ancient a lineage, for such management on even a pseudo-scientific basis is a relatively recent development. Even today there are many retail and mercantile enterprises which have no credit department, where credit work is not specialized, and where practically no credit management in any true sense of the term is exercised. But when industry and trade as a whole are considered, one may be justified in the conclusion that the organization and management of credit as we know them today have gone through certain distinct evolutionary processes and that credit work in a scientific sense has finally come of age.

Evolution of the Credit Profession.—From the standpoint of responsibility in credit work, the history of its development may be divided into four periods. During the first period the responsibility for dispensing credit devolved on the proprietor or the head of the firm, who was personally in touch with his comparatively small number of customers and, consequently, familiar with the essential facts governing the determination of his credit policy. In the average small business establishment credit work is even yet performed by the proprietor or head of the firm, who may, in addition, have complete charge of other functions, such as buying, advertising, merchandising, financing, and general office management.

In the second stage, credit-making power was delegated, though with great reluctance, to the bookkeeper, and in retail establishments, to the cashier-bookkeeper. With the complete recovery from the panic of 1873 and the business depression that followed it, the proprietor or head of the firm found it beyond his ability to interview new applicants for credit personally and to supervise all work related to credit granting. The period of personal observation of customers and their businesses has passed and indirect and impersonal contact substituted. During this period the country progressed and developed rapidly—the Far West was opened up, the financial and commercial reconstruction made necessary by conditions growing out of the Civil War and the crisis of 1873 was almost completed,

the influx of immigrants was unusual, and accounts of individual firms grew by leaps and bounds in both number and amount. The sudden and enormous increase in the volume of business necessitated the adoption of some form of organization with powers delegated to officials in responsible positions. Under these circumstances it was impossible for the proprietor to maintain contact with the trade and acquire an accurate knowledge concerning credit customers. Accordingly, the responsibility for dispensing credit, although primarily devolving upon the bookkeeper, was not infrequently shared by other individuals. In addition to the manager and owners, salesmen were still relied upon in the selection of credit risks, principally because of their direct contact with the trade. It was a period of mixed or at least dual responsibility, as far as credit granting was concerned.

The formation of the National Association of Credit Men in 1896 marked the beginning of a new era in the evolution of the credit expert in the mercantile and banking fields. As trade grew and developed still further, the bookkeeper found it beyond his ability to handle both accounting records and credits successfully, for credit work alone required, in the majority of instances, the entire time of one or more persons. Thus it came to pass that credit work was finally placed in the hands of a special man, more or less of an expert, whose function it was not only to select the risks carefully, but also to supervise accounts constantly, collect bills promptly, and the like. To be sure, this expert, though considered indispensable, was at first in many instances given a rather inconspicuous place in the organization. This he still occupies in some of the smaller businesses which have not as yet expanded sufficiently to realize the importance of his services.

It is the author's belief that we are now on the threshold of a new stage in the evolution of the credit profession. The designations "credit manager" and "credit executive" are fast replacing that of "credit man." This transition first became discernible as we emerged from the depression which began in 1929. During that depression the credit manager had been put to the acid test. He had been faced with difficulties of an almost insurmountable character. In the desire to secure additional business, badly needed during these trying times, much pressure had been brought upon him to be lenient in the handling of his accounts. It has required considerable moral stamina to withstand such pressure and, thus, avoid the danger of being flooded with an avalanche of losses from bad debts. On the other hand, much work of a constructive nature was needed in order to save customers from business ruin and, thus, also keep losses down to a minimum. Out of this crucible of experience has come forth triumphantly the credit executive, whose qualifications, personal and educational, are discussed below.

FUNCTIONS OF THE CREDIT MANAGER

The precarious position of the credit manager has already been referred to in a previous discussion. His primary function is to keep the percentage of losses at a minimum. However, a low percentage of losses from bad debts alone is not a sufficient criterion of a successful credit manager, for losses can be kept at a low point by refusing all but premier risks. In doing so, much profitable trade is driven away from the house. Furthermore, it would hardly require the superior knowledge of a specialist merely to distinguish between merchants whose credit standing is reliable beyond any shadow of a doubt and those whose credit standing is not of the first class. The inauguration of too strict a policy invariably results in the refusal of much valuable business, the profits from which may greatly exceed all possible losses from bad debts. On the other hand, great liberality in accepting doubtful accounts means a loss in excess of the profit derived from such trade. It, therefore, devolves upon the credit manager to exercise nice judgment in so managing his work as to have a minimum of losses with a maximum of sales.

Reduce Losses.—To attain the double object of reducing losses to a minimum and at the same time increasing sales volume, the credit manager must first of all exercise special care in the selection of risks. Upon receipt of an application for credit, the risk should be thoroughly investigated and adequate information gathered and carefully analyzed. Should the applicant fail to measure up to the standards of the house, the credit manager should not hesitate to decline credit, for by extending credit liberally to merchants who are incompetent and whose standing does not warrant such treatment, the whole credit system is abused and irreparable injury results to business and credit standards.

Conditions affecting the credit standing of customers are continuously changing with the variations in local conditions and general oscillations of the business cycle. Profits may decrease, or the customer may overexpand his plant or overstock with unsalable merchandise. For this reason, the activity and progress of both old and newly opened accounts should be watched carefully. Records should be revised periodically and kept up to date. The results of these periodic revisions will indicate whether the limits of credit established should be continued, increased, decreased, or altogether discontinued. Unpleasant surprises will thus be avoided and weaknesses probably discovered in time, so that even in the worst case the account may be carefully eliminated if in the opinion of the credit manager the weakness disclosed is of a permanent and incurable nature. On the other hand, if the weakness is temporary, it might be advisable for the creditors to lend their assistance in an attempt to rescue the debtor and restore the account to its former position.

The business conditions in a community determine, in a way, the prospects of safety in extending credit. Local conditions affecting different parts of the country in which customers and prospects are located must be diligently studied. A community may be industrially and financially in its youth, maturity, or old age. It may be on the upgrade, downgrade, or at a standstill. To grant credit freely to individuals or merchants in a downgrade stage of a community is to invite failure. Other conditions affecting different localities in which the house is interested should be studied. If the sphere of interest is a farming community, crop conditions and other important factors relating to agriculture must be given adequate consideration. Knowledge of all of these industrial factors, coupled with an intimate acquaintance with the character of the people themselves, will prove an invaluable aid to the credit manager in the extension of credit accommodations and in the collection of accounts.

In addition to a study of local trade conditions, the credit manager should familiarize himself with all the elements that combine to spell success or failure of the respective businesses of his customers. He should know the nature of the businesses they are conducting, probability of success or failure, financial strength of the enterprises, efficiency of the managements, and local competitive conditions affecting them. In a word, everything which goes into the composite of the three C's, which will be discussed in the following chapter, must be known if the functions of reducing losses and increasing sales are to be well performed.

Another part of a credit manager's task lies in the application of his skill in making collections. Delinquent debtors are to be followed up vigorously and persistently, and knowledge must be had as to the different steps that may be taken in forcing the payment of past-due accounts. As will be shown in Part IV, this phase of the work requires an intimate knowledge of the legal remedies of creditors, adjustments, compositions, receiverships, bankruptcy, and the like. Above all, it calls for an unusual degree of tact and diplomacy and strategy of a very high order, for, after all, the human equation is all-important in both credits and collections.

Increase Sales Volume.—The second important function of the credit manager is to stimulate sales, by working in harmony with the sales department, but primarily by creating and maintaining the good will of the trade. If his duties are intelligently and conscientiously performed, he will not only win the customer's entire business, in the lines handled, over to his house but will also become a significant factor in the development of their ability as merchants. The latter will strengthen his customers' positions in their respective local fields and larger sales will thus be obtained.

There are also a number of positive ways in which a credit manager may build business for his concern. In every firm there are many dormant or inactive accounts. These can often be revived by direct-mail material; letters bearing either the credit manager's signature or that of the president of the company inquiring as to the reasons for inactivity, when couched in diplomatic language, often produce satisfactory results. New credit accounts can be solicited from among those who enjoy a good credit standing, cash customers may be profitably converted into charge accounts, and in mercantile concerns close cooperation with the sales force will accomplish similar results.

Cooperate with Other Credit Departments.—A third function of the credit manager is to cooperate with other credit departments either directly through interchange of credit information in response to inquiries, through personal interviews, and group meetings; or, indirectly, by furnishing information concerning credit risks to mercantile agencies and credit interchange bureaus. The knowledge of a credit manager cannot be considered an asset until it is put into circulation and shared with others in the profession.

It is probable that no other form of business activity is so dependent upon collective action and cooperation as is credit work. As a result, the need for an exchange of ideas and experiences is so universally recognized that credit information is readily imparted by one merchant to another. The wisdom of years of experience has burned the necessity of cooperation into the very soul of credit men's organizations. The mutual benefits derived from the interchange of credit information and cooperation are so widely recognized that many credit managers possessed of the true cooperative spirit are deterred from acting independently, even in cases of liquidations and bankruptcies, where preferences could be readily secured and an immediate gain obtained.

It is a big task to harmonize all credit managers into one smoothly working cooperative organization, but if one is to judge by the steady progress since the formation of the National Association of Credit Men in 1896 and the Retail Credit Men's National Association in 1912, future prospects for cooperation in credit work are rather bright.

ESSENTIAL PERSONAL QUALIFICATIONS OF A CREDIT MANAGER

Adaptability.—Adaptability for the work is one of the principal qualifications of a credit manager. A credit man is not born and is not so much the result of inheritance as he is a product of training. To succeed in his work, a credit manager must have a love for it, which, to be sure, may be cultivated.

All work may be divided into two classes or types: There is the kind of work that the average person considers unpleasant, such as mining, run-

ning a machine in a factory, driving a truck, running a typewriter in an office, and the like. This type of work embraces all the unpleasant and purely machine-like industrial processes and the dull routine work, all of which are essential to our complex existence. People are compelled to perform these duties in order to gain a livelihood. Other people regard work as pleasure. In this class are included most professional persons, such as lawyers, doctors of medicine, and others. Where the work is unpleasant, many difficulties in the form of strikes, inefficiency, and other disturbances are experienced. Wage earners for the most part feel the urgency for work solely as a means of obtaining enjoyment in their spare hours. Accordingly, demands for higher wages, shorter days, and better conditions with respect to environment are continuously made of employers, and the possibilities are that so long as work is regarded as a necessary evil so long will the performers remain partially dissatisfied. On the other hand, professionals and the vast group of business men, in addition to the compensation they receive in terms of money, derive no little satisfaction from following a chosen line of endeavor and from serving humanity in general. Adaptability is, therefore, the fitness of a person to the requirements of his position.

Thoroughness.—This is perhaps the chief quality in credit granting and in collection procedure. To succeed, a credit manager must not jump to hasty conclusions. Risks should be thoroughly investigated and decisions based upon an accurate knowledge of facts. He must scrutinize the information secured from the various sources available, since apparently insignificant items might have an important bearing upon the nature of the risk. He must constantly watch for the out-of-the-ordinary, such as opening up accounts in new markets, failure to take advantage of cash discounts, and the like.

To be thorough does not necessarily mean going into great detail. It does mean, however, that a task must be so performed as rightly to deserve the designation of completeness. By properly centering his attention on one thing at a time, the credit dispenser can analyze conditions thoroughly and yet require little time and effort for the process.

Even Temperament.—A successful credit manager must be of even temperament and not affected from day to day by personal feeling and mental attitude. Evenness of temper and coolness of judgment are two indispensable requisites in the profession under consideration. Unpleasant occasions in and outside of business frequently arise, to the influence of which credit grantors must be immune in exercising their judgment. When orders are declined on the basis of information secured and interpreted by the credit department, the sales force may be disappointed. On the other hand, when orders are accepted on its advice, and losses are consequently suffered, the management is very likely to place the blame

on the credit department. The credit manager is often in a precarious position which requires good, sound business judgment and an extremely even keel. He cannot afford to be a pessimist one day and an optimist the next.

Firmness.—A credit manager should be firm in his decisions and in executing policies. He will often be criticized and prevailed upon by the salesmen, sales manager, customers, and others, but should nevertheless adhere to his conclusions, unless additional facts are presented which would tend to modify the original decision. He should be firm and yet not stubborn, progressive in his attitude, willing to learn at all times, possess an open though critical mind, and change his attitude only when warranted by additional evidence in the case.

Quickness of Decision.—This qualification is particularly desirable in a retail credit manager, where deliberation and undue slowness in appraising circumstances may mean a loss of trade. Some risks are extremely sensitive and resent any delays on the part of credit men in passing judgment, and deliberations are interpreted as a slight. A credit manager must, therefore, be resourceful, quickly appraise given conditions, and effectively handle them.

EDUCATIONAL QUALIFICATIONS OF THE CREDIT MANAGER

To steer the wheel of our great business ship so that it will run through sound and safe credit channels there is need for a credit manager with up-to-date educational equipment. It is not intended at this point to list specific courses that a person should study in preparation for this work. We are probably suffering altogether too much from "coursitis," because of the wrong emphasis on specific curricular subjects to be studied rather than on the segments of knowledge to be acquired. Instead, an attempt will be made to point out a few of the major fields of knowledge with which a credit manager must be familiar if he is to occupy the position for which he is destined.

Fundamentals of Credits and Collections.—That every credit manager must be grounded in the fundamentals of credits and collections goes without saying. It is generally conceded that a credit manager must understand what his main functions are. It is also agreed that he must be thoroughly acquainted with all possible sources of information so that he may base his decisions upon facts and not fancies. He must know what these sources are, the kind of information they are prepared to furnish, the value of each as to freshness and completeness, and how to use them under various circumstances. In the use of these sources of information, the credit manager must be highly selective, lest the costs of credit management exceed budgetary limitations. A credit manager must exercise good judgment, he must have an effective system of check-

ing credits, and he must know how to collect accounts without losing the good will of his customers. The latter requires an efficient collection system, familiarity with existing commercial laws applying to his accounts, and care in the use of collection agencies and attorneys in the enforcement of payment. In the performance of this work, naturally, the credit manager must be familiar with business law, accounting, and statistics, in addition to credits and collections proper.

Knowledge of all this must be taken for granted. It is the backbone of the credit profession. It is assumed that every credit man today, deserving of the name, is familiar with the rudiments just outlined. No one can dispute the essential nature of this sort of preparation for credit work. However, knowledge of all these rudimentary principles of credits and collections is not sufficient for the progressive credit manager. A person who is merely thus equipped is nothing but a journeyman credit man or a mere credit technician.

Fundamentals of Economics.—To qualify for the important position of credit manager, a person must have a thorough understanding of our economic system. It is such an understanding that gives stability to his thinking, lends breadth to his work, and enables him to project himself imaginatively into the future. A good background in the fundamentals of economics or economic principles will help to explain many phenomena for which on the surface there may seem to be no reason.

The American Business Structure.—Even more important is it for the credit manager to know what our business structure is, how our marketing system functions, what channels of distribution are available and what their relative positions are. The Federal government, through its Bureau of the Census, has spent a total of over $15 millions to take three censuses of distribution covering the years 1929, 1933, and 1935, respectively. As a result of these enumerations and many studies that have been made on the basis of these and other factual data, there is now fairly complete information on the structure of American business. Every credit manager should study these results in order that the various credit risks may be properly evaluated from the standpoint of the position which they occupy in American business.

Trends and Tendencies.—It is not sufficient to know what our credit system is and how it functions at the present time. A progressive manager is on the alert for changes that may affect his work. He keeps abreast of the times by studying the periodic reports on collections, losses from bad debts, and such other matters as are being made available by the Bureau of Foreign and Domestic Commerce, and by his associations, from time to time. He watches for new legislation, whether it be an amendment to the Bankruptcy Act or a change in the garnishment law in a certain state in which his customers are located. In similar fashion,

he constantly watches what is taking place in our distribution system, the new channels that are being carved out, the new types of retailing and wholesaling that are being established, and other changes that may profoundly affect the status of his customers or would-be credit customers.

Importance of the Credit Manager.—The credit manager occupies a unique position in business, one which is difficult to fill successfully and creditably. He is held responsible for losses arising from bad debts and at the same time required not to refuse too many applicants for credit and thereby turn away business. He is responsible for practices resulting either in losses from accepting doubtful accounts or in volume of sales through liberal refusals of applications for credit. Again, when buyers are given credit sparingly and prompt payments are insisted on, merchants will not overstock their stores with unsalable merchandise; while failure to insist upon prompt collections, coupled with extreme liberality in granting credits, invariably results in glutted markets, poor merchandising, and perhaps ultimate failure of the credit giver.

The credit manager is, in a sense, the financial officer of the concern he represents. He constitutes an important thinking part of the enterprise. The credit desk is the natural center to which all sorts of information gravitate and where many important facts bearing upon the business are registered. Obviously, the credit department has a much wider field than merely preventing losses. There are, therefore, great opportunities for gaining all sorts of knowledge, particularly financial knowledge, and for general and rapid advancement in the business enterprise.

There are still many misconceptions concerning the credit manager's position. In certain quarters, he is still regarded as a "glorified bookkeeper" or as a "treasury watchdog." This type of position he still occupies in some of the smaller businesses which have not as yet expanded sufficiently to realize the importance of his services. It is to be noted that the four stages in the evolution of the credit profession apply to expanding businesses even today. These stages are characteristic of large concerns from the standpoint of time and of small enterprises from the standpoint of size in their growth. Even in the larger concerns there is some justification for the unfavorable opinions and judgments concerning the credit manager, for some so-called "credit men" are still primitive in both their technique and attitude toward their profession. But the progressive credit managers, whose number is legion, are men and women who are broadly grounded not only in the fundamentals of credit, but equally as well in the rudiments of economics and American business. They are persons with a broad background and a keen understanding of business conditions and significant trends. In short, they are practical economists charged with the all-important duty of dispensing

credit so that it may flow freely through the veins of our business structure giving it the needed nourishment and sustenance at all times.

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Questions and Problems

1. Through what distinctive stages has credit management evolved?

2. What particular event gave probably the greatest impetus to the development of scientific credit management?

3. Prove that the credit manager who performs his duties in a creditable manner occupies a pivotal position in the modern business enterprise.

4. In the selection of a credit manager, what qualifications should be especially sought for? Personal? Educational?

5. "The function of a credit man is to keep losses down." Criticize this statement.

6. What would be your opinion of a credit manager who boasts of the fact that his losses from bad debts are practically nothing? Justify your answer.

7. Which of the credit man's functions is the most important? Why?

8. How true is the following statement: "A good credit man is a good business man."

9. What specific kinds of information of value to a credit manager can be secured from the United States Bureau of the Census?

10. What kind of information of direct concern to the credit man is made available by the Bureau of Foreign and Domestic Commerce?

CHAPTER IX

THE CREDIT RISK

Every credit transaction involves the element of futurity, *i.e.*, a promise to pay in the future in exchange for a present consideration. There is, therefore, more or less risk whenever goods or services are sold on time, and it is not an ordinary task to determine in just what degree the risk is present in any given instance. One of the chief functions of the credit manager is to determine whether the application for credit is to be accepted or turned down. To do this, he must search for and obtain sufficient evidence, an examination of which will either prove or disprove the existence of willingness and ability on the part of the credit seeker to make payment at the expiration of the credit period. Without any likelihood of the applicant's being both able and willing to pay the bill at maturity, no credit should be extended, lest the losses incurred from freely accepting doubtful accounts exceed the profits incident to increased sales.

BASIC FACTORS DETERMINING THE CREDIT RISK

In preferring one applicant for credit over another, a process of elimination must necessarily be carried on. This process is based upon information considered essential for the judgment of the grantor in the selection of his risks. If confidence as to the customer's willingness and ability to pay is thereby established, the risk is accepted; otherwise it is turned down or at best accepted under special or restricted terms. There are at least two decisions in the consideration of applications for credit. First, shall credit be granted? Is the risk good? Second, assuming the first decision to have been made in favor of the credit seeker, to what extent shall credit be extended? What limitation shall be placed upon it?

The principal factors to be taken into account in deciding whether or not credit should be extended and in what amounts comprise what are commonly referred to by men in the credit profession as the "three C's" —Character, Capacity, and Capital. A fourth C is sometimes included to designate Collateral, as an adjunct to or substitute for what is normally considered under Capital. All these C's of credit bear on the reliability and resources of the risk or on "the man and the means."

Character.—By "character" the credit grantor understands honesty. It is a barometer of a person's willingness, intention, or determination to pay his bills when due and to discharge his obligations promptly. The

applicant's character may be revealed in his antecedents, in his standing in the community, his habits, and moral principles. Obviously, a person's character is not subject to frequent changes. An investigation should, therefore, never fail to include a customer's general history, reputation, and similar factors bearing upon the moral aspects of the risk.

Although character is the least tangible of the factors in the determination of the credit risk, it is nevertheless *normally* the most important basis and is susceptible to definite ascertainment. It is not extremely difficult, for example, to discover and separate the honest from the dishonest, the sane livers from the extravagant, the abstainers from the drinkers and gamblers, and the moral from the immoral. Experience has shown that capacity and capital count for little when a clever crook deliberately determines to "beat" his creditors. Where character is doubtful or distinctly inferior, no credit should be extended if the purchase of a lawsuit is to be avoided.

According to the testimony of the late J. P. Morgan before a committee of Congress investigating the Pujo Money Trust and other economic conditions, character is of prime importance in the selection of credit risks. As much as a million dollars was extended by him to a single person on this basis alone. He also stated that a "man with character, without anything at all behind it, can get all the credit he wants, and a man with the property (but without character) cannot get it."[1] The character element doubtless does frequently constitute the most significant factor in the determination as to whether or not credit should be granted, with the exception of banking credit, which is often based on collateral. It is doubtful, however, whether many credit managers would assign character such an exaggerated and envious position in the course of normal business activity and part with their goods on this basis alone. Character merely determines whether the credit risk is good and honest and probably affects 40 per cent of the credit decision. The road to a certain undesirable place is supposed to be "paved with good intentions." Even the noblest character on earth would indeed be a poor risk without at least capacity to support it.

Capacity.—To ascertain the credit seeker's ability to redeem his pledge at maturity, his capacity in all of its phases must be thoroughly investigated and appraised. From the standpoint of retail credit, capacity is judged by one's ability to earn enough to pay for his purchases, or the ability to get ahead as determined by earning power, the consistency with which the customer holds his position or the efficiency with which he conducts his business, if in business for himself. From the standpoint of banking, and particularly mercantile credit, capacity connotes efficiency. It is ability of the merchant, native or acquired, to conduct his

[1] Pujo Money Trust Investigation, Vol. 2. p. 1084.

business at a profit. Other things being equal, the farsighted, able, and aggressive business man is more likely to succeed than the shortsighted, narrow-minded, and easygoing individual.

Capacity may be reflected primarily in the customer's knowledge of his business, technical and otherwise, alertness, shrewdness, and ambition. A person's age is usually one of the reliable indexes to his progressiveness or conservatism. Again, the inexperienced man "going into business for himself" is greatly handicapped, and the chances of success are much against him, unless sufficient experience in the given line has been previously acquired with similar establishments and a reasonable amount of capital has been accumulated to carry the undertaking through the experimental stage. Finally, buying and selling methods and policies and general business management are important considerations in an attempt to ascertain the presence or lack of capacity or ability to make good. Definite knowledge can be gained concerning these matters from records showing the credit seeker's antecedents, paying habits, and the extent to which modern business methods have been adopted in the management of the business.

Under normal business conditions, capacity is next in importance to character, for, other things being equal, the able, experienced, healthy, and aggressive person has a greater chance to succeed than the one who lacks business ability, is inexperienced, sickly, and easygoing. This element should be given a rating of at least 35 per cent of the credit decision.

Capital.—The third "C"—capital—determines the actual means of payment at the time the transaction is consummated. Without the financial strength as denoted by the term, the granting of credit constitutes a "moral risk," meaning thereby that the grantor relies chiefly or entirely upon the character and capacity of the risk. When coupled with capacity, capital furnishes a satisfactory answer to the query relating to the limitation which should be placed on the amount of credit to be extended.

Capital, for credit purposes, is the financial strength of the risk; it consists of the amount and quality of goods and property, expressed in terms of money, which an individual or firm possesses in excess of what it owes. It is the margin of safety or the cushion with which the credit manager is particularly concerned, and this is reflected by the amount of assets and liabilities, their various qualities and proportions. The financial strength can be accurately ascertained by securing and carefully analyzing property or financial statements indicating the relationships between the various assets, liabilities, and proprietorships.

While wealthy debtors can be forced to pay eventually, it is hardly desirable to accept a risk with capital as the only basis to recommend it.

Forced collection is too expensive a process and the eventual loss of good will as a result is a sufficient deterrent to prevent drastic action from being taken. For these reasons, capital is usually assigned a third place in the relative estimation of the three C's, except where large loans are extended, for the assumption is that capital of the right quality and proportion normally produces capacity, although it is equally true that capacity, connoting efficiency, also produces capital. Obviously, the relationship between the two is a very close one.

Collateral.—A fourth C, frequently employed in testing the credit seeker's claim to be considered a desirable and acceptable risk, is collateral. A bank making loans on security examines carefully the nature of the collateral offered for deposit, irrespective of the moral responsibility of the borrower. In selling automobiles to the ultimate consumer, chattel mortgages are frequently taken by the seller as security behind the promissory notes for the unpaid balances. In such instances the chattel or chattels offered as collateral must be thoroughly scrutinized, for it is the property thus conveyed upon which main reliance is placed in financing the transaction. Under these circumstances, even character assumes a position of secondary importance. Normally, however, the fourth C is totally lacking in most mercantile and retail credit extensions.

Relative Importance of the Three "C's."—The relative grouping and significance of the three C's are in large measure determined by the angle from which these factors are viewed, as well as the philosophy underlying the given viewpoint. A writer of considerable experience in credit work assigns capital the most important position, with capacity placed second, and character third. Two reasons may be advanced in justification and support of such a valuation. In the first place, it is argued that, to begin with, a credit seeker must display sufficient financial strength of his own to finance the volume of business he expects to do. Once this fact is adequately demonstrated, the applicant must convince the credit grantor of his ability to conserve his financial resources through conservative management and that he will discount his bills or meet his obligations at maturity. Finally, the applicant must display qualities of honesty and integrity, denoting willingness and intention on his part to fulfill his obligations to creditors, irrespective of contingencies that might arise, calling for action to the contrary if a line of least resistance is to be pursued.

The principal objection to such reasoning lies in the fact that relatively few credit seekers are likely to qualify in the demonstration of sufficient capital to finance the entire volume of business. Furthermore, if an individual or firm should ever attain such an enviable position they would hardly need to enlist the financial aid of supply houses and bankers, but would be buying totally on a cash basis. It follows, therefore, that a

credit manager must, in practice, reverse his reasoning as indicated in the foregoing discussion and not place "the cart before the horse." He must determine: first, the applicant's willingness to discharge his obligations promptly, as determined by his character, or honesty and integrity; second, his ability to live up to his intention as reflected by his present financial standing and his ability to conserve it, or by his capacity to conserve the proceeds from the sale of merchandise secured on credit terms, and so to carry on his business as ultimately to accumulate larger capital.

Another argument in support of the transposition of capital to first place as a basis for credit extensions is that almost 75 per cent of the orders in most houses are accepted on the basis of mercantile agency ratings alone, and that only 25 to 30 per cent of the orders fall into a separate class requiring careful scrutiny of the other two elements or bases, namely, capacity and character.

In advancing this argument, the assumption apparently is that mercantile agency ratings reflect financial strength exclusively. As a matter of fact, the ratings also indicate paying habits and general character, as well as capital strength. Besides, in determining the relative value of the various bases, it is not the A-1 risks that are kept in mind. These seldom give any worry or anxiety to sellers, and the passing upon such risks would hardly justify the employment of an expert. What a credit manager is concerned with primarily is the doubtful or borderline account, for it is this kind of risk that calls for nice judgment and the exercise of extreme care and caution and the display of all the fine qualities a credit manager should possess. In a word, it is not the *total number* of risks, but the number of *doubtful accounts*, accepted on a given basis, which should govern the determination of the relative position of that basis or factor. A quantitative index alone falls short in an attempt to convince one of the propriety of placing capital in the premier position as a factor in the credit decision, for it is the qualitative analysis which is the more important in this connection.

To enable the credit man who strives for exactness in his decisions to measure the risk mathematically, it is suggested that, because of the reasons advanced in the previous discussion and in cases dealing with other than moral risks, character be assigned a value of 40 per cent; capacity, 35 per cent; and capital, 25 per cent; making a total of 100 per cent for the three C's.

The Credit Equation.—Assuming normal transactions under normal economic conditions, the credit equation may be stated in the following manner:

$$\text{Character} + \text{Capacity} + \text{Capital} = \text{Safety in Credit Limit.}$$

To indicate more clearly the relative significance of the three factors, several other equations may be developed as follows:

1. Character + Capacity + Insufficient Capital = Fair Credit Risk.
2. Character + Capital + Insufficient Capacity = Fair Credit Risk.
3. Capacity + Capital + Impaired Character = Doubtful Credit Risk.
4. Character + Capacity − Capital = Limited Success.
5. Capacity + Capital − Character = Dangerous Risk.
6. Character + Capital − Capacity = Inferior Credit Risk.
7. Capital − Character − Capacity = Distinctly Poor Risk.
8. Character − Capacity − Capital = Inferior Credit Risk.
9. Capacity − Character − Capital = Fraudulent Credit Risk.

MODIFYING ELEMENTS DETERMINING THE CREDIT RISK

In measuring credit with a view to ascertaining the risk involved as evidenced by the three elements of character, capacity, and capital, credit managers differ widely in estimating their relative importance. Not infrequently do the same credit grantors vary their own opinions as to the relative strength of the chief and basic factors by which risks are measured, with the general trend of business conditions, and the like. For these reasons, additional factors may be introduced the effect of which is to modify the credit equation as declared operative in the majority of cases under normal economic and business conditions. These are:

1. The credit policy of the house.
2. The attitude of the credit manager.
3. The business cycle.

Policy of the House.—In deciding whether or not a risk is acceptable, the credit manager must be governed in large measure by the policy of his house. It is a matter of common knowledge that the percentage of net profit on which different houses in various lines, or even in the same trade, operate shows a marked variation. It naturally follows that longer chances can be run by concerns whose margin of profit is high than by those whose margin is exceedingly narrow. A liberal policy in relation to credit granting may justly and profitably be adopted by the former, whereas a similar plan when followed by the latter may prove disastrous. Again, an industry operating on a decreasing cost basis will find it to its advantage to secure volume through liberal extensions of credit, thereby increasing the scale of operation and making for the economies resulting therefrom.

As a means of meeting and overcoming competitive conditions, liberality in the formulation of a credit policy is commonly employed.

On the other hand, monopolistic or semi-monopolistic enterprises are seldom, if ever, liberal in the adoption of a general credit policy, unless it could be shown that the effect of such procedure would be greater sales, large-scale production, and consequently higher total profits.

The type of its customers must also be considered by the house in formulating its policies. When one is selling to farmers or miners, liberal terms are required, as illustrated by the relative ease with which agricultural machinery can be purchased by the soil tiller. On the other hand, merchants dealing with city trade are more likely to sell on shorter terms and to be more exacting in making collections and in general credit requirements.

Attitude of Credit Manager.—Within certain broad limitations, as determined by the policy of the house, credit managers are given a great deal of latitude in the exercise of their power as credit dispensers. Accordingly, some lay greatest stress on a customer's financial responsibility, others judge the risk primarily by character, while still others maintain that capacity as manifested by one's ability to manage his business properly is the prime essential. Again, some credit managers follow a more or less rigid policy of keeping down losses from bad debts to a minimum, losing sight of the real perspective of credit work, which calls for a minimum of losses consistent with a maximum of sales. On the other hand, many credit managers grant credit too freely, accept too many large hazards, roll up excessive losses, and generally demoralize the entire credit system. The purpose of most houses, however, is to steer a middle course and avoid a too free or a too exacting policy.

It should be noted at this point that the difference of opinion among credit grantors as to the relative strength of the three C's is determined by one or two things. The commonest basis is a credit manager's personal experience. When he insists upon the presence of financial responsibility, it is likely that in the past he has probably suffered greatest loss because of the lack of that element. On the other hand, another man whose house has found it most advantageous to insist upon moral responsibility as a basis for a line of credit would naturally assign character the greatest value.

Another basis used as a guide by credit managers consists in statistical data relating to failures. If it is known that the largest percentage of failures within a given period is due to fraud and the next largest to incompetency, it is natural that character should be considered of prime importance, capacity assigned second place, and capital third.

The Business Cycle.—As pointed out in the first chapter, business is dynamic and not static. The oscillating movement of business from prosperity, to crisis, to depression, to revival, to prosperity, and over again, has been clearly and conclusively demonstrated by the experience

of over a century in the United States and abroad. A credit executive must, therefore, constantly keep his hand on the pulse of general business conditions and movements and sense changes in direction clearly and unmistakably. In a period of rising prices, men with little or no ability may succeed in business, whereas under adverse conditions they are unable to cope with competitive forces. During a period of falling prices and general deflation not only is capital rapidly dissipated, but even character not infrequently undergoes abrupt changes. Many an honest person is forced by circumstances to resort to measures not approved of by moralists.

Because of the foregoing, it can readily be appreciated that, to succeed, the credit manager must project into the future and imaginatively foresee changes in economic conditions and their bearing upon his risks. Since all time transactions involve the future and payments for goods are deferred, it is essential that in seeking and in analyzing credit information all elements be considered which not only have a bearing upon the present status of the customer, but also upon the more or less immediate future. In other words, the information obtained must be construed not only in the light of prevailing business conditions, but also with respect to the future.

Moral Risks.—Banks and mercantile concerns have essentially the same credit problems, for they deal with the same type of clientele, both utilize the same sources of information, and both are interested in the business success of their customers. In these fields of operation, credit customers or applicants for such accommodations are frequently designated as "moral risks," "business risks," or "financial risks," depending largely upon which of the three C's of credit predominates. Moral risks are those whose financial means are so limited that, from a credit standpoint, chief reliance is placed upon the character or determination to pay and secondly upon ability to run the business with reasonable efficiency. Many young men who possess these qualities when starting in business can obtain a limited amount of credit at least for short periods of time. The number of such risks is veritably legion. A customer is labeled a business risk if his chief asset is ability to run his business at a profit. If, on the other hand, the available capital of the subject is the main consideration in extending credit, the subject constitutes a financial or property risk which is best analyzed by an examination of the financial statement.

In the field of retail credit, the number of so-called "moral risks" is much greater in absolute figures or in proportion to all credit customers than in banking or in the mercantile field. In these cases, moral risks are judged primarily by their integrity, paying habits, mode of living, and earning capacity. Thus, while all three C's of credit are universal

in their application, Capital has relatively little bearing in dealings with charge accounts used by consumers or when consumers borrow on their signatures. Consequently, more stress needs to be put on the moral character of the risk here than in other types of credit.

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Questions and Problems

1. Are the three C's of credit of limited or universal application, *i.e.*, do they apply only to mercantile credit risks or are they of equal significance in judging risks for retail or bank credit?

2. What, if any, is the relationship between capacity and character?

3. How would you, as a credit manager, proceed to judge an applicant's character? Give a specific illustration of the items of information you would wish to gather as a basis for your judgment.

4. In judging a credit risk who applied for credit accommodations at a local department store, under which of the C's of credit would you classify each of the following items of information:

a. Highest amount of credit extended by other stores.
b. Presence or absence of a checking or savings account at the bank.
c. Information secured from a neighbor.
d. Length of residence at the present location.
e. Assessed valuation of owned real estate.
f. Size of the family.
g. Social standing in the community.
h. Chattel mortgages given to creditors.
i. Size of the bank account.
j. Inheritance of property.
k. Mode of living.
l. Judgments held against the risk.
m. Position occupied and salary earned.

5. Which of the major factors determining the desirability of a credit risk is the most significant? Explain.

6. Classify the items in the following credit report according to character, capacity, and capital:

A. C. Johnson, aged thirty-five, druggist. Net worth in business alone $8,560. Married. Investment in real estate $4,500. Business established 4 years ago. Was engaged as salesman for a wholesale drug firm for 3 years before starting in business for himself. Business record apparently clear. One fire 2 years after he had started in business. Cause unknown. Trade reports favorable. Good health. Secondary location. Carries satisfactory account at his bank. Drives Ford sedan. Spends most of his time in store. Employs pharmacist and one clerk. Sales are increasing steadily. Extends

no credit. Owns dividend-paying stock valued at about $1,000. Stock well arranged. Director of the local Retail Druggists' Association.

7. What policy would you recommend that a credit manager adopt toward his customers during:

a. A period of prosperity?

b. A depression?

c. The revival stage of the business cycle?

8. Why do some credit managers rely largely on the customer's character, while others base their decisions primarily on the customer's financial responsibility? Explain.

PART II

SOURCES OF CREDIT INFORMATION

CHAPTER X

GENERAL MERCANTILE AGENCIES

In analyzing the credit risk, whether it represents an active or prospective account, a creditor must secure essential information on character, capacity, and capital. In this and several subsequent chapters is presented a discussion of the sources of information at the disposal of mercantile and bank creditors engaged in domestic commerce. A later chapter is devoted to a consideration of the sources of credit facts relative to foreign trade transactions, followed by a chapter on sources commonly used in the extension of credit to consumers.

Sources of Information in the Mercantile and Banking Fields.—For the sake of clearness and brevity the various sources of credit information available to mercantile and bank creditors may be classified as follows, based partly on the order in which they are commonly brought into play but largely on their relative importance:

I. Mercantile agencies:
   1. General.
   2. Special.

II. Other creditors, through direct interchange:
   1. Orally, by means of personal contact and through trade-group meetings.
   2. By correspondence.

III. Credit bureaus for the interchange of ledger experience:
   1. Credit interchange bureaus maintained by associations of credit men.
   2. Trade credit bureaus operated under the auspices of trade associations.

IV. Special representatives who are familiar with the risk's locale:
   1. Salesmen of the creditor.
   2. Attorneys.
   3. Banks.

V. The credit risk himself, through:
   1. Personal interviews.
   2. Financial statements furnished directly upon request of the creditor.

VI. The creditor's own records of past dealings with the risk in question. This applies only to old accounts.

VII. Miscellaneous sources, such as:
1. Corporation manuals.
2. Corporation financial services.
3. Trade and financial publications.
4. Credit character reports.
5. "Credit Manual of Commercial Laws," published annually by the National Association of Credit Men.

It is imperative that every credit manager be thoroughly familiar with all of these classes of sources supplying credit information. He must know what they are, the kind of data they are prepared to supply, the value of each source as to the completeness of its service and freshness of the information, how quickly the intelligence may be secured, what the cost of the service is, and how to use the various sources under different circumstances. Only through such an intimate acquaintance will the credit manager be able to tap them at the proper time, properly and correctly interpret the information thus secured, and keep the costs of credit management within budgetary limitations.

Types of Mercantile Agencies.—In many houses by far the largest percentage of orders is checked for credit principally or entirely on the basis of information obtained from mercantile agencies through their rating books, special reports, or both. Mercantile agencies are institutions formed for the sole purpose of gathering information concerning the credit standing of business men and disseminating that information to their respective members or subscribers. These agencies are of two types—general and special. The former consist of very large organizations, covering many and varied lines of trade over an extensive area; the special agencies restrict their operations either territorially or according to lines of trade and types of names investigated. At the present time there is but one *bona fide* general mercantile agency in the United States, *viz.*, Dun & Bradstreet, Inc., but the number of special agencies is legion and still growing, as will be shown in the chapter immediately following.

Origin of General Mercantile Agencies.—The mercantile agency system was an immediate outgrowth of the crisis which occurred in 1837. Prior to that date, Western and Southern merchants visited their sources of supply in the Eastern market once or twice a year. Credit relations were then established through personal contact and through recommendations of old customers in good standing.

In those earlier days there was but little definite information accessible to the seller concerning his customers' character, capacity, and financial strength; confidence was, therefore, not infrequently badly misplaced. The means of travel were slow, uncertain, and difficult, and the traveling

salesman had not yet made his appearance. Communication facilities were equally inferior and inadequate, so that but meager data, of an uncertain nature, could be obtained through mail inquiries. As a result, credit was injudiciously dispensed and during times of stress the losses incident thereto were appalling. To be sure, a few of the larger houses employed agents whose duty it was primarily to collect accounts and incidentally to gather all sorts of data pertaining to the customers' credit standing. The vast group of smaller houses, however, found this method prohibitive from the standpoint of cost and were forced to base their credit decisions upon the inadequate and uncertain information obtained principally through the personal interview.

The avalanche-like movement which finally swept the country as a result of the crisis of 1837 carried with it destruction and ruin to numerous banking institutions and business houses, the effect of which was felt the more keenly and painfully in the market of the East. With the passing of the clouds, merchants throughout the country began to realize that one of the chief contributory causes of the crash and the depression which followed was inherent in the conditions which governed credit granting in this country. Verily, no other factor was responsible to any greater extent for the extensive speculation and overtrading which prevailed in the West prior to the panic than the assumption of unnecessary hazards involved in the unsystematic and unscientific credit extensions. Thus the crisis of 1837 brought the merchants face to face with the necessity of closer and more thorough scrutiny of credit risks. The eagerness with which information was sought for by sellers of goods on time finally resulted in the establishment of the mercantile agency.

History of R. G. Dun & Company.[1]—The first general mercantile agency opened its doors for business in August, 1841. It was established by Lewis Tappan, who, as credit man for A. Tappan & Co., carefully recorded all the information he could gather concerning the standing of his firm's customers. The records thus compiled covered a series of years and embodied the concern's entire experience with all firms that had traded with it. The New York silk jobbing house of A. Tappan & Co., for which the information had been collected failed, together with other sound firms that were swept away in the path of the onrushing waters released by the business storm of 1837. The soundness of A. Tappan & Co. may be gleaned from the fact that within 18 months of its bankruptcy every dollar of its liabilities was repaid, although at time of

[1] Most of the historical material on R. G. Dun & Co. is based upon a special memorandum prepared for the author by STEPHEN I. MILLER, formerly economist for the company, supplemented by the facts published in the company's reference books and in an article on the formation of Dun & Bradstreet, Inc., appearing in *Dun & Bradstreet Weekly Review*, Mar. 4, 1933.

failure they were in excess of a million dollars. Lewis Tappan decided to utilize his credit experience and the excellent records that were preserved as the basis for a business of his own dealing in credit information. His wide experience in appraising the credit responsibility of traders and the high regard in which his opinions on credit were held by other wholesale merchants encouraged him in the enterprise, and "The Mercantile Agency"—a term which has been retained in the title of R. G. Dun & Company throughout all the years of its experience and is still a part of the firm style of Dun & Bradstreet, Inc.—opened its doors for the transaction of business at the corner of Hanover Street and Exchange Place, New York City. That city was probably one of the most logical places for such an organization, for in it were located many of the prospective users of the information.

In 1845, Benjamin Douglass joined Lewis Tappan and his brother Arthur, who was associated with him, and in June, 1847, Douglass was admitted as a partner, the firm becoming known as Lewis Tappan & Co. In 1849, Lewis Tappan retired, his brother taking his place, and the firm style was changed to Tappan & Douglass. In 1854, Benjamin Douglass became the sole proprietor, changing the firm name to that of B. Douglass & Co., when his brother-in-law, Robert Graham Dun, was admitted to partnership. Douglass finally withdrew from the business in 1859, selling his interest to his partner, and the concern was succeeded by R. G. Dun & Co., The Mercantile Agency. Mr. Dun was the active head of the business until claimed by death in 1900, when the management was assumed by a board of trustees under the chairmanship of Robert Dun Douglass, a nephew of R. G. Dun. In 1930, the R. G. Dun Corporation was organized, and Mr. A. D. Whiteside became its president. In this fashion the agency operated until the time of its merger with the Bradstreet Company in March, 1933.

When the forerunner of R. G. Dun & Company was organized the first step taken by Mr. Tappan was to issue a circular to lawyers and others inviting them to become his correspondents. The responses to this circular were immediate and satisfactory, so that the agency rapidly accumulated a valuable mass of information in anticipation of requests from subscribers. Among the correspondents of the agency in its early years was Abraham Lincoln whose reports are still preserved in the files of the company. In those days there were no typewriters, telephones, or any satisfactory reproduction devices; hence, the reports were written in longhand, by skilled penmen, in huge ledgers bound in sheepskin. If a subscriber wished to see one of the reports he had to visit the office of the agency in person, calling for the ledger and inspecting the report therein recorded. It was not until 1874 that the concern began to experiment with the use of typewriters and not until late in 1875 that

an order was placed for 100 machines and thus helped to establish the writing machine on a sound footing. Carbon paper, however, was still unheard of at that time.

At the inception of the mercantile agency in 1841, it consisted of one office in New York City comprising one room and six clerks. Several branches were soon established along the Eastern seaboard and the first foreign office was opened in 1857 in London, England and another at Montreal during the same year. The first detailed statistics ever compiled regarding failures in the United States and Canada were published in 1857. This information has been forthcoming ever since. In 1859 the first issue of the company's Reference Book made its appearance, containing the ratings for 20,268 names. At the time of the merger six issues of the Reference Book were published annually, each containing approximately 2 million names. Of the periodical publications which became well known throughout the business world, *Dun's Review* was inaugurated in 1893, *Dun's International Review* made its first appearance in 1903, and the *World's Market* saw the light of day in 1917.

Thus R. G. Dun & Company has grown from a small beginning until it maintained branch offices in practically all the principal cities of the world and listed over 100,000 representatives in the less important commercial centers. At the time of its merger with the Bradstreet Company, it was the largest mercantile agency in the world with 172 offices in the United States and with branches in 21 foreign countries. Of the latter, 17 offices were maintained in Canada and 54 in other parts of the world. In addition it had arrangements with other mercantile agencies in several European countries to supply information to its subscribers upon presentation of a letter of introduction, thus adding the facilities of another 39 offices.

History of the Bradstreet Company.[1]—The Bradstreet Company was organized in 1849. In the year preceding the formation of the company, John M. Bradstreet, a Cincinnati attorney, was made assignee of a large insolvent estate. While thus performing his duties, he necessarily acquired a great deal of information concerning debtors and creditors of the estate, residing in and near Cincinnati, at that time constituting the most important city of the American frontier where credit risks were the greatest and concerning which information was most difficult to secure by the Eastern wholesalers. Thus, the second general mercantile agency had its origin near the so-called "source of raw material," from

[1] The basis for the historical data concerning the Bradstreet Company is to be found in a memorandum especially prepared for the author by one of the branch managers of the company on November 7, 1932; also in the prefatory statements in the company's rating books and in an article on the formation of Dun & Bradstreet, Inc., in the *Dun & Bradstreet Weekly Review*, Mar. 4, 1933.

the standpoint of credit information, while the first was located in the center which "consumed" this information.

Bradstreet, thereupon, proceeded to make arrangements with several New York concerns for the selling of the credit information which he accumulated. The venture proved a success, and he was led to found an institution similar to that described in the previous paragraphs for the exclusive purpose of dealing in credit data. Bradstreet's Improved Commercial Agency was consequently inaugurated in 1849, and the firm was finally incorporated in 1876 as The Bradstreet Company.

The first reference book to cover commercial ratings was issued by Bradstreet in 1857. Just prior to the merger the rating books were printed four times a year, the volume for the United States and Canada consisting of 3,600 large pages of finely printed matter. In addition it published six sectional books and pocket editions to cover individual states. It also performed other services of a specific and general character not unlike those rendered by its competitor, R. G. Dun & Company. When this company was absorbed by R. G. Dun & Company, it operated 166 offices in the United States, 17 in Canada, and 17 in other parts of the world. It also maintained close connections with mercantile agencies in several foreign countries as a supplement to the work of its own companies abroad.

Obstacles Encountered.—Many difficulties were first experienced by the agencies. Retailers looked upon their activities with suspicion, not wishing anyone to pry into their personal and business affairs. Many jobbers and manufacturers were equally opposed to them because of the inquisitorial nature of the work. Again, agencies feared legal obstacles until the courts declared that communications rendered to subscribers in good faith and without malice and upon request come under the law of qualified privilege. This obviously exempts mercantile agencies from the general law relative to the publication of libelous matter.

Notwithstanding these difficulties and handicaps, the agencies grew and succeeded until the prejudice was gradually overcome, primarily because of the business conditions which prevailed in the early days of their development. With the westward movement then taking place, merchants began to appear in newly settled parts of the country, and business relations necessarily extended over a much larger geographic area. Many firms at this time had but a transient and temporary existence; others migrated from place to place, constantly experimenting with new conditions and opportunities. The rate of mortality among dealers was abnormally high, business connections were rather loose, and speculation was rampant.

All the unsettled conditions just described were many times accentuated by the effects of the Civil War. Under such circumstances, it was

not difficult for the agencies to justify their methods of doing business.

The publication of the standing of business men by the agencies widened the market for retailers who heretofore, because of lack of contact with distant markets, were compelled to confine their dealings to the jobbers and manufacturers of the immediate vicinity. Manufacturers and jobbers, on the other hand, discovered that, by properly cooperating with these institutions, credit information of a more reliable character could be secured more economically than through their own corps of investigators. For these reasons merchants at first involuntarily, and later more willingly, submitted their information, thereby paving the way to success for both of the mercantile agencies.

Other General Mercantile Agencies.—Numerous other agencies attempted to compete with the two leading organizations but were compelled to abandon the undertaking and retire, so that R. G. Dun & Company and the Bradstreet Company had practically a monopoly of the *general* agency business throughout their coexistence. The new agencies found it impossible to perfect their organizations to a point where it would be possible for them to furnish the same kind of service on so vast a scale as the two older rivals. This fact enhanced considerably the reputation for reliability, permanency, and superiority which the general agencies enjoyed for many years. Not only did they have the undisputed advantage of an early start, but they were also a product of a long series of years of gradual expansion and invaluable experience.

Formation of Dun & Bradstreet, Inc.—After a coexistence of more than 80 years the two leading general mercantile agencies merged in March, 1933, and formed the only general mercantile agency now operating in the United States, under the firm style of Dun & Bradstreet, Inc. One of the major reasons for the merger was the alleged desire to eliminate a "duplication of expense of millions of dollars annually to thousands of subscribers using both services, and to over two millions of commercial concerns which have in the past furnished pertinent credit data to both agencies," inasmuch as both performed substantially identical functions. Another reason advanced was the hope of improving the efficiency of the general mercantile agency by increasing the number of concerns furnishing data and by consolidating the number of subscribers to its service. While these motives are not questioned, it is believed in some quarters that the precarious financial condition of the Bradstreet Company, precipitated by the severe depression, was a major contributing factor, and for this reason it is often said that the Bradstreet Company was merely "absorbed" by its older competitor.

Just what the implications of this consolidation may be is as yet difficult to predict. It should certainly lend strength for the time being to the newly formed organization, through a lessening of expense, an

increase in the number of subscribers, a minimizing of annoyance in the collection of credit data, retention of the most qualified personnel, and greatly enhanced size. On the other hand, it makes the general agency business completely monopolistic. Whether the new organization will take advantage of its position is a matter of conjecture. So far, it has exercised the good judgment of not resting on its oars but of continually improving its service and widening, through sheer merit, its sphere of influence in the business world. It may be forced to continue such a policy by the competition from the numerous special mercantile agencies and the possibility of another general mercantile agency appearing on the scene. The latter may come about as an indirect result of the consolidation. The many excellent managers of the Bradstreet Company who found themselves out of a job have capitalized their experience in the field by establishing local agencies for supplying a service similar to that of the general agency. These local organizations have cooperated from the first in the exchange of reports and in other ways. This cooperation has become so closely knit that a new general mercantile agency—General American Credits—has been formed and functioning for more than three years throughout the United States.

ORGANIZATION AND OPERATION OF THE GENERAL MERCANTILE AGENCY

Organization of Dun & Bradstreet, Inc.—The executive or central offices of Dun & Bradstreet, Inc., from which general control is exercised over the entire system, are located in New York City. Next are two clearing houses maintained in New York and Chicago, respectively. It is the function of these offices to conduct investigations along certain specialized lines and to clear information concerning names in those trades for all of the branches of the company. Among the special lines thus handled are women's ready-to-wear and male apparel. It is interesting to note that these trades are concentrated in no small degree in the two cities in which the special offices are located.

The United States is divided into districts, each identified by a number and under the immediate control of a district manager. A district may cover one or more counties, the number of counties in the majority of cases exceeding 10 per district, depending largely upon the amount of actual or potential business available. Each of the districts may also operate one or more sub-offices and reporting stations, as dictated by the size of territory included in the district and the amount of business transacted. Both sub-offices and reporting stations are located at the focal points in the district and are used as headquarters for field reporters as well as a means of facilitating service to the respective sections of the district. District offices are usually self-supporting and con-

stitute central points at which credit information is conveniently assembled and transmitted to subscribers and other interested offices of the company. Sometimes offices are maintained at great expense for the same reasons that unprofitable items are knowingly carried in stock by merchants.

In the United States approximately 70,000 communities are covered by the general mercantile agency through headquarters and its 161 district offices and sub-offices, many reporting stations, and thousands of representatives and correspondents who are busily engaged everywhere, investigating local business concerns and new enterprises. By the establishment of branch offices in practically every city of mercantile or industrial importance, a corps of investigators is assured whose acquaintance with business men in the territory they cover and whose knowledge of local affairs place them in a position where they can secure information otherwise not obtainable.

To assist in foreign trade, Dun & Bradstreet, Inc., has extended its sphere of influence until it has covered practically the entire civilized world. Through Dun & Bradstreet of Canada, Ltd., it operates 17 branches in that country, while 61 additional offices are maintained in other countries under the ownership of separate subsidiary corporations of Dun & Bradstreet. Eighty-one offices are available in Germany, through special arrangements with two German mercantile agencies, whereby information is furnished to subscribers of Dun & Bradstreet, Inc., upon presentation of a letter of introduction. Through the same German agencies similar arrangements are in effect with Austria, Hungary, Czechoslovakia, Jugoslavia, Sweden, Norway, Denmark, the Free City of Danzig, and Latvia, resulting in the availability of 19 more offices. This makes a total for the company of 340 offices including headquarters, 162 of which are located in this country and 178 in other lands.

Collecting the Data.—As will be shown in the pages that follow, the general mercantile agency performs several distinct functions for the business world in general and for its subscribers in particular. For this purpose it must assemble a large variety of business facts some of which may relate only to general business conditions or to factors affecting a given line of trade while others pertain to a specific credit risk. Credit information is the agency's stock in trade, hence great care must be exercised to secure all important facts in the most reliable way. To a certain extent information may be obtained by the various branches of the agency by direct communication with the credit risk. For example, upon receipt of an inquiry concerning a given business firm the branch office directly involved may communicate with the risk requesting the information desired. References furnished by the subject are cleared directly through the branch office. It is also the practice of Dun & Brad-

street, Inc., to mail every January a statement form to each of the business enterprises so that the information may be kept up to date

STATEMENT FORM A
(Combination—OR. and Rev.)

STATEMENT MADE TO
DUN & BRADSTREET, Inc.
THE MERCANTILE AGENCY
For the use of Subscribers as a Basis for Credit and Insurance

10582

County: .....

Name of Concern.....Trade Style Used.....
Street Address.....Town.....State.....Business.....
Location of Branches.....

Give Full Name of Each Officer, Director, Partner or Proprietor. If Partners, state if General, Special or Limited. (See Over—Remarks)

FULL NAMES and TITLES	Age	Married?	Native of	U. S. Citizen?
1.				
2.				
3.				
4.				
5.				
6.				

Business Started.. ..... 19....Succeeding .....Original Capital $.....
Date Style was Registered.....19....By Whom .....
If a Corporation—Date Incorporated.....State.....Authorized Capital—Common $.....
Preferred $.....Paid In Capital—Common $.....Preferred $.....

Financial Condition on.....19....as per.....
Date Inventory or Estimate

ASSETS	(Where no figures are entered use the word NONE)		LIABILITIES	(Where no figures are entered use the word NONE)	
Cash on Hand			Accounts Payable		
Cash in Bank			Notes and Trade Accep. Payable (Mdse.)		
Accounts Receivable (good) Customers			Loans from Banks		
Notes Receivable (good) Customers			Loans from Stockholders ☐ Others ☐		
Merchandise			⊕Chattel Mtgs. or Sales Liens		
			Accrued Wages and Taxes		
			Accrued Rent		
TOTAL CURRENT ASSETS			TOTAL CURRENT LIABILITIES		
Machinery and Fixtures			Mortgages (Give Due Date)		
Real Estate and Buildings (Describe below)			Reserve for Depreciation on Fixed Assets		
Investments					
			Net Worth { if partnership / or individual }		
			Capital Stock		
			Surplus and Undivided Profits		
TOTAL ASSETS			TOTAL LIABILITIES		

REAL ESTATE: Description and Location	Title in Name of	Value	Mortgages or Liens	Annual Income
		$	$	$

NET SALES from.....to.....$.....NET PROFITS { Same Period } $..... { Dividends or Withdrawals } $.....
How much of the above indebtedness is past due? $.....Contingent liabilities as endorser, etc. $.....
Receivables pledged for loans or discounted $.....If any pledged or discounted, are they included in above Assets? Yes ☐ No. ☐
Bank Loans Secured by?.....Other Loans Secured by?.....
Monthly Rent $.....Lease, if any, expires.....19 .. LIFE INSURANCE: For benefit of the business $.....
FIRE INSURANCE: Merchandise $..... Machinery and Fixtures $.....Buildings $.....
Dates and particulars of any Fire, Water, Storm or Burglary losses.....
⊕Chattel Mtgs. or Sales Liens: Items covered .....Aggregate monthly payments $.....

Names of books of accounts kept.....

IS THIS STATEMENT AUDITED? Yes ☐ No ☐ By—
Name..... Licensed?.....
Address.....

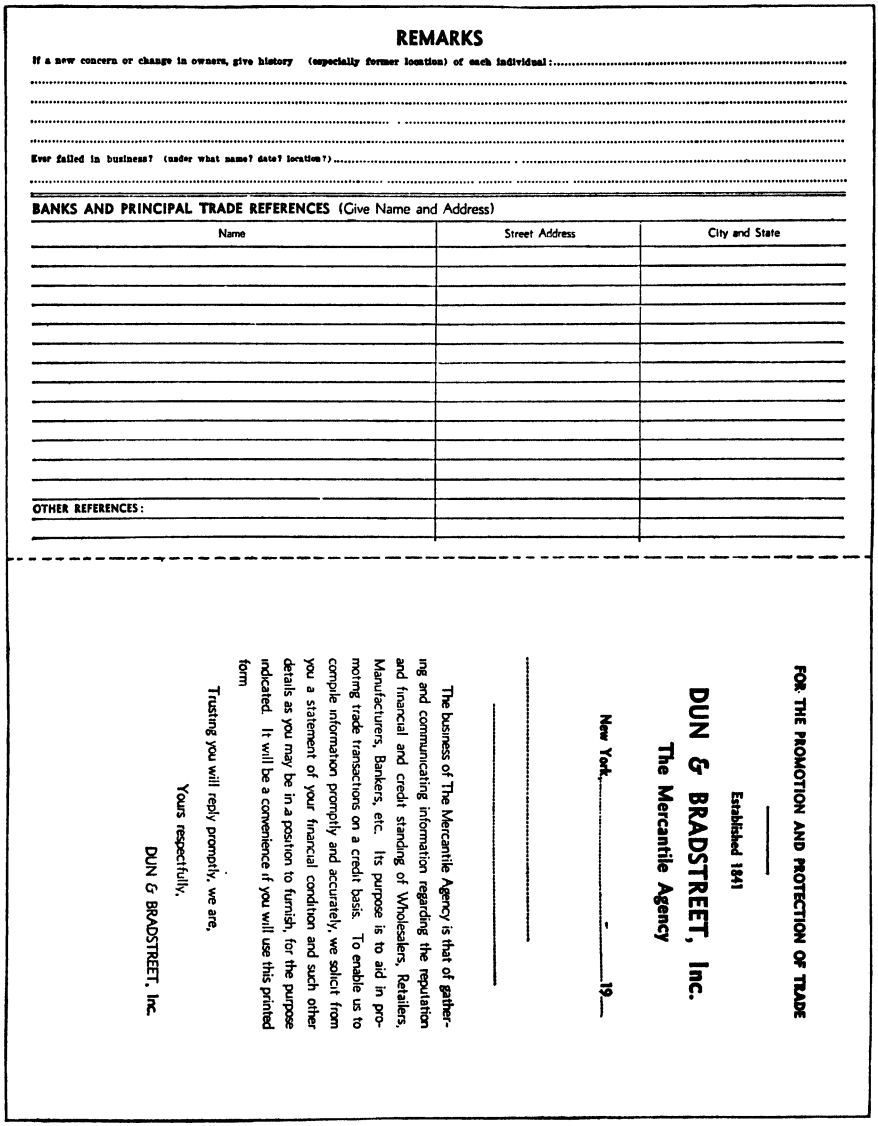
Date of Signing.....
Signed { Name of Concern.....
Per { Authorized Individual.....

(PLEASE TURN OVER)

FIG. 12*A*.—Statement form mailed out each January to smaller business enterprises. A similar form but calling for greater detail is mailed about the same time to the larger business concerns.

(see Fig. 12). The great bulk of the information is collected, however, through a vast corps of reporters, who may be conveniently divided into the following classes or types:

1. Local reporters or correspondents.
2. Traveling reporters.
3. Special reporters in recorders' offices.



REMARKS

If a new concern or change in owners, give history (especially former location) of each individual:

Ever failed in business? (under what name? date? location?)

BANKS AND PRINCIPAL TRADE REFERENCES (Give Name and Address)

Name	Street Address	City and State
OTHER REFERENCES:		

FOR THE PROMOTION AND PROTECTION OF TRADE

Established 1841

DUN & BRADSTREET, Inc.

The Mercantile Agency

New York, _____ 19__

_____

The business of The Mercantile Agency is that of gathering and communicating information regarding the reputation and financial and credit standing of Wholesalers, Retailers, Manufacturers, Bankers, etc. Its purpose is to aid in promoting trade transactions on a credit basis. To enable us to compile information promptly and accurately, we solicit from you a statement of your financial condition and such other details as you may be in a position to furnish, for the purpose indicated. It will be a convenience if you will use this printed form

Trusting you will reply promptly, we are,

Yours respectfully,

DUN & BRADSTREET, Inc.

FIG. 12*B*.—Reverse side of Fig. 12*A*.

1. *Local Reporters or Correspondents.*—These reporters are located in thousands of the smaller communities throughout the United States and are sometimes known as resident reporters or mercantile agency repre-

HEADING

Business name - - - - - - - - - - Line of business - - - - - - - - - - - Location
Names and Titles of - - - - - Officers - - - - - - - - Partners - - - - - - - - Proprietor
Board of Directors - - - - - - - - - -

HISTORY

Date incorporated or business started - - - - - - - Where - - - - - Original Capital - - - - - - Source
Succeeded - - - - Date style was registered - - - By whom - - - Changes in style - - - Authorized capital
Common - - - Preferred - - - Paid-in - - - Common - - - Preferred - - - General - - - Special - - - Maturity
Increases or decreases in paid-in capital - - - - - - Changes in officers or partners - - - - - - - Changes in location
Other companies controlled - - - % of stock owned - - - Line of business - - - Location - - - Inter-company relations
Record - Financial difficulties - - - - - - - - - - - - - - Closed suits - - - - - - - - - - - - - - - Satisfied judgments

Each officer, director, partner, or the proprietor must be accounted for as follows:

Age - - Married - - Single - - Widowed - - Divorced - - Native of - - U. S. Citizen - - With company since - - Duties
Former business connections and locations - - - - - Duties - - - - - Outside business connections - - - - - Outside means
Character - - - - - Habits - - - - - Morals - - - - - Record - Financial difficulties - - - - - Suits - - - - - Judgments

METHOD OF OPERATION

Manufacturer - - - Jobber - - - Wholesaler - - - Retailer - - - Products - - - Brands - - - Services - - - % of annual
business represented by services - - - Price range - - - % of each line to total sales - - - % of merchandise from or
to allied companies - - - - - - Number of active accounts - - - - - Is large % of total sales to one or a few accounts
Classes of trade sold - - - % of total sales to each class - - - - Terms to each class - - - % of total sales on cash basis
Territory covered - - - - Competition - - - - Changes in policies - - - - Location - Central shopping district - - - - Side
Street - - - Suburban section - - - Store or shop frontage - - - Depth - - - Type of building - - Stone - - - Brick
Wood - - - - Are display windows attractive - - - - Number of employees - - - - Delivery equipment - - - - Branches

FIRE HAZARD

Owns - - - - Rents - - - - Number of stories - - - - Business and character of other occupants - - - - Building repair
Good - - - Poor - - - Adjacent buildings - - Good - - - Poor - - - Has building outlived its usefulness - - Yes - - - No
Adjacent buildings - - Yes - - - - - - - - No - - - - - - - - Business and character of occupants of adjacent buildings
Appearance of store, rear of building, equipment and stock - Neat - - - - - - Disorderly - - - - - - Plant capacity
Merchandise - New - - Old - - Is any one in subject or adjacent buildings suspected of being engaged in any unlawful
occupation? - - - Are there any features which make this Fire Risk Undesirable? - - - Yes - - - No - - - If yes, state
what they are (If B D use B D blank) - - - - - FIRE RECORD - of company and each individual - - - - - - - -

STATEMENT OR FINANCIAL INFORMATION

When no statement is obtained - Date - - - - Who - - - - Deferred or declined a financial statement - - - Reason why
Use statement skeleton for estimates - - - - - - - - - - - When figures are refused each visible asset must be estimated
Open suits and unsatisfied judgments must be brought out under this caption - - - - - Comment on the outstanding
features of the statement or your estimates - - - - - - - - Bring out the relation of such facts as the ability of the
personnel, or the method of operation to the financial position of the concern - - - - - - In some cases the important
point may be the selling terms, or the credit and collection policies, while in other instances banking or trade rela-
tions may have a decisive bearing on the conclusion

BANK AND TRADE COMMENTS

Names and locations of banks and finance companies - - - - - - - - - - - - For trade references use Trade 13 Form
Bank checking - - - Amount owing $ - - - Straight - - - Endorsed - - - Guaranteed - - - Collateral - - - Receivables
Average balances - - - - - - When last off - - - - - - How regarded - - - - - - - - Local comments on trade payments

SUMMARY

Process of thought necessary to produce a summary.
Would I check this account for a reasonable amount?

YES - - - NO - - - I AM IN DOUBT

I have given a mental answer to the above question after thinking about what I have written in the report, and the reasons for my decision are as follows:— *"Because"*
(Start writing with a word that naturally follows Because)

THE SUMMARY

The reasons given were based on the OUTSTANDING features of the report that I wrote, and I have refrained from - - - - - - - - - -
"Recommending" "Suggesting" "Predicting" "Precluding"

20120

FIG. 13.—Outline form used by Dun & Bradstreet reporters.

sentatives. In many instances they are attorneys who devote only a portion of their time to the work of the mercantile agency. Local business men, bankers, justices of the peace, or other qualified individuals are also used as correspondents. It is the task of these reporters to secure by personal inquiry the necessary information on all businesses located in the community or district to which they are assigned and to report on the various lines of trade in their respective areas. To facilitate the investigation of a given subject each reporter is provided with an outline form indicating the lines of inquiry to be followed and the expressions that may prove pertinent to the case (see Fig. 13). During his call the reporter is required to fill out a form furnished by the agency which contains spaces for a wealth of information (see Fig. 14). After this report is obtained, an effort is made to investigate every statement contained therein and to check every item. This is done through inquiries made of bankers, merchants, and other members of the community. This is made possible by virtue of the fact that a reporter or correspondent covers the same territory year after year, thereby gaining the advantage of close acquaintance with local trade conditions and with individual business men in his district. It is further strengthened by the disinterested character of the institution which the reporter represents, whose sole object is to protect and promote business. In this manner the reporter can secure a great deal of necessary information bearing on the antecedents of the risk, its general character, business ability of the person investigated, and other facts of interest.

Even after the initial report has been placed on file at the branch office the reporter is required to make periodical visits to ascertain if there has been any change in the financial condition of the party about whom the inquiry was conducted. Thus local reporters afford points of contact for the mercantile agency with each part of the country and are available for instant use, although they are not always so efficient as might be desired owing partly to the fact that the fee may not be large enough to justify the necessary time for an investigation, partly to native-ability limitations, and to some extent to the fact that they have not had the advantage of the training to which the agency's full-time employees are subjected. For these reasons, the agency does not rely upon local reporters altogether, even insofar as the territory which they are presumed to cover is concerned. Traveling reporters may be used to check upon the efficiency of correspondents at regular intervals as well as on special occasions. When two local reporters are employed in a given community, both of them may be asked to make the same investigation, each one unaware of the fact that the work is being duplicated. A comparison of the results will reveal discrepancies which might occur and serve as a check upon the efficiency of correspondents.

2. *Traveling Reporters.*—This class of reporters constitutes the backbone of the general mercantile agency in the collection of information.

STATEMENT FORM B
Reporters' Combination
C.O. ☐ O.R. ☐

STATEMENT MADE TO
DUN & BRADSTREET, Inc.
THE MERCANTILE AGENCY

County:

Reporter No. Date 19 — For the use of Subscribers as a Basis for Credit and Insurance
Name of Concern Trade Style Used
Street Address Town State Business
Location of Branches

Give Full Name of Each Officer, Director, Partner or Proprietor (Amplify History on Reverse Side.)

FULL NAMES and TITLES	Age	Married?	Native of	U. S. Citizen	With Co. Since	Duties
1.						
2.						
3.						
4.						
5.						

Business Started 19 Succeeding Original Capital $
Source of Capital Date Style was Registered 19 By Whom
If a Corporation—Date Incorporated State Authorized Capital—Common $
Preferred $ Paid in Capital—Common $ Preferred $

Financial Condition on 193 from (Inventory or Estimate?)

ASSETS	[Where no figure are entered use the word NONE]	LIABILITIES	[Where no figure are entered use the word NONE]
Cash on Hand		Accounts Payable	
Cash in Bank		Notes and Trade Accep Payable (Mdse.)	
Accounts Receivable (good) Customers		Loans from Banks	
Notes and Trade Accep Rec. (good) Customers		Loans from Stockholders ☐ Others ☐	
Merchandise		*Chattel Mtgs. or Sales Liens	
		Accrued or Unpaid Wages and Taxes	
		Accrued or Unpaid Rent	
		Personal Debts	
TOTAL CURRENT ASSETS		TOTAL CURRENT LIABILITIES	
Machinery and Fixtures		Mortgages (Give Due Date)	
Real Estate and Buildings		Reserve for Depreciation on Fixed Assets	
Investments			
		Net Worth { if partnership / or individual }	
		Capital Stock	
		Surplus and Undivided Profits	
TOTAL ASSETS		TOTAL LIABILITIES	

REAL ESTATE: Description and Location	Title in Name of	Value	Mortgages or Liens	Annual Income
		$	$	$

NET SALES from to $ NET PROFITS { Same Period } $ { Dividends, if Corporation } $
Owner or Partners { Salaries and withdrawals
How much of the above indebtedness is past due? $ Contingent liabilities as endorser, etc. $
Receivables pledged for loans or discounted $ If any pledged or discounted, are they included in above Assets? Yes ☐ No ☐
Bank Loans Secured by? Other Loans Secured by?
Monthly Rent $ Lease, if any, expires 19 LIFE INSURANCE: For benefit of the business $
FIRE INSURANCE: Merchandise $ Machinery and Fixtures $ Buildings $
Dates and particulars of any Fire, Water, Store or Burglary losses
*Chattel Mtgs. or Sales Liens: Items covered Aggregate monthly payments $
Names and Addresses of: Bank Landlord
Names of books of accounts kept

IS THIS STATEMENT AUDITED? Yes ☐ No ☐ By—
Name Licensed?
Address

Date of Signing
SIGN { Name of Concern
By { Authorized Individual

19033 (OVER)

FIG. 14*A*.—Statement request form used when Dun & Bradstreet reporter makes a direct call.

All regular employees of the agency who devote all their time to investigating work belong in this classification, even though some of them may confine their activities to the city in which the branch office to which they

are attached is located. In the larger cities these reporters are usually assigned definite lines of trade, to enable them in time to become experts

REPORTERS' NOTES

HISTORY—(If O.B. or in business less than one year) Changes in Style—Increases or Decreases in Paid In Capital—Changes in Officers, or Partners—Changes in Location—Record.....

Each Officer, Director, Partner or the Proprietor must be accounted for as follows: Outside Means—Former Connections and Locations—Duties—Outside Connections—Character, Habits and Morals—Record.....

METHOD OF OPERATION—Manufacturer ☐ Jobber ☐ Wholesaler ☐ Retailer ☐ Products .....Brands .....

Services.....% of Annual Sales Represented by Services.....Price Range.....

No. of Accounts.....Class of Trade Sold .....Selling Terms.....% of Sales for Cash.....

Territory Covered.....Competition .....

Location—Central Shopping District ☐ Side Street ☐ Suburban Section ☐ Store Frontage.....Ft. Depth.....Ft.....

Type of Building—Stone ☐ Brick ☐ Wood ☐ Are window displays attractive?.....No. of Employees.....

FIRE HAZARD—.....Owns ☐ Rents ☐ No. of Stories.....Business and character of other occupants.....

Building Repair—Good ☐ Poor ☐ Adjacent Buildings—Good ☐ Poor ☐ Has Building Outlived its Usefulness? Yes ☐ No ☐ Adjacent Buildings? Yes ☐ No ☐

Business and character of occupants of Adjacent Buildings.....

.....Appearance of Store, Rear of Building, Equipment and Stock—Neat ☐ Disorderly ☐ Merchandise—New ☐ Old ☐

Is any one in Subject or Adjacent Buildings suspected of being engaged in any Unlawful Occupation?.....

Are there any features which make this Fire Risk Undesirable? Yes ☐ No ☐ If yes, state what they are (If B D use B D blank).....

Fire Record.....

STATEMENT OR FINANCIAL INFORMATION—(When no statement is obtained) ON.....19..... {deferred} {declined} a (Name)

Financial Statement (reason why).....Use Statement skeleton for estimates.

Comments: Outstanding features of statement or your estimates; and anything else, personal or otherwise, affecting a conclusion.....

BANK AND TRADE COMMENTS—Names and locations of Banks and Finance Companies.....

.....Amount now Owing $.....Straight ☐ Endorsed ☐ Guaranteed ☐ Collateral ☐ Receivables ☐

When last Paid Up.....19....Average Balances.....How regarded.....

Local Comments on Trade Payments.....

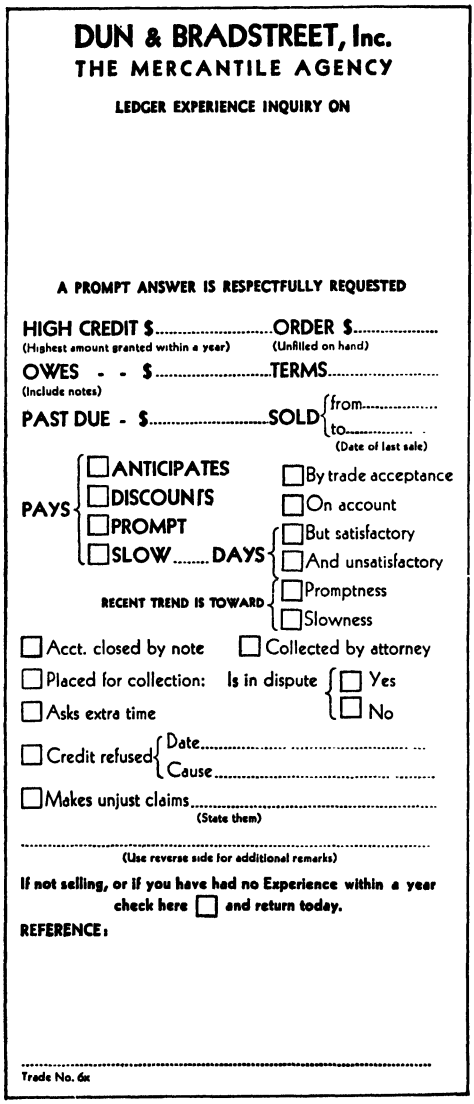
SUMMARY—Would you check a reasonable credit to this account? YES ☐ NO ☐ IN DOUBT ☐ Give your reasons.....

RATING

FIG. 14*B*.—Reverse side of Fig. 14*A*.

in their respective fields and thereby inspire confidence in the business men on whom they call for more or less confidential information. Reporters in this general category are required to serve an apprentice-

ship in the office, are given rigorous training in credit fundamentals and in the preparation of acceptable reports, and must be keen and conscientious.



DUN & BRADSTREET, Inc.
THE MERCANTILE AGENCY

LEDGER EXPERIENCE INQUIRY ON

A PROMPT ANSWER IS RESPECTFULLY REQUESTED

HIGH CREDIT $..... **ORDER $**.....
(Highest amount granted within a year) (Unfilled on hand)

OWES - - $..... **TERMS**.....
(Include notes)

PAST DUE - $..... **SOLD** { from..... to..... } (Date of last sale)

PAYS { ☐ ANTICIPATES ☐ DISCOUNTS ☐ PROMPT ☐ SLOW..... DAYS }

☐ By trade acceptance
☐ On account
☐ But satisfactory
☐ And unsatisfactory

RECENT TREND IS TOWARD { ☐ Promptness ☐ Slowness }

☐ Acct. closed by note ☐ Collected by attorney

☐ Placed for collection: Is in dispute { ☐ Yes ☐ No }

☐ Asks extra time

☐ Credit refused { Date..... Cause..... }

☐ Makes unjust claims.....
(State them)

.....
(Use reverse side for additional remarks)

If not selling, or if you have had no Experience within a year check here ☐ and return today.

REFERENCE:

.....
Trade No. 6x

FIG. 15.—Inquiry form used by Dun & Bradstreet's when asking a creditor for ledger experience with a given risk.

Traveling reporters visit every locality in their territory at least once a year. Business men are called upon, financial statements secured, and references are obtained and verified. They are often asked to submit reports for comparison with those obtained through local correspondents, as a test of the effectiveness of the latter's work. It is also their task to

make thorough investigations which will supply data frequently lacking in the reports submitted by local correspondents. Furthermore, it is their duty to circulate among business men, particularly in the financial districts, with a view toward securing information concerning general business conditions, trends, and movements, and searching for material for the magazine published by the agency.

3. *Special Correspondents in Recorders' Offices.*—Court and county records are being constantly examined for deeds, lawsuits, mortgages, judgments, other liens, damage of property by fire, and such other facts as are likely to affect anyone engaged in business. Daily memoranda to that effect are being supplied in the larger cities by the agency's own representatives and in the smaller communities by some person who is regularly employed in the recorder's office. In the latter instance the clerk serving as the agency representative receives extra compensation for the service in the form of a fee. The information thus acquired is summarized, added to the dossier already on file in the office of the agency, and made immediately available to every interested subscriber.

Completing the Investigation.—From the foregoing it is obvious that most of the information secured by credit reporters other than those located in county recorders' offices is of the type that can be obtained in the locality of the risk. The subject's place of business is visited, his stock of goods and merchandising methods are observed, and his location and other factors surrounding the business are noted. Local sources of information, including the bank, are called upon, and every effort is made to collect and verify whatever facts can be obtained locally. All of this is exceedingly important, especially since it also includes a financial statement obtained directly from the subject. This information must be supplemented, however, by facts gathered elsewhere, especially from creditors who have had dealings with the risk. The names of these creditors are obtained in various ways, including the references secured directly from the firm under investigation. From the reporting or district office of the agency communication is immediately established with these creditors by sending them an inquiry form (see Fig. 15) which calls for information obtainable from the creditors' ledgers. Courthouse records supply additional facts, and other independent sources are utilized as circumstances justify until as complete and rounded a picture as is humanly possible is obtained concerning the subject.

Selected References

See SELECTED REFERENCES for Chap. XI, p. 196.

Questions and Problems

1. Name and classify the sources of credit information available to credit managers of banks, wholesale establishments of all kinds, and manufacturing enterprises.

2. Why should a credit manager familiarize himself with all the sources of credit information?

3. Is it essential that a creditor know how the various credit agencies function in the gathering of data for their reports to members and subscribers? Give reasons for your answer.

4. What is the connection, if any, between the panic of 1837 and the establishment of mercantile agencies?

5. What connection, if any, is there between the railroad building era and the development of mercantile agencies?

6. How do you explain the difficulties that were encountered by mercantile agencies in the early stages when attempting to secure credit information? How have these difficulties been overcome?

7. What significance may be attached to the fact that one of the two general mercantile agencies began its operations in New York and the other in Cincinnati?

8. How is it possible for mercantile agencies to supply derogatory information without subjecting themselves to prosecution for libel or slander? Explain.

9. In your judgment, was the merger of R. G. Dun & Co. and the Bradstreet Company a desirable act, from the standpoint of:

a. Subscribers?

b. Business men generally?

c. The newly formed company itself?

10. Name and distinguish between the various classes of reporters used by Dun & Bradstreet. Which of them is the most important?

CHAPTER XI

SERVICES OF DUN & BRADSTREET, INC., AND HOW TO USE THEM

Dun & Bradstreet, Inc., which is the only general mercantile agency in the United States today, performs a number of distinct functions. Most of the services are intended for its subscribers or members, as they are frequently called, while the remainder are available to the public or to those especially interested. These services may be summarized as follows:[1]

1. It publishes reference books containing ratings of business concerns.
2. Issues special reports to members.
3. Supplies analytical reports.
4. Issues specialized reports.
5. Provides a continuous report service.
6. Furnishes a limited credit-checking service.
7. Collects overdue accounts.
8. Publishes *Dun's Review.*
9. Prepares business analyses.
10. Conducts special surveys.

RATINGS AND THEIR USES

Reference Books.—One of the principal functions of the general mercantile agency is to publish reference books which give a general idea of the credit standing of concerns whose ratings are included. These books are often regarded by the profession as credit encyclopedias. They are issued six times a year (bimonthly), the date of each book being the month of its publication. Reference book No. 1 covers businesses located in the United States, Canada, Newfoundland, and St. Pierre et Miquelon; book No. 2 covers concerns located in the United States only, while eight other books are published for various sections of the United States. The latter is done to prevent waste, since a subscriber who does business exclusively in the Southwest, for example, has little use for ratings of concerns located elsewhere; such a subscriber

[1] For some of the information contained in this chapter the author is indebted to Roy A. Foulke, General Manager, Analytical Report Department, and to John E. Ryder, formerly Manager of the District Office at Columbus, Ohio, of Dun & Bradstreet, Inc.

is satisfied with a sectional book covering his area of operations which he can obtain at lower cost than the amount charged for the use of books for the entire country. The number of names included in the large reference book covering the United States and Canada is usually in excess of 2,200,000. The books are loaned and not sold to subscribers, with the provision that no one outside the subscriber and his employees is entitled to use them.

Pocket editions of any of the states included in the volumes loaned to subscribers can be obtained from the agency for the convenience of the subscriber's representatives, especially salesmen. These editions are exact replicas of the information contained in the larger volumes, are conveniently bound in flexible covers, are printed on lightweight paper, and may be secured only by regular subscribers for an extra charge as per schedule published in the company's reference books. The price per copy of these small editions of the reference books varies from $6 for the smaller states to $17 per copy for some of the large states, and $12 per copy for the state of New York without New York City for which a similar amount is charged.

LEETONIA Columbiana Co.—4)
(R D to Franklin Square)
Pop 2,329—A banking town
EAdcraft Products Corp.....Mfrs Neon Signs. Toys & Nov
AAltomare J. V.....Var M
TAltomare R. F.....Gro M
CAnglemyer John M .Auto Ser. Gaso & Oil R 3½
EBeilhart Shoe Co (not inc.) Shoes & Rep G 3½
%Berg Conrad.....Mfr Pretzels F 3½
ZBurick & Morris Pharmacy (not inc.)
VCrescent Machine Co.. The.....
GCrothers Cecil A. Fill Stn & Rep M 4
DCrowell & Woods . Und
IDavison Coke & Iron Co. Inc..Mfrs (Br of Pittsburgh Pa.) AA 1
IDelmore Coal Co. The..... G 3
TElwonger Wilbur R .....Gro G 3
SEsterly Clarence L .. . Bsmith J 3½
%Farry Tony..... Confec. &c L 4
+Fisher Valentine F..... Tlr M
TFlooding & Sitler ..... Meat D+2
*Geneva Supply Co. .....G S D 1½ (Also Martin. Pa.)
*Grafton Supply Co . The.....G S F 3
*Hephner John C.. .....G S C+1
AHolz Edward W.....Var G 4
%Kunkle H. F .. .. Bak M
VLeetonia Boiler Co.. The.....Mfrs E 3
VLeetonia Tool Co.. The.....Mfrs F 3
IMcKeefrey Coal Co. of West Virginia ... .Producers (Also Branches)
IMcKeefrey & Co...Whol Coal & Coke
◆Marshall C. S. .....Jwlr & Opt H 3
TMauro Antonio T. .....Gro M
TMellinger Ira F..... .Whol Lbr & Bldrs Supp C 1½
●Morelli John.....Shoe Rep M
GMorris Elby A .....Ser Stn L 4
ZMorris Supply Co. (not inc.)..... Pharm Supp
TMulch G. M.....Meat

FIG. 16.—Part of a page from the Reference Book of Dun & Bradstreet, Inc.

Contents of Reference Books.—Reference books contain the ratings of merchants, manufacturers, and traders generally. They are arranged alphabetically by states and the different communities within each state, with the names of the business concerns in each locality similarly presented. The plan of arrangement calls for the listing of the community, whether it is a city, town, village, or hamlet in which a place of business is to be found; the county in which the community is located; its population; post-office facilities; and bank facilities. If the community has no bank or banker, the nearest town or city having such accommodations is indicated. This information is followed by the listing of business firms in strict alphabetical order. Each name is preceded by a symbol designating the general kind of business in which the subject is engaged. For this purpose, all businesses and occupations

have been classified in 30 categories, represented by as many different symbols. Following the name of the enterprise is a more specific characterization of the business or occupation of the subject since the 30 general classes of business have been further subdivided into 291 different trades and occupations. All of this is then supplemented by the rating itself which is shown on the extreme right of the name listed. (For an illustration of the main contents of reference books, see Fig. 16.)

The above data for each state are preceded by a route map showing the principal business towns and junction points, a list of the counties and county seats, and a full and enlarged map of the entire state. At the end of each state is to be found a list of banks and bankers, showing for each the paid-in capital, surplus, undivided profits, the names of the principal officers, and the correspondent connections; also an abstract of the principal collection laws in that state. In addition to the travelers' route maps for each state, a number of long distance maps are presented in the last few pages of the reference book. The book is concluded with copies of the negotiable instruments law, the Bankruptcy Act of 1898 with its various amendments, and the Canadian Bankruptcy Law.

KEY TO RATINGS

		Estimated Pecuniary Strength		General Credit			
				High	Good	Fair	Ltd.
*-1	Aa	Over	$1,000,000	A1	1	1½	2
	A+	Over	750,000	A1	1	1½	2
	A	$500,000 to	750,000	A1	1	1½	2
	B+	300,000 to	500,000	1	1½	2	2½
	B	200,000 to	300,000	1	1½	2	2½
	C+	125,000 to	200,000	1	1½	2	2½
*-2	C	75,000 to	125,000	1½	2	2½	3
	D+	50 000 to	75,000	1½	2	2½	3
	D	35,000 to	50 000	1½	2	2½	3
	E	20,000 to	35,000	2	2½	3	3½
*-3	F	10,000 to	20 000	2½	3	3½	4
	G	5,000 to	10,000		3	3½	4
	H	3 000 to	5,000		3	3½	4
	J	2,000 to	3 000		3	3½	4
*-4	K	1 000 to	2,000		3	3½	4
	L	500 to	1 000			3½	4
	M	Less than	500			3½	4

* When a numeral only (1, 2, 3 or 4) follows a name in the Reference Book it is an indication that the financial strength, while not definitely determined, is considered within the range of the dollar ($) figures in the corresponding bracket, and that a condition is believed to exist which warrants credit in keeping with that assumption.

The absence of any rating following a name signifies circumstances which preclude forming a definite decision as to financial strength or credit standing of the individual or concern named, and should suggest to the Client the advisability of reading the detailed report.

(d) Where an italic *d* in parentheses precedes a rating, it is an indication that one or more of the partners in the firm are liable in another or other firms, and the responsibility is in that sense divided. THUS: *(d)* B+2

Ratings of Branch Houses should always be looked up at Headquarters

FIG. 17.—Key to Dun & Bradstreet's ratings.

Nature and Significance of Ratings. Ratings consist of symbols used by the mercantile agency to express its conclusions in condensed form concerning a subject's credit standing. They comprise two elements, financial strength and general credit position. With three exceptions, as shown in Fig. 17, letters are used by Dun & Bradstreet to signify estimated pecuniary strength or the capital position of the risk, and numerals and fractions thereof are utilized to express the general credit grade of the subject. The first of the two symbols employed in assigning ratings denotes capital resources and reflects the estimated tangible, going-concern, yet conservative, value of the net worth after appropriate deductions and allowances for shrinkages in assets have been made by the agency. In this capital range are included concerns from the smallest to the largest showing a net worth from less than $500

to over a million dollars and involving 17 classifications. The second symbol denotes the grade of credit and is based upon an investigation as to the manner of payment, business ability, personal habits, and similar factors which affect the success of a business. To express this position of the risk, four classifications are used, representing "high," "good," "fair," or "limited" credit, or first, second, third, and fourth credit grades.

The assumption in assigning ratings is that there exists a close relationship and relative proportion between the capital strength of a business as evidenced by its estimated net worth, and its general credit standing as reflected by willingness and ability to meet obligations promptly. For these purposes, capital is considered the foundation for credit, which is then qualified by character and business capacity. Thus, the first grade of credit (high) opposite the "Estimated pecuniary Strength" column indicates that the elements are in exact proportion, while the limited grade would seem to reflect inferior character or lack of business ability, or both. To illustrate, if it is determined that the estimated wealth of a given concern is approximately $30,000, and the credit grade superior, the rating assigned would be E2.

As shown in Fig. 17, the high credit rating is restricted to firms with a minimum net worth of $10,000, which, by virtue of their capital position, presumably have skillful management and a workable organization. Furthermore, a high credit rating is reserved for concerns which have been established in business for some time, which have a good record, discount their bills or anticipate payment, and are otherwise highly regarded. If the subject fails to qualify for this rating by some small margin and has a net worth of more than $1,000 he may be assigned the good credit rating. Only essentially sound concerns which pay their bills promptly are given this rating. The fair rating is generally assigned to firms which are usually slow in paying bills but are in fairly sound financial condition. Finally, the limited grade of credit indicates a relatively poor credit risk from which payments may be forthcoming rather slowly. A concern thus rated may operate for a long time without actually becoming financially involved, but there is considerable hazard in selling to it on time. If the subject is actually in financial difficulty or on the verge of such embarrassment, he is likely to be assigned a "blank-blank" rating, which would serve as a warning, calling for further investigation.

Attention is called to the fact that a given numeral may signify different grades of credit, depending upon the capital rating with which it is associated. For example, the numeral 2 represents a high general credit when connected with a pecuniary strength rated E. The same numeral represents but a good general credit if it is associated with the

capital ratings C, D+, or D. When connected with capital ratings shown by the symbols B+, B, or C+, numeral 2 denotes only a fair general credit and in connection with the highest capital ratings this numeral indicates only limited general credit, or a fourth credit grade. At the other extreme of the scale, subjects with a capital rating of F or lower are never assigned a general credit rating as high as numeral 2 would reflect. This is explained by the logic that a business enterprise with a net worth of less than $500 cannot be assigned a general credit rating higher than fair or a numeral better than 3½. A business in such a poor financial condition has too precarious an existence to justify much confidence in its debt-paying capacity.

If credit responsibility is divided as when one or more of the partners in the firm are liable in other firms, such fact is indicated by the italic *d* in parentheses (*d*) preceding the rating. A capital rating may sometimes be given without a credit rating, especially in the case of very small businesses where general credit information is lacking. More often, the agency finds it difficult to secure adequate facts to justify a definite estimate of the financial responsibility of the subject. If the subject is recognized in the community as having credit, a rating may be assigned consisting only of a grade of credit. This is sometimes referred to as a "one-legged" rating. In such instances, the rating represents a credit relative in degree to that reflected by the symbols in the capital-rating column shown in Fig. 17. For example, a "one-legged" rating 3 would indicate a credit rating similar to that assigned a subject having an estimated pecuniary strength anywhere from $2,000 to $20,000, which is equivalent to a good credit grade. In the absence of any reliable information concerning a subject pertaining either to his capital position or to his general credit standing or when the risk is in bad condition, a "blank-blank" rating is assigned, which is the same as saying that the risk is not rated at all.

Utility of Reference Books to Credit Managers.—Credit managers generally hold rating books in high regard. Altogether too many of them rely too heavily upon ratings contained therein. Most credit men, however, use ratings with caution, realizing that they may have been based upon insufficient information, that they merely express opinions of the editors of the reference book and those of the officials in the various offices who prepared the reports upon which the ratings are based; that through sheer error wrong ratings may have been assigned; and, further, that ratings are subject to change. Sometimes reporters fail to secure pertinent data. Whatever facts are gathered may be misinterpreted in the office of the agency. It is conceivable that the opinions of the agency officials may be divergent with the views of the credit managers using the ratings and that the latter might have reached

different conclusions had they had the same facts before them. Containing so many names, it is possible that errors have crept in and that wrong ratings appear opposite certain names. To avoid all errors in a monumental task of this sort is humanly impossible, although in justice to the agency it should be said that such errors are relatively few.

The chief weakness of the reference books lies in the incorrectness of the status which the ratings may reflect, except perhaps at the date of issue. Business conditions are constantly changing, and ratings are, consequently, subject to considerable revision. It is estimated that changes in names and ratings average around 5,000 each business day, so that notwithstanding the correctness of a rating at date of publication, it soon may become less useful. During the year 1936 the following changes took place:[1]

New names inserted	441,189
Names obliterated or deleted (defunct concerns)	374,740
Changes made in ratings (favorable & unfavorable)	474,887
Changes made in styles (names of firms)	111,897
Alterations made in bank list	81,779
Total changes made during year	1,484,492

It should be pointed out that these figures do not include the many thousands of revisions which do not affect capital or credit ratings but are merely of an editorial nature.

In view of the foregoing, ratings should not be relied upon as the sole basis for reaching credit decisions. Rather should they be used by credit managers as an index to orientate themselves with respect to the risk under advisement. Thus, if the rating is distinctly inferior, credit may at once be refused, and if unquestionably favorable, the order may be accepted on that basis alone (especially if the amount is small and immediate shipment is required) and a detailed investigation instituted at a later date for the purpose of establishing a credit limit for the customer. On the other hand, if the rating shows a doubtful credit risk, shipment must be delayed and supplementary information from other sources sought before definite conclusions may be reached.

Ratings may be profitably used for making periodic revisions of the credit files. A downward change in a rating as shown by the latest reference book or special report may necessitate a new investigation of the customer thus affected, whereas an improvement in the rating may point to the advisability of revising the credit limit upward. Ratings should be used as a check upon other sources of information, particularly

[1] Special bulletin by Dun & Bradstreet giving "a condensed statement of its functions in the business life of America."

the credit reports which are normally submitted by salesmen, at least with first orders. Credit managers will also find reference books useful in cooperating with the sales department. By this means, lists of prospective customers with desirable ratings may be compiled for promotional purposes, thereby preventing the solicitation of inferior accounts which would have to be rejected ultimately and thus effecting a worth-while saving of time on the part of the salesmen who might otherwise attempt to secure undesirable trade. An alternative to the preparation of specific lists for solicitation is for the credit manager to instruct the salesmen of his firm not to call upon prospects whose ratings are below a certain minimum. When this is done, it is essential that salesmen be furnished pocket editions of reference books for their respective territories. Salesmen may also be equipped with letters of introduction, which can be obtained from the agency on request, which entitle the bearers to consult the reference book or ask for credit information at any of the agency's offices.

A fourth use of ratings by credit managers is to determine or set credit limits. Some credit managers set arbitrary limits for all accounts having a certain rating, and thus develop a whole table for that purpose, similar to the practice of credit insurance companies in determining the amount of coverage to be allowed on each account under the policy in question. These matters will be more adequately discussed in subsequent chapters. Finally, the reference books are utilized by credit men as an aid in securing additional data for credit and for collection purposes as well, since from them one can ascertain whether or not there is a bank in a given community wherein a given risk is located, as well as the name of the bank and some of its officers. Such banks can then be used both as a source of credit information and as an agency for the collection of accounts by means of drafts.

Use of Reference Books outside the Credit Department.—Sales departments that are alert to their opportunities make effective use of reference books in their sales research in all or part of the territory covered, in the selection of the most desirable outlets from a credit standpoint, in compiling mailing lists for sales promotional purposes, in measuring the purchasing power of the customers or prospects, in routing salesmen, in judging results of salesmen by territories, and in determining the number of outlets for their goods. In making purchases, the buyer of the subscriber may find it useful to ascertain from the reference book the status of the source of supply, financially and functionally, to verify statements regarding manufacturing facilities and the like, and in other ways to check upon the reliability of his resources. Retailers frequently use these books for similar purposes. Banks, naturally, make constant use of the reference books, for the same purposes as used by mercantile

creditors. In addition, they use the books to check on unknown names appearing on paper presented to them by their clients for discount.

THE DUN & BRADSTREET REPORT SERVICE

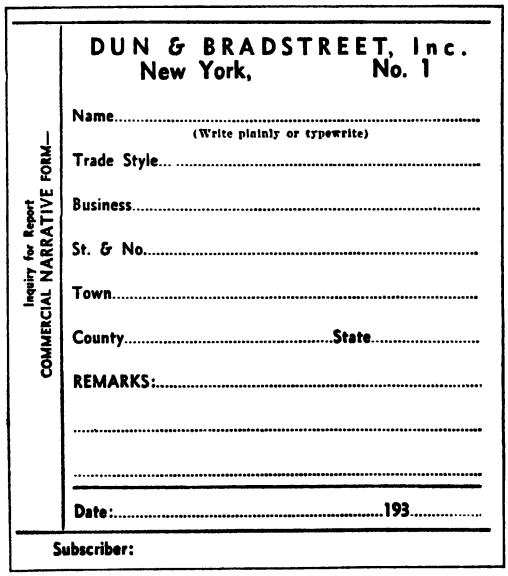
The report service of Dun & Bradstreet, Inc., constitutes the backbone of its operations. It is from the various reports which the company prepares for clients that practically all other services issue; it is from them that the ratings are derived, and upon their contents depends much of the analysis work done by the company. It should be stated in this connection that the agency has no possible motive to injure or misrepresent any merchant, for its only and true interest, for obvious reasons, is to convey as nearly as possible the whole truth in every report. The prosperity of the agency is directly proportional to the extent to which the reports prove beneficial to subscribers. Accordingly, should a report exaggerate the financial and moral responsibility of a trader, subscribers will be apt to trust him in like measure and the agency would be blamed for the losses suffered because of the reliance upon such report. Should a trader be reported too unfavorably, subscribers, by denying credit, would be losing a good paying customer, and the institution would be equally blamed. It must be conceded, therefore, that the entire success of a mercantile agency system depends upon the general truthfulness and complete impartiality of its reports and records.

Obviously, it sometimes becomes necessary to report unfavorable information which may prove damaging to the character of the subject reported on or which may even indicate evidence of fraud. In such cases extreme caution must be exercised in giving out the information in order not to subject oneself to libel suits. Such reports are therefore surrounded with unusual safeguards. One method is to send them by special messenger to be read, but not copied, by the subscriber, although a credit report is considered a "privileged communication" so long as it is prepared and given without malice, to a subscriber, upon request.

Until a few years ago, only one type of report was being prepared for commercial subscribers by the agency. This was known as the special report, apparently in contradistinction to the ratings given in the reference books which might have been regarded as general reports. Special notices bearing derogatory information supplemented these special reports. As a result of some experimentation, motivated no doubt by a desire to improve its service, the company is now issuing several different kinds of reports including the usual special reports, analytical reports, and so-called "specialized reports," supplemented by a continuous report service, which includes not only the special notices bearing limited information but a more elaborate report service to all interested parties for

the period of a year. All of these are discussed in some detail in the following pages. In addition, the company is now rendering a few other report services of smaller scope, but most of these are for other than commercial clients. Brief reference to these reports will also be made.

Special Reports.—It is probable that in about three fourths of the cases, Dun & Bradstreet supplies its commercial subscribers with special reports rather than those of the analytical type, although the latter is


DUN & BRADSTREET, Inc.
New York, No. 1

Inquiry for Report
COMMERCIAL NARRATIVE FORM—

Name.....
(Write plainly or typewrite)

Trade Style.....

Business.....

St. & No.....

Town.....

County.....State.....

REMARKS:.....

.....

.....

Date:.....193.....

Subscriber:

FIG. 18.—Inquiry ticket used by a member when asking for a Dun & Bradstreet report.

growing in importance. Ordinarily, reports are advisable under the following circumstances (see Fig. 18):

1. When an order is received and it is found that no data are on file and that the rating alone is inadequate as a basis for a credit decision.
2. When a revision of an account is being made.
3. When the last agency report on file is too old and out of date.
4. When the credit manager has little confidence in the rating and desires full details touching the risk's antecedents, financial condition, and paying habits.

Contents of a Special Report.—Special reports which may be regarded as the regular reports of the agency are uniform in style and the facts, according to the company, are presented in order of importance. In addition to the heading which contains the identifying features of the subject, the report is divided into six parts designated as history, method of operation, fire hazard, financial statement, trade record, and summary

and rating. The contents of each of these sections of the report are as follows (for a copy of a typical special report, see Fig. 19):

1. *Heading.*—This contains all information necessary to identify the subject, including the exact name of the firm in question, the kind of business, address, names of the proprietors, partners, officers and directors, and date of the report.

2. *History.*—The section of the report thus headed includes the antecedents of the firm and its members and pertinent facts relating to the business. This information is presented in point of time so as to sketch the progress of the organization and the responsible officials and to throw light on the character aspect of the risk.

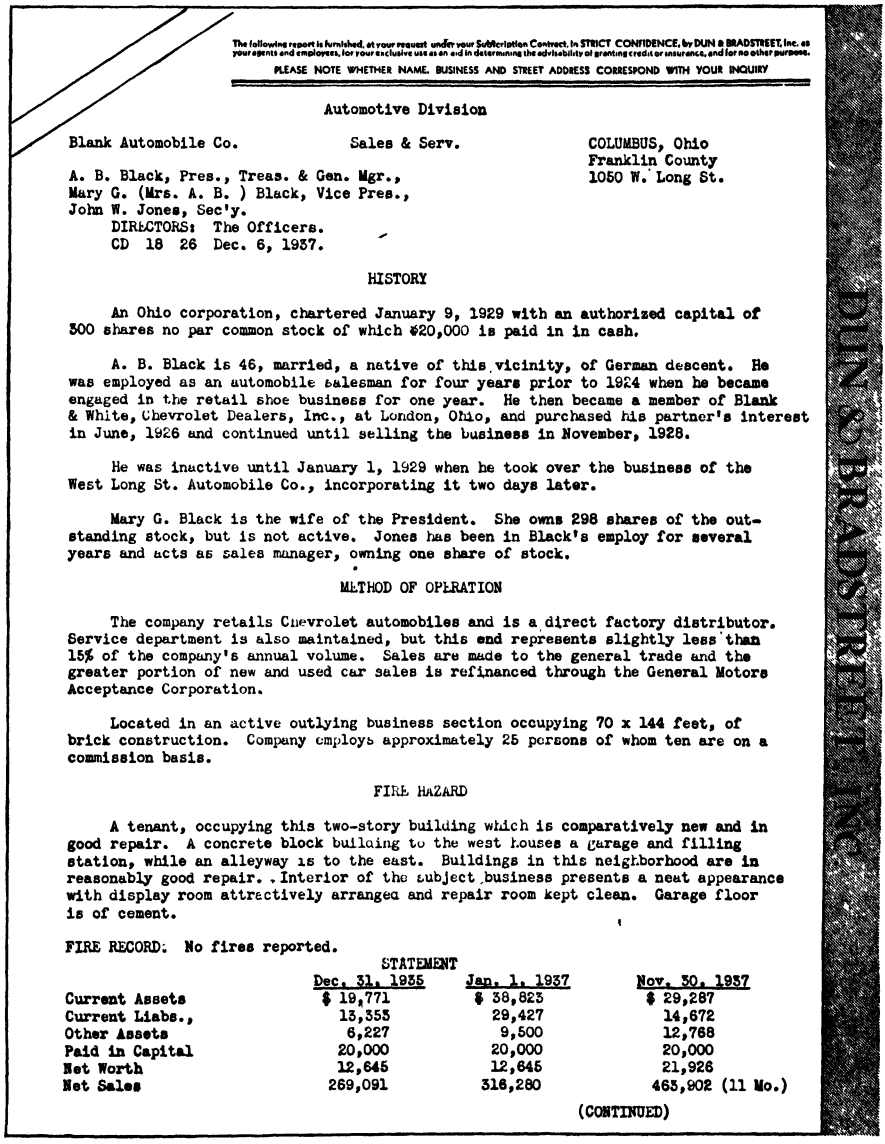
3. *Method of Operation.*—This part of the report gives a deeper insight into the business, for it indicates what kind of business it actually is; how it is classified; how it is operated; what products it handles or produces; the character of the place of business and its physical qualities as to construction, floor space occupied, and the like; the nature of its location; how goods are displayed; the number of people employed; and so on. While the contents of this section reflect primarily the capacity phase of the risk, they are also helpful in appraising the financial condition of the enterprise.

4. *Fire Hazard.*—In this part of the report a statement appears whether the risk owns or rents the place of business, the exact nature of the building as to the type of construction, state of repair, its use, whether detached, and the nature and condition of adjacent structures. This is followed by a report on fires and fire losses, if any have occurred, together with the circumstances surrounding the case.

5. *Statement.*—This includes a complete and detailed statement of assets, liabilities, and proprietorship, usually obtained directly from the subject, and is intended to represent the recent status of the firm's financial responsibility. If available, comparative statement summaries are presented for 3 years. Attempts are made wherever possible to secure a statement over the trader's signature, but in many instances unsigned statements are still presented. Under such circumstances, however, the fact that the property statement is unsigned is definitely stated in the report.

Then follow comments on the correctness of the figures presented in the statements. These comments are made by the employees of the agency and reflect the opinions of authorities consulted which are, of course, no better than the persons giving them. Some of the figures nevertheless lend themselves to verification, and this is often done by the agency. Cash in bank, for example, may be readily and substantially verified. Estimates may be obtained from outside sources, such as independent appraisers, as to the actual and conservative value of

properties listed in the statement. In any event, the comments respecting the facts presented in the statements are valuable and should be regarded as such in most cases, for these are frequently based on other



The following report is furnished, at your request under your Subscription Contract, in STRICT CONFIDENCE, by DUN & BRADSTREET, Inc. as your agents and employees, for your exclusive use as an aid in determining the advisability of granting credit or insurance, and for no other purpose.

PLEASE NOTE WHETHER NAME, BUSINESS AND STREET ADDRESS CORRESPOND WITH YOUR INQUIRY

Automotive Division

Blank Automobile Co. Sales & Serv. COLUMBUS, Ohio
Franklin County
1050 W. Long St.

A. B. Black, Pres., Treas. & Gen. Mgr.,
Mary G. (Mrs. A. B.) Black, Vice Pres.,
John W. Jones, Sec'y.
DIRECTORS: The Officers.
CD 18 26 Dec. 6, 1937.

HISTORY

An Ohio corporation, chartered January 9, 1929 with an authorized capital of 500 shares no par common stock of which $20,000 is paid in in cash.

A. B. Black is 46, married, a native of this vicinity, of German descent. He was employed as an automobile salesman for four years prior to 1924 when he became engaged in the retail shoe business for one year. He then became a member of Blank & White, Chevrolet Dealers, Inc., at London, Ohio, and purchased his partner's interest in June, 1926 and continued until selling the business in November, 1928.

He was inactive until January 1, 1929 when he took over the business of the West Long St. Automobile Co., incorporating it two days later.

Mary G. Black is the wife of the President. She owns 298 shares of the outstanding stock, but is not active. Jones has been in Black's employ for several years and acts as sales manager, owning one share of stock.

METHOD OF OPERATION

The company retails Chevrolet automobiles and is a direct factory distributor. Service department is also maintained, but this end represents slightly less than 15% of the company's annual volume. Sales are made to the general trade and the greater portion of new and used car sales is refinanced through the General Motors Acceptance Corporation.

Located in an active outlying business section occupying 70 x 144 feet, of brick construction. Company employs approximately 25 persons of whom ten are on a commission basis.

FIRE HAZARD

A tenant, occupying this two-story building which is comparatively new and in good repair. A concrete block building to the west houses a garage and filling station, while an alleyway is to the east. Buildings in this neighborhood are in reasonably good repair. Interior of the subject business presents a neat appearance with display room attractively arranged and repair room kept clean. Garage floor is of cement.

FIRE RECORD: No fires reported.

STATEMENT

	Dec. 31, 1935	Jan. 1, 1937	Nov. 30, 1937
Current Assets	$ 19,771	$ 38,823	$ 29,287
Current Liabs.,	13,353	29,427	14,672
Other Assets	6,227	9,500	12,768
Paid in Capital	20,000	20,000	20,000
Net Worth	12,645	12,645	21,926
Net Sales	269,091	316,280	465,902 (11 Mo.)

(CONTINUED)

DUN & BRADSTREET, INC.

FIG. 19A.—Copy of a more or less typical Dun & Bradstreet special report.

information secured by the reporter in the course of his investigation directly or indirectly, and may also reflect a knowledge of the general trend of affairs which every competent editor should possess.

6. *Trade Record or Trade Reports.*—This part of the report presents, in tabulated form, the experiences of a number of creditors with the

The following report is furnished, at your request, under your Subscription Contract, in STRICT CONFIDENCE, by DUN & BRADSTREET, Inc. or your agents and employees, for your exclusive use as an aid in determining the advisability of granting credit or insurance, and for no other purpose.

PLEASE NOTE WHETHER NAME, BUSINESS AND STREET ADDRESS CORRESPOND WITH YOUR INQUIRY

From Inventory of October 30, 1937:

ASSETS		LIABILITIES	
Cash on hand	$ 160.00	Accts. Pay.	$ 4,271.93
Cash in bank	5,106.91	Trade Acceptances	6,709.16
Accts. Receivable	2,580.64	Accrued Wages & Taxes & Used Car Res.,	3,222.12
Notes Receivable	192.20	Credits on Accts. Rec.	468.70
Merchandise	21,247.71		
Total Current	29,287.46	Total Current	14,671.91
Machy. & Fixts.,	7,796.61	Reserve for Depreciation on Fixed assets	5,457.48
Prepaid	325.85	Common Stock	20,000.00
Deferred Assets	4,847.79	Deficit, (Red)	7,421.71
Total Assets	42,055.71	Undivided Profits	9,548.03
		Total	42,055.71

(Signed) November 22, 1937, Black Automobile Co.,
(by) A. B. Black
Pres.

Although statement shows net worth to be $21,926, it is understood that capital account has been adjusted until it is now $5,000 while a surplus of $8,354 is shown. This reduction in net worth was brought about by declaring large cash dividends. Sales for 1936 were over 40% higher than the preceding year while volume thus far in 1937 is 60% over sales for the corresponding period last year. The company continues to make headway, and cash is more than sufficient to meet all trade obligations. However, trade acceptances to principal suppliers are heavy and increase liabilities to a point beyond net worth. The trade acceptances are on new merchandise and will be eliminated as cars are sold. As an excellent volume is maintained, this is not considered an unhealthy condition, but it causes total indebtedness to appear heavy.

Black understands this line thoroughly, is considered a good manager, and pays strict attention to meeting trade obligations promptly.

TRADE REPORTS
(Nov.21, 1936)

HC	OWE	P. DUE	TERMS	PAYMENTS	REMARKS
3			2%-10M30	Disc	Sold yrs to June 4,1936
68	55		Reg	Disc	Sold yrs to Oct.1936.
50	13		—	Disc	Sold yrs to Nov.1936.
50			Reg	Disc	Sold Some time. Satis.
366			30 da	Prompt	Sold Nov. 21,1929 to Sep, 1936.

SUMMARY

BUSINESS IS ESTABLISHED AND WELL MANAGED BUT INDEBTEDNESS IS OUT OF PROPORTION TO NET WORTH.
5-5-37 (61).

H 3½ to - -

FIG. 19*B*.—Fig. 19*A* (*Continued*).

subject of the inquiry. It shows for each reporting creditor the highest amount of credit extended to the risk, the amount owing, the amount past due, the terms granted, and the debtor's manner of meeting his

obligations, whether prompt, slow, very slow, discounts, anticipates, and the like.

7. *Summary and Rating.*—The summary consists of a terse statement, usually in a single sentence, which is intended to throw significant light on the question: shall credit be granted and, if so, how much? This is followed by the latest available rating, and if such rating is different from the preceding one, attention is called to the change.

Analytical Reports.—In lieu of the special report, the agency may furnish the client an analytical report, which differs from the special report in several respects. It is much more detailed in all the sections of which it is composed. Usually, it contains financial statements for the 3 preceding years, together with a detailed analysis or explanation of the data in the balance sheet for the latest year. Finally, it differs greatly in the arrangement, being made up of three main parts. The first part is headed "Rating, Summary, Investigation," and covers the rating for the firm and its branches, if any, followed by a summary statement of the condition of the risk, the results of a direct investigation resulting from an interview with one or more of the officers of the subject company, the facts brought out from a bank investigation, and the results of a trade investigation. The second phase of the report is entitled "Financial Information," covering statements for 3 years and an analysis thereof. The third part deals with "Antecedents and Method of Operation"; it presents the names of the officers and directors, together with a brief statement concerning this personnel which would reflect their age and experience. This is followed by the history of the firm, its method of operation, a statement about each of its subsidiaries, if any, and concludes with some facts on the location of the business and the fire hazard.

Analytical reports are prepared, under the supervision of the Analytical Report Department of Dun & Bradstreet, only for the larger concerns and for such others as in the judgment of the agency would seem to justify greater detail than shown on the special reports. Analytical reports are more expensive to prepare, the cost being practically twice as much as for a special report, yet no differentiation is made in the charges to clients on the basis of the kind of report they are furnished. Furthermore, financial statements for the last 3 years are seldom available for smaller concerns. Besides, the personal factor or human equation is of greater significance in judging smaller enterprises for credit purposes; consequently there is less urgent need for complete financial statistics concerning them. Firms for which analytical reports are available are shown in the reference books in italics.

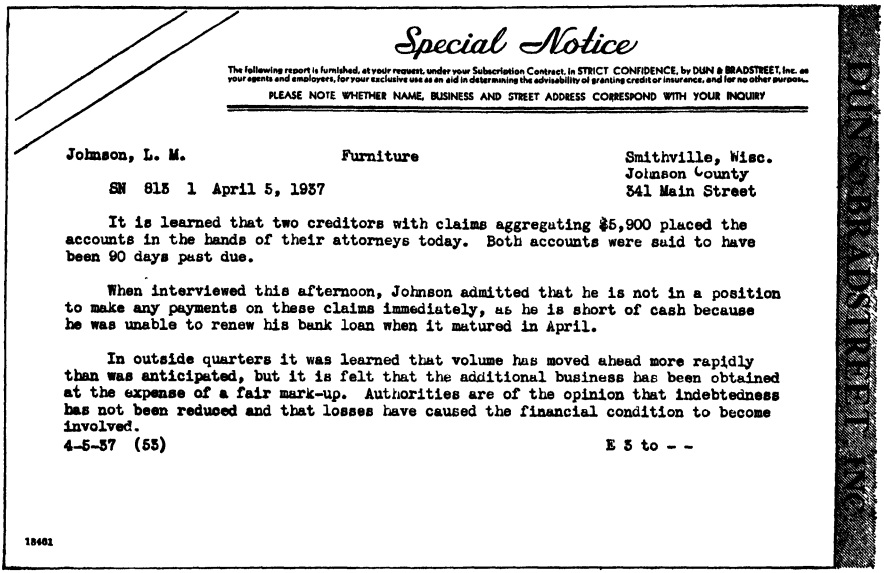
Specialized Reports.—For certain industries, so-called "specialized reports" are being prepared, under the supervision of the Specialized Report Department of Dun & Bradstreet, in place of either of the pre-

ceding two types of reports. The specialized report is designed for a specific industry by a trained personnel especially fitted for the task, including in each case the local reporter and a qualified regional man. For the solid-fuel industry; for example, this report includes information regarding storage, receiving and unloading facilities, a breakdown of the volume of business under "method of operation" to show whether the subject is a suitable outlet for the subscriber's products, and a trade paragraph resulting from a direct investigation by an experienced reporter of suppliers who have had dealings with the risk in question. The arrangement of the factual information in these reports is identical with that used for the special reports.

Specialized reporting represents an attempt to give the credit manager "the benefits of a nation-wide reporting organization, plus the specialized personal service made possible by intimate daily contact with the specific sources of supply of each concern investigated." This expanding program of industrial specialization is apparently aimed to meet the competition which the general mercantile agency has encountered for many years from the numerous special agencies which confine their activities to a single line of business.

Continuous Report Service.—Reports are subject to constant change. Attempts are made to revise the special reports periodically, usually twice a year. In addition, special investigations are conducted from time to time as circumstances may demand. Under the continuous report system, such new reports are furnished promptly and voluntarily to all subscribers whose interest in the subject has been registered, without any additional cost. Upon receipt of an inquiry from a subscriber concerning a given subject, the subscriber's number is registered, *i.e.*, it is placed opposite the name inquired about, and for a period of one year thereafter the agency submits automatically a copy of each new report made on the risk. These reports differ in no important respect from the special or analytical reports, for they may be of either type.

Besides the periodic revisions of reports or the special investigations resulting in complete reports, the agency secures much information from time to time which involves material changes of a derogatory character. These include lawsuits, assignments, foreclosures, bankruptcy, mortgages, irregular transfers of property, and other information which tends to detract from, lessen, or in any other way impair the credit standing of the risk. This type of information is put on "Special Notices," copies of which are supplied to all interested clients (see Figs. 20 and 21). Similar memoranda are also forwarded without request to all branches of the agency which are interested in the name thus affected, as evidenced by previous inquiries received concerning the subject. When an inquiry is received from a branch office, the number by which the inquiring



Special Notice

The following report is furnished, at your request, under your Subscription Contract, in STRICT CONFIDENCE, by DUN & BRADSTREET, Inc. as your agents and employees, for your exclusive use as an aid in determining the advisability of granting credit or insurance, and for no other purpose.

PLEASE NOTE WHETHER NAME, BUSINESS AND STREET ADDRESS CORRESPOND WITH YOUR INQUIRY

Johnson, L. M. Furniture Smithville, Wisc.
Johnson County
SN 815 1 April 5, 1937 341 Main Street

It is learned that two creditors with claims aggregating $5,900 placed the accounts in the hands of their attorneys today. Both accounts were said to have been 90 days past due.

When interviewed this afternoon, Johnson admitted that he is not in a position to make any payments on these claims immediately, as he is short of cash because he was unable to renew his bank loan when it matured in April.

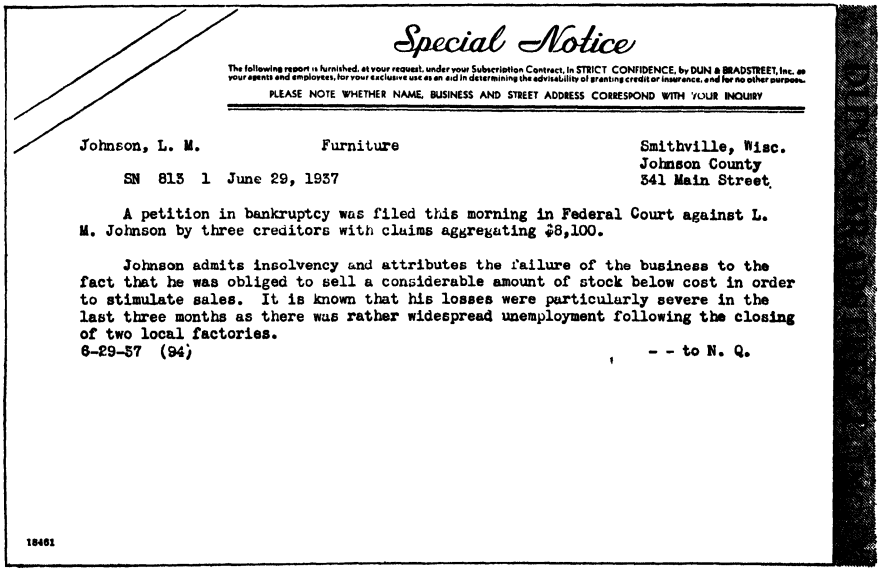
In outside quarters it was learned that volume has moved ahead more rapidly than was anticipated, but it is felt that the additional business has been obtained at the expense of a fair mark-up. Authorities are of the opinion that indebtedness has not been reduced and that losses have caused the financial condition to become involved.

4-5-37 (55) E 3 to - -

18461

DUN & BRADSTREET, INC.

FIG. 20.—Special Notice showing a change in rating from E 3 to — —.



Special Notice

The following report is furnished, at your request, under your Subscription Contract, in STRICT CONFIDENCE, by DUN & BRADSTREET, Inc. as your agents and employees, for your exclusive use as an aid in determining the advisability of granting credit or insurance, and for no other purpose.

PLEASE NOTE WHETHER NAME, BUSINESS AND STREET ADDRESS CORRESPOND WITH YOUR INQUIRY

Johnson, L. M. Furniture Smithville, Wisc.
Johnson County
SN 815 1 June 29, 1937 341 Main Street

A petition in bankruptcy was filed this morning in Federal Court against L. M. Johnson by three creditors with claims aggregating $8,100.

Johnson admits insolvency and attributes the failure of the business to the fact that he was obliged to sell a considerable amount of stock below cost in order to stimulate sales. It is known that his losses were particularly severe in the last three months as there was rather widespread unemployment following the closing of two local factories.

6-29-37 (94) - - to N. Q.

18461

DUN & BRADSTREET, INC.

FIG. 21.—Special Notice showing the concern went bankrupt.

branch is designated is placed on the record bearing the name of the party inquired about, and the same procedure is followed as outlined with respect to subscribers.

The continuous report service makes possible a steady flow of pertinent credit data regarding the subscriber's accounts. This new information may show no change and thus justify the position already taken toward the account, may indicate a more favorable condition and thus justify the opening of the account if it has previously been declined or a further extension of credit, or it may show a less favorable condition than indicated in a previous report and thus serve as a cautionary signal. For a few lines of business the agency also compiles data of past-due accounts which are released monthly to the clients directly concerned with a given class of customers.

Miscellaneous Reports.—Dun & Bradstreet maintains an insurance division which serves the needs of fire insurance underwriters in the judgment of commercial risks. The so-called "Fire-Character Report" reveals the physical aspects of the building and neighborhood, presents essential antecedent data, shows the trend of the business enterprise, its financial condition, and the fire record, if any. Continuous service and "tip sheets" warn the insurance company of any unfavorable changes, and special surveys on fire risks are made upon request. Real estate search reports are prepared and issued upon request to subscribers, giving the exact description of the property; its assessed valuation; mortgages, vendors' liens, bonds, and deeds of trust for every parcel of real estate owned; as well as judgments and other liens that may be outstanding against such property. Reports have also been devised for individuals, most of which are for the benefit of insurance companies. Other reports have been designed to cover the operations of farmers, trucking companies, and such other organizations as have peculiar characteristics for which specialized information is required.

For those subscribers who are interested in foreign trade, a Foreign Department is maintained, which supplies information to American exporters on leading foreign customers for American goods. The operations of this department will be discussed in a subsequent chapter, together with the nature of the reports issued and the method of preparation followed. A Municipal Department gathers information concerning the financial condition of state, county, and municipal governmental units, for the benefit of investors in securities issued by such organizations. The reports enable investors to determine the merits of any bond issue offered for sale, and the continuous service on such bond issues keeps investors informed of changing conditions which might depreciate their value or earning power. This kind of service is of especial interest

to insurance companies, investment and commercial banks, and trust companies.

Interpretation of a Dun & Bradstreet Report.[1]—The firm style or name often reveals interesting bits of information. If it is too pretentious it may be intended to cover up weaknesses, and if too many changes have been made in the name, it may indicate either an unfavorable reputation or manipulation of assets to the detriment of creditors.

From the kind of business many things can be learned concerning the risk. If the business is of a highly seasonal character, the information at hand may not be recent enough, the amount of credit requested may be unduly large if in off season, and slow payment may be expected during certain periods. The kind of business indicates the extent of the risk, nature of price and other competition, the type of persons who are attached to it, attitude of the public toward it, how it is affected by business depressions and periods of recovery, degree of stability in production and distribution channels, and the credit requirements. In the light of this intelligence, a credit man can determine whether the amount of credit asked for is in line or excessive, whether it is to be used for other operations or side lines, and, other things being equal, what chance the subject has of succeeding in it.

Closely allied to the kind of business is its location, since local conditions of an adverse nature, such as crop failures or shutdowns of factories in a single-industry town, may have a profound effect upon it. Its location in relation to sources of supply is an important factor, as well as the specific site on which the business is conducted. Some locations require too high rentals, or heavy investments in fixtures and equipment which have relatively little value in case of liquidation, or they are out of the beaten paths of customers. The geographic location of the business is directly affected by state laws regarding the collection of accounts and may be favorable or unfavorable from the standpoint of obtaining the necessary credit information.

The names of the principals and their history are of great significance in appraising a credit risk. They may be of certain social groups that are customarily poor pay and make unjust claims for allowance, or vice versa. Their record may point to the necessity for injecting new blood, either because of incompetence, advanced age, or undue attention to other interests. Some of the principals may be mere figureheads, and the outside interests may even prove detrimental to the business in question. For the same reason, changes in the directorate or officers should be watched for a clue as to underlying reasons. Obviously, the history

[1] Based in part upon "How to Read a Dun & Brad," by F. M. Bellows, *System and Business Management*, March, 1934.

of the enterprise is closely tied up with the personnel. No business can run itself; it must be managed. How successful has the management been? Has there been any financial embarrassment in the past? Has any attempt been made to avoid lawful obligations? What changes have been made in the legal form of the organization? All these can be obtained from the history section of the report. Similarly, in this section of the report light is thrown on changes in the capital structure of the concern, changes in ownership, acquisitions, and relationships to other concerns. Frequent changes in ownership or management may signify instability. A history of frequent mergers may reveal a tendency toward overexpansion. If the concern is a subsidiary, what is its legal liability as well as that of the parent concern?

From the section of the report on method of operation, one can determine whether the business is conducted soundly, to what extent it is subject to weather or other natural hazards, what the marked potentialities are, and how much it depends upon factors beyond its immediate control as when it operates on an agency basis the contract for which is subject to cancellation by the principal. The fire record is scrutinized in order to evaluate the moral hazard of the subject, while the facts on insurance will indicate the adequacy of coverage.

If no financial statement is presented in the report, the risk is regarded in an unfavorable light, unless the other information is exceptionally good. If a statement is given, its value is enhanced if it is signed, audited by a certified public accountant, and of recent date. A comparison with previous statements shows the general trend. If the items on the statement are in round figures they have probably been estimated and should be greatly discounted. When the risk is that of an individual or partnership, it is important to know whether the statement contains merely the business assets or includes those outside the business. A few of the items can be checked, such as the amount owed to the bank or the total amount owed to merchandise creditors, the former through the bank and the latter through a credit-interchange report. The existence of chattel mortgages, judgments, or liens should be watched. Liens ordinarily signify financial stress. Judgments may have been the result of claims which the risk had a right to contest or may have been caused by unwillingness of the subject to meet his just obligations. Chattel mortgages also represent a danger signal, unless they arise out of the purchase of new equipment. The latest statement presented in the report should be carefully analyzed according to the ratio method even though a fairly complete analysis has been made by the agency, provided, of course, that the credit man is capable of doing it. Unless the credit man is skilled in statement analysis, it is probable that the agency can do a better job of it.

In judging the trade investigation part of the report, one should first ascertain whether the number of creditors reporting is sufficiently representative and whether the amounts extended by these creditors are typical for the business. Paying habits shown here may be used as a check upon the accuracy of the financial statement. If a few large creditors are being paid promptly but not the others it may show a necessity for doing this or losing principal sources of supply; small creditors would then be handicapped. On the other hand, if only the very small creditors are being paid promptly, it may mean that the concern is unable to pay the larger amounts but wishes to maintain a good standing with a few small creditors for reference purposes.

It is best for the credit manager first to reach his own conclusion and then to compare it with that reached by the agency. For this reason it is advisable for the agency to place the summary at the end of the report as in the case of the special reports rather than at the beginning as is done with the analytical reports. Any change in rating shown at the end of the report calls for a careful analysis of the report itself to ascertain which factors have been responsible for the change and whether such factors are of great significance for the specific purpose under consideration.

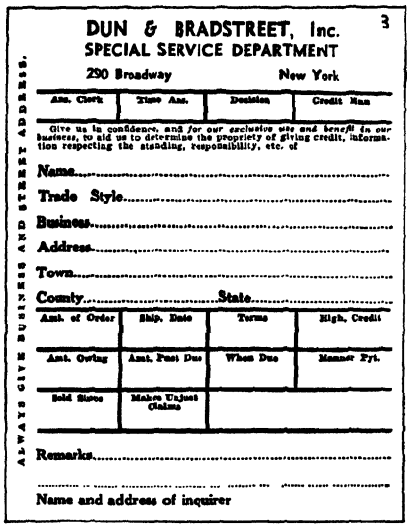
MISCELLANEOUS SERVICES OF DUN & BRADSTREET, INC.

Credit-checking Service.—Through its Special Service Department, Dun & Bradstreet serves the apparel trades and their affiliated lines of business with specific advice and recommendations as to whether to accept or reject a given order. This is known as credit checking and is discussed in some detail in the chapter immediately following. A subscriber to this service may, upon receipt of an order, consult the agency by telephone or by means of a form shown in Fig. 22. A staff of credit analysts, familiar with the buying habits, trade customs, buying seasons, style hazards, and other pertinent facts about the industry make the decision for the vendor with as great speed and accuracy as possible. As a basis for this decision, it is essential that the supplier furnish information as to the amount of the order, terms of sale, past paying habits, and such other facts pertaining to the risk as may be gleaned from previous experience. This service is limited to women's wear and male apparel and, further, is confined to New York City, Chicago, Cleveland, and St. Louis, all of them clearing through the New York office.

Collection of Overdue Accounts.—A Mercantile Claims Division is charged with the duty of collecting past-due accounts for clients, both by means of personal call and through the mail. Because of its great prestige in the business world, a simple reminder often brings results.

The forms of such a reminder are supplied to subscribers free of charge, but if it fails to produce results the account is turned over to the agency for collection. Personal presentation of the subscriber's claim against a delinquent debtor is made only in the important trade centers. If litigation is found necessary, the account is turned over to an attorney in the usual fashion.

Periodical.—A monthly publication under the title *Dun's Review* is given gratis to subscribers as part of the service of the general mercantile agency. This much-quoted periodical contains an analysis of current business conditions in different sections of the country and in various lines of trade, features special articles on trends and developments affecting industry, trade, and finance, presents in summarized fashion the results of research work done by the staff of the agency, and publishes basic statistical data including records of commercial failures, bank clearings, building permits, commodity price indexes, and the like. Bankruptcy statistics are also included in the *Review*. Most of this material is republished in the various newspapers and financial magazines, for a great deal of the data contained in the *Review* is compiled firsthand by the agency, hence, it is looked upon as a primary source for such information. Dun & Bradstreet's daily weighted price index of 30 basic commodities, which appears in many newspapers throughout the United States, is an illustration of such firsthand information gathered by the agency.



DUN & BRADSTREET, Inc. 3
SPECIAL SERVICE DEPARTMENT
290 Broadway New York

ALWAYS GIVE BUSINESS AND STREET ADDRESS.

Asst. Clerk	Time Asst.	Decision	Credit Man

Give us in confidence, and for our exclusive use and benefit in our business, to aid us to determine the propriety of giving credit, information respecting the standing, responsibility, etc. of

Name.....
Trade Style.....
Business.....
Address.....
Town.....
County..... State.....

Amt. of Order	Ship. Date	Terms	High. Credit
Amt. Owing	Amt. Past Due	When Due	Manner Pyt.
Sold Since	Makes Unjust Claims		

Remarks.....

Name and address of inquirer

FIG. 22.—Inquiry ticket used by a member who subscribes for the credit-checking service of Dun & Bradstreet's.

Business Analyses.—Largely in connection with its principal function of collecting credit information, a great many facts are obtained concerning business enterprises in the various production and merchandising fields, some of which, at least, are analyzed by the company's research and statistical staff. Many of the facts are reduced to charts and ratios which are made available to business men through newspaper and trade-paper releases, through the columns of *Dun's Review* and through special publications. An illustration of the latter is the annual publication of the agency entitled *Behind the Scenes of Business*,[1] which presents and

[1] By ROY A. FOULKE, Manager, Analytical Department, Dun & Bradstreet, Inc.

analyzes a number of capital, inventory, sales, and net profit ratios for a number of different kinds of business in the manufacturing, wholesaling, and retailing fields. It is to be regretted that this kind of work was not started sooner in order to utilize at least a small part of the factual material of importance to business men that the agency has in its files. It is further to be regretted that in making the ratio analysis of financial statements, little or no attention has apparently been given to the pioneering efforts of the Robert Morris Associates. It is the author's opinion that some of the most important ratios have not as yet been developed by Dun & Bradstreet and that certain others which are being stressed are of little significance. Furthermore, the agency has an unusual opportunity of serving the progressive business man by putting ratio analysis on a truly scientific basis, as will be explained in a later chapter on the subject. This in no way detracts from the importance of the work that is already being done, but merely points the way to greater achievements in this realm.

Special Surveys.—Through its Research and Statistical Division, the agency has been conducting special surveys. An annual *Retail Survey* was undertaken for the first time in 1935 covering operations for the year 1934. Sales and a breakdown of operating expenses are being collected for 100 different kinds of retailing business from thousands of stores in every section of the United States. These data are tabulated and presented for each kind of business in summary form and are supplied free of charge to all cooperating retailers, as a guide to improved and more profitable management. Others than retailers are interested in this kind of information, including the retailers' sources of supply, wholesaling and manufacturing, as well as banks, insurance companies, and students of business generally. A similar survey was conducted in 1935 for a number of manufacturing and wholesaling types of enterprises. Since operating expenses have been found to vary but little from year to year, it is planned to cover alternately, perhaps in two-year cycles, retailing, certain wholesale trades, and some manufacturing industries.

The importance of this kind of information cannot be overemphasized. As early as 1916, the Harvard Bureau of Business Research undertook to collect, on a sample basis, data on operating expenses. This was done for but a few kinds of business. Other educational institutions and trade associations have attempted to follow suit, but so far only scattered and exceedingly meager data are available on the subject. Then came along the First Census of Distribution for 1929, followed by the Census of American Business for 1933 and the Census of Business for 1935. While much business information has been collected for these censuses, the enormity of the task precluded the collection of detailed operating-expense figures; only totals and salaries

and wages can be obtained satisfactorily from that source, although for 1929 rent and interest expense data were also collected. Consequently, the surveys made by Dun & Bradstreet along this line are the only source for operating-expense information broken down in some detail that can be obtained for as many different kinds of business and on as large a scale.

Cost of Agency Service.—The cost of securing information from the general mercantile agency varies directly with the extent of service required by the contract entered into by the subscriber. Although rating books are published bimonthly, many houses are satisfied with only three books, whereas others consider all six indispensable. Again, some concerns prefer more special reports than others, the cost naturally varying proportionally with the number of special reports required. Then, too, the size of territory covered by the books loaned to the subscriber has a direct bearing upon the charge made. In each instance, however, the contract calls for a specific number of reference books and special reports. The minimum cost of the service, which includes three sectional books and 50 reports, is $150. It is estimated, however, that the average subscription calls for all six books and 300 reports. If these books are sectional, then the cost of the subscription contract is $425, and if the books are for the entire United States, the cost of the average subscription approximates $525. Additional reports are furnished at a cost of $1.25 per report, or $87.50 per hundred reports. For pocket editions of the reference books, extra charges are made in accordance with a definite schedule. Similarly, for collecting past-due accounts the usual collection fees are charged.

CRITICISMS OF THE GENERAL MERCANTILE AGENCY SERVICE

Lack of Promptness in Reporting.—Probably the most unsatisfactory feature of the existing agency service is the delay in rendering reports. It is charged that in case of many first orders or new accounts, or orders requiring immediate shipment, credit decisions must be made on the basis of information secured from other sources, because of the extraordinary delay in furnishing special reports by the general agency.

This criticism is only partially true. The agency is aiming to anticipate inquiries and to have reports concerning debtors in its files. Credit managers, however, continually demand data reflecting newly created conditions. In such instances, as well as in those cases where information is totally lacking, investigations must be conducted at the expense of promptness in returns. Again, much depends upon the nature of the information required and the difficulty of obtaining it. Should the agency possess all the necessary data on file, a report can be furnished on the same day that it is requested. On the other hand, if

the data must be procured from widely scattered sources, more time is necessarily consumed in the process. Furthermore, it is claimed that of the inquiries received, fully 90 per cent are answered immediately—meaning on the date of receipt of the inquiries.

Failure to Revise Reports Frequently.—Some complaints are registered to the effect that reports are not revised frequently and consequently lack recency and freshness. Several reasons are assigned by critics in explanation of this weakness. One of them is failure to maintain the standard set by the institution itself calling for semiannual revision of the entire data, because of negligence or incompetency. Another cause is the inability of the organization to keep pace with the constantly increasing number of names reported on. The truth of the matter is that too frequent a revision is both expensive and difficult. The agency derives the larger part of its profit from selling a given report several times instead of each time incurring the expense of collecting new and recent information for the substance of the report. Besides, merchants inquired about would assume an antagonistic attitude toward the agency and undoubtedly resent too many investigations into their affairs and would ultimately refuse to furnish the required facts. In recent years, much progress has been made in this direction and this criticism is losing strength.

Failure to Furnish Financial Statements.—Complaint is also current to the effect that the agency fails to obtain financial statements in too many of the cases reported on, and that many of the statements furnished are unsigned. The agency does not deny this fact entirely but places the responsibility for the repeated refusal of merchants either to submit statements or to sign them at the door of the credit grantors themselves. If credit managers would themselves require and insist upon financial statements from their debtors, these merchants would in time become educated to the fact that the rendering of statements is good business and justifiable from many viewpoints. As it is, many debtors claim that they are able to secure all the credit without furnishing a statement of their affairs and can see, therefore, no necessity for complying with the request of the agency to that effect. The agency is, however, rapidly overcoming this situation and diminishing the validity of the criticism. In fact, it is believed that in more than 75 per cent of the reports financial statements are now given.

Deficiencies in Trade Opinions.—Several criticisms are advanced on this point. Some subscribers claim that the information under this heading frequently lacks in freshness and is too old to be of any material significance. Other critics attack the agency on the ground that opinions are too limited in number and of inferior quality, for they may not cover those references from whom principal purchases are made by the risk.

Being limited in number, the list of trade opinions is far from representative and may consist only of those few references with whom satisfactory dealings are maintained solely for the purpose.

In reply to the criticism relative to trade opinions it may be stated that the objections no longer apply to the same degree as in the past. Phenomenal improvements were inaugurated by the agency in an attempt to remedy an evil long complained of by subscribers. Whether it is or ever will be in a position to present such material as effectively as other sources of information, the chief and perhaps only function of which is to gather and disseminate ledger or trade experience, is a disputed question and must be decided by each credit manager for himself.

Selected References

BRISCO, N. A.: "Retail Credit Procedure," Chap. 7.
CHAPIN, A. F.: "Credit and Collection Principles and Practices," Chaps. 11 and 12.
ETTINGER, R. P., and GOLIEB, D. E.: "Credits and Collections," Chap. 10.
HAGERTY, J. E.: "Mercantile Credit," Part I, Chap. 8.
PRENDERGAST, W. A., and STEINER, W. H.: "Credit and Its Uses," Chap. 7.
STEINER, W. H.: "Mercantile Credit," Chap. 3.
TREGOE, J. H.: "Credit and Its Management," Chap. 12, Harper & Brothers, 1930.

Questions and Problems

1. As a subscriber of Dun & Bradstreet, what services may you expect from the agency?

2. Do you think it advisable for Dun & Bradstreet to continue to rent their reference books rather than sell them? What are the legal implications?

3. Explain just what a Dun & Bradstreet rating is, and show what uses may be made of the ratings contained in the reference books by the credit department? Are any other departments of the subscriber's business interested in ratings and for what specific purposes?

4. What is the theory underlying the credit rating structure? Is it valid? Why or why not?

5. What qualifications are especially lacking when a subject is assigned an inferior rating? Does a "limited" credit rating necessarily reflect a bad financial condition or an undesirable credit risk? Explain.

6. How much can a credit manager rely upon ratings in deciding on a credit risk? Give reasons for your answer.

7. What is the significance of:

a. "One-legged" rating?
b. "Blank-blank" rating?
c. General credit rating, such as indicated by numeral 2?
d. Listing of a name in the rating book in italics?

8. Under what circumstances is it advisable for a subscriber to ask for a report concerning a given risk?

9. Distinguish between special and analytical reports and indicate when each of them is prepared and who is entitled to use them.

10. Analyze the special report reproduced in Fig. 19 (pp. 183–184) and indicate what decision you would reach as to the desirability of the risk and the amount of

credit that might be extended to the subject. Compare your decision with that given in the summary of the report.

11. In what respects are the general mercantile agency reports especially strong in comparison with data secured from other sources of credit information?

12. Classify the information in Fig. 19 according to character, capacity, and capital.

13. In examining a Dun & Bradstreet report, what special significance should be attached to the section of the report entitled:

a. History?

b. Fire hazard?

14. Is a high-sounding name of a firm, other things being equal, on the surface a favorable or unfavorable sign from the standpoint of credit?

15. In view of the dynamic nature of business in these times, what can the agency do to make its reference books more timely? What has been done to date along this line?

16. Why is the agency preparing so many different kinds of reports? List all types of such reports available to business at the present time and give reasons for each.

17. Of what value is *Dun's Review* to a business man?

18. List all the functions performed by Dun & Bradstreet, in the order of their importance to commercial subscribers? to the business community at large? to students of business?

19. How costly is the agency's service and how does the cost, in your estimation, compare with its worth? Give reasons for your answer.

20. Indicate the alleged deficiencies in the services of the general mercantile agency and show in what ways attempts have been made to overcome them.

CHAPTER XII

SPECIAL MERCANTILE AGENCIES

In addition to Dun & Bradstreet, the general mercantile agency, there are at present a large number of special agencies of varying size and importance. These are often referred to as "trade agencies," since they generally confine their activities to a single trade or to a limited number of allied trades. Most of the large cities have local special reporting agencies covering local names in one or more lines of business. Thus, special agencies differ from the general type of mercantile agency in that they either operate in a single trade or in a limited number of trades or cover a narrow territory. The general agency, on the other hand, purports to cover all lines of business and extends its operations over the entire civilized world.

Special agencies differ further from the general agency in that they sometimes render a more complete assortment of services, and sometimes their services are much more abbreviated so as to include only ledger experience.

Types of Special Agencies.—Special agencies may be classified on the basis of ownership and control, scope of operation, or the functions they perform. Some of these agencies are privately owned, and are, therefore, operated for profit. Examples of this type may be found in the Lyon Furniture Mercantile Agency, the National Credit Office, and the Credit Clearing House. Other agencies are of the mutual or cooperative type, usually maintained by trade associations. They are voluntary associations organized for the purpose of collecting and distributing credit information among the membership. Such associations usually engage in other activities in which trade associations may be interested. Among the mutual agencies may be counted the Manufacturing Jewelers Board of Trade; the Lumberman's Credit Association, Inc.; and the Credit Association of the Building Trades of New York.

From the standpoint of scope of operation, special mercantile agencies may be placed in three categories. The first comprises those serving a single trade or line of business as illustrated by the Packer Produce Mercantile Agency. Some of the larger mercantile agencies cover several allied or special trades, the outstanding example being the National Credit Office which serves eight fields. Finally, there are agencies, like the Ohio Bureau of Credits of Columbus, which are territorially restricted and which report on local names without respect to trade lines.

According to the functions which they perform, special mercantile agencies may be further divided into four classes. Some of these organizations restrict their activities solely to the collection and dissemination of ledger facts. Most of the mutual agencies are of this type. The information may be of the incomplete type, whereby customer cards are maintained at a central office on which are listed the names of subscribers dealing with the customer. By means of a code and key, the inquiring member is informed of others who have ledger experiences with the risk so that direct communication may be established with them. Only where there are relatively few credit grantors in a trade, or where the members are concentrated geographically, can this simple incomplete system be of value. Most of the agencies in question render the ledger information through reports compiled from the experiences of creditor members. A third group is of the hybrid type and offers ledger information of a limited nature. The most common service is the issuance of a monthly list of past-due accounts, as is done by the Central States Paper Trade Association.

In the second functional class are agencies which offer services similar to those of the general agency, although they are usually heavily spiced with trade flavor. The services performed by them may include rating books, special reports, trade bulletins, derogatory news, and collections. The agencies of this type are, as a group, larger, older, and more powerful than those belonging in the other categories. In this group belongs the Shoe and Leather Mercantile Agency, Inc., which was established in 1879 to serve dealers and manufacturers in leather, shoe, and kindred trades, located chiefly in the East. It has grown to national proportions and maintains executive offices in Boston and branch offices in New York, Chicago, and Philadelphia. The agency now reports on tanners, leather manufacturers, wholesale and commission dealers in leather and findings; manufacturers, wholesalers and retailers in boots and shoes; wholesale and retail dealers and manufacturers of saddlery hardware, harness, and harness specialties; dealers in general merchandise carrying leather, boots, and shoes; dealers in upholstery goods; and collateral types of business throughout the United States and Canada. Others of this type are exemplified by the Lyon Furniture Mercantile Agency, the Produce Reporter Company, the Packer Produce Mercantile Agency, the Manufacturing Jewelers Board of Trade, the Graphic Arts Board of Trade, the Lumberman's Credit Association, Inc., the National Credit Office, and the Alfred M. Best Company which reports on insurance companies other than life.

The third functional class consists of but few agencies that offer a peculiar type of service known as "credit checking," the details of which will be discussed later in this chapter, but which is in essence a

plan under which the agency makes definite recommendations on whether a specific order shall be accepted or rejected. The leading exponent of this service is the Credit Clearing House, which for several years offered this service only, but has later added other functions until "credit checking" has become "just another service." The Credit Exchange, Inc., is another well-known agency rendering a "credit checking" service. Both of these organizations cover the textile trade where most of the manufacturers operate on a small scale, probably have no credit departments, and make shipments hurriedly on account of the style element.

In the fourth and final functional category belongs a group of special mercantile agencies which make personal and special investigations for their members or subscribers, principally to establish the existence or absence of moral responsibility of the risk. Proudfoot's Commercial Agency may be given as an example. It reports on all those engaged in brokerage, financial, and promotional lines of work. Bishop's Service is similar in nature.

MAJOR FUNCTIONS OF SPECIAL AGENCIES

Reference Books.—Practically all the special mercantile agencies that are privately owned, and a few of the mutual type, publish rating books for the use of their subscribers. These books are often designated by their color and are known as "Blue Books" or "Red Books." They are published annually, semiannually, or quarterly, as the case may be, and contain the credit ratings of all names which the respective organizations purport to cover.

While the ratings of the special agencies follow the plan of the general mercantile agency, they often consist of three symbols in the place of two, which is regarded as a much desired improvement. In such instances the signs expressing ratings denote the credit standing, capital resources, and paying habits, respectively. To aid in the interpretation of these ratings, a key showing the conditions reflected by the various signs used in the ratings is furnished each subscriber.

The third symbol of the rating usually denotes the manner of payment, showing whether the merchant discounts his bills, pays promptly at maturity, or is slow in making settlement. The pay ratings are usually based on the majority reports received concerning the subject rated. One of these symbols, which may be the one showing the general credit standing, or the third one denoting the manner of payment, also covers trade abuses, if any, such as the habitual registering of complaints without cause, disregard of terms of sale, deduction of unearned discounts, and other practices of a like nature.

A good illustration of the contents of rating books issued by special agencies is afforded by the Lyon Furniture Mercantile Agency, Inc.

According to their Red Book credit key, capital ratings showing estimated financial worth are designated by letters; pay ratings are shown by numbers from 1 to 8, inclusive; indicating respectively, whether the subject discounts, is prompt, satisfactory, fairly satisfactory (occasionally slow), slow, exceedingly slow, C.O.D. or C.B.D., or whether pay rating is not established but the information available seems to be favorable; other numbers show special credit conditions based on general information. Thus, a rating of 18R4 indicates that the subject takes discounts in violation of terms, that his capital rating is from $3,000 to $5,000, and that he pays some accounts promptly and is slow with others.

Reports.—Special reports similar to those of the general mercantile agencies are issued upon the request of subscribers by most of the special agencies. Such reports cover antecedents, financial resources, trade experiences secured largely from other creditors who are subscribers for the agency's service, general comments by the special reporter or correspondent who made the investigation, and the most recent rating assigned. In the place of such reports, some of the cooperative bureaus merely furnish unfavorable information which they have gathered from the members. Thus, one organization requires that each member list with them at certain intervals the names of all his customers who have become delinquent, are being sued, have been found disagreeable to do business with, make unjust claims, or those concerning whom he is in possession of information that would tend to detract from their credit standing. Such agencies obviously aim to protect their members or subscribers by making available to them only unfavorable experience. This abbreviated service, while meritorious in some respects, tends to have a negative effect in that it prevents losses from bad debts, but does not serve as a business builder, which only a complete picture of the credit risk, dealing with both favorable and unfavorable experiences, would make possible.

Periodic Supplement Sheets.—Supplement sheets bearing changes in ratings are issued periodically to subscribers who may thus keep their books corrected until the subsequent revision. Ratings published in book form reflect conditions believed to exist at date of issue only. They do not aim to show accurately the conditions at a later date, inasmuch as such conditions are constantly changing. Supplement sheets are therefore a necessity, and are usually issued weekly under the designation "service sheets," "credit report sheets," or bulletins.

In addition, these service sheets supply all kinds of derogatory information obtained through court records and other sources. They aim early to warn subscribers of the financial weakening of their customers and of impending business disaster, citing various shady transactions involving suspicious transfers of property, assignments, bankruptcies, dissolutions, records of fire, and the like. They report protested checks,

judgments entered, executions issued, claims placed with attorneys and collection agencies for collection, loss by swindle, appointment of receivers, and all other changes in the credit standing of customers which would naturally be of interest to creditors. Sometimes it may also be suggested by means of these sheets that subscribers make inquiry and request special reports on certain names listed therein, especially when important new reports are available for distribution.

Collection Departments.—Special agencies ordinarily provide a collection service for the trades they serve. The collection department thus maintained is not only an important source of revenue but also serves as an excellent source of information for the credit files of the agency.

ADVANTAGES OF SPECIAL AGENCIES

Specialization.—By specializing in a limited line of business, or by operating over a decidedly narrow territory, the special agency learns to know its trade intimately. Its reporters constantly circulate among the same traders and credit managers. They become familiar with all the idiosyncrasies of the merchants and the peculiarities of the trade in which they operate. They learn the problems of the subscribers' customers, their methods of doing business, normal operating expenses incurred, seasonal fluctuations in demand, and various rates of turnover. It then becomes relatively easy to discover poor management or to detect impending financial embarrassment. Since many special agencies are organized by or for a trade for the protection of its members, exact and complete information can be procured.

Promptness in Reporting.—Lacking the elaborate organization and the wide scope of the general agency, it is maintained that special agencies are prepared to institute immediate investigations for the compilation of reports, and, being local in character, in many cases, they are in a position to interview at once all those who possess information regarding the subject of the investigation. A report can thus be rendered on the same day on which the request is received, even when a clearance must first be made. Furthermore, like their competitor, they aim to anticipate inquiries by maintaining complete records on file.

Superiority of Reports.—Special agencies are said to be particularly strong in the number and quality of trade opinions which they furnish. These ledger facts are secured directly from the creditors of the risk and are generally complete, as to both contents and number. Another conspicuous feature of these reports is a supplementary record of collection items handled by the agency and of complaints registered against the subject. Moreover, the reports contain a good bit of trade flavor, are more frequently revised, usually every three months, and are as a rule complete, detailed, analytical, and sometimes even interpretive in the sense of making recommendations and suggesting decisions.

Complete Ratings.—As a rule, a finer division marks the ratings used by special agencies. A third symbol, denoting paying habits, is added to the other two symbols which express capital resources and general credit standing, respectively. The object apparently is to overcome an objection voiced against the inadequacy and shortcomings of general agency ratings, and to avoid generalizations wherever possible. Some agencies have an additional symbol denoting special conditions as per a code shown in the key to the ratings.

WEAKNESSES OF SPECIAL AGENCIES

Limited Facilities.—The special agency very often must rely upon the cooperation of its subscribers, inasmuch as its facilities for gathering information are usually limited. No small agency can maintain the extensive and elaborate equipment which is usually required in order to assemble all the essential facts reflecting the true status of a customer. Few branches are maintained by special agencies and reporters are usually attached only to such offices; hence they cover a limited territory. Information must be gathered largely through local attorneys, who act as correspondents, from the risk's own statements and from trade sources, much of which goes unchecked. Fortunately, however, subscribers and other creditors in the trade covered by the agency cooperate fully with the agency, which is regarded more or less as part of the trade itself.

Limited References.—Chief among the weaknesses of these organizations is the inadequacy of ledger information from the standpoint of variety of references interviewed or otherwise consulted. Operating within a restricted line or territory, special agencies will likely consult only those creditors who are confined to the special line of trade under consideration or who sell within a limited geographic area. In this way many merchants from whom large purchases may have been made by the subject of the inquiry are automatically excluded, merely because such sellers deal in a different line of goods or operate chiefly in a different district.

THE NATIONAL CREDIT OFFICE

The National Credit Office, organized in 1900, is one of the largest of the special mercantile agencies. It maintains its headquarters in New York City and operates branches in Chicago, Cleveland, Philadelphia, and Boston. The organization operates through eight distinct departments or divisions, serving several important industries and the financial institutions interested in these industries.[1] In addition to the Bank Service Department, its departments cover textiles, furniture, rubber,

[1] The bulk of the information for this section was furnished directly by W. C. Batchelder, Executive Secretary of the National Credit Office, whose courtesy in this respect is hereby gratefully acknowledged.

leather, automotive products, radio, and aeronautical goods. Unlike other special agencies, it reports chiefly on large concerns, the majority of which have an estimated net worth of $50,000 and over, and unlike other special agencies of the same functional class, it publishes no rating book. For the various trades the agency gathers data and analyzes market trends, and a sales division is maintained to give merchandising advice to sales departments of textile firms and to concerns in the steel industry. It is probable that the best picture of the scope and activities of the National Credit Office can be obtained through a brief description and analysis of the Bank Service Department, which is distinctive, and of the textile department, which is typical of the others.

Bank Service Department.—This department serves the leading commercial banks in the country by helping them to select eligible commercial paper. It reports on every line of industry borrowing in the open market, as well as the larger finance companies borrowing from banks directly or through commercial-paper brokers.

The reports furnished to financial institutions are very comprehensive and are made up of three sections. Part One consists of a synopsis of the business and gives a brief statement of the important facts embodied in the report. It includes information on the personnel, the history of the subject company, a summary of its financial condition, bank and trade opinions, the brokers handling the paper, form of the offering, depositories of the company, and a classification of the note showing whether it is to be regarded as a prime purchase, desirable, satisfactory, fair, or not recommended. Part Two consists of comparative financial statements and additional data on working capital, sales, profits, dividends, and the current ratio. The more important items of the financial statements are analyzed in relation to the company's policies and outside factors. It also shows the position of the company in the industry, its capitalization, mergers and growth, and methods of operation. In Part Three are listed the officers and directors, together with their antecedents, and a more detailed statement is given of the company's history, affiliations, and the like. The report is then concluded by some general information on the company's method of operation and similar pertinent facts.

The sources of the information for the reports issued by the bank department belong in the following groups:

1. Commercial-paper brokers offering the notes for sale.
2. The companies themselves.
3. Banks sharing the account.
4. Trade houses selling the concern investigated.
5. Leading officials in other companies operating in the same industry.
6. Comparative ratios which have been computed by the agency for a period of more than five years.

Each company borrowing in the open market, as well as each finance company, is analyzed: first, internally; second, on the basis of sales; and third, on the basis of its comparative position. Furthermore, a record is made in the office, upon receipt of each inquiry, so that each bank receives an automatic follow-up service on the concerns in which it is interested. In addition, the larger banks receive automatically complete service on all open market names.

The Textile Department.—This department reports on all converters, cutters, wholesalers, and department stores buying textile piece goods. It claims to have among its members 95 per cent of the mills, commission houses, factors, manufacturers, and converters selling textile piece goods. The reports issued by this department, as well as by the other departments outside of the bank division, consist of three parts. Part One contains a synopsis of most recent information, trade opinions, a brief statement of the subject's financial condition, comments of the banks, a summary of the concern's history and method of operation, and concludes with a summary of requirements and a credit recommendation. Part Two gives the history of the concern in greater detail, including its major officers and their antecedents together with an estimate of their capacity. The method of operation is described in detail, and the company's affiliations and banks are given. Part Three includes a photostatic copy of the concern's financial statement and profit and loss sheet for the latest period and comparative statements for the preceding 3 years are also presented, together with supplementary figures on the company's tangible net worth, sales, profits, dividends, current ratio, and the like.

Interpretation of Reports.—The reports issued by this division emphasize trade comment to a much greater degree than is the case with the reports submitted by the bank department. Individual experiences of creditors are quoted in detail. The information is reviewed by a supervisor under whose division the subject of the inquiry falls. The aim of this review is to decide upon an average credit which may be assigned to the subject. This organization differs from other special agencies partly because it attempts to interpret the information gathered and to suggest to the inquiring member a definite line of credit that may be safely extended to the subject. This line of credit is not intended, however, as a credit limit; it is merely an indication of what the subject concern would normally require, provided it is buying from a normal number of suppliers.

Follow-up Service.—The members of the textile division receive an automatic follow-up service on each name as long as they are interested in the concern. The larger suppliers automatically receive complete

service on certain trades, such as manufacturers of dresses or manufacturers of cloaks and suits.

Sources of Information.—The sources of information for the reports in this and the other departments are the same as in the case of the bank department, except that of commercial-paper brokers. Trade comments are received in part through a written clearance.

Monthly Interchange Service.—Once a month the members report their new, declined, and past-due accounts. These reports are concentrated in a Ledger Abstracts Book which is mailed to every concern participating. The record of each account is covered for 6 months—one month added, another dropped—at each publication, so that the trend may be followed, particularly on delinquent accounts and those owing large sums. The Ledger Abstracts Books are prepared separately for the woolen division, the silk division, the cotton and knit goods division, and the leather division of the textile industry. Some of the other departments also have their ledger abstracts.

Collection Service.—The company also operates, in connection with the textile department, a free collection service for members.

Principal Features of the National Credit Office Service.—The National Credit Office claims to be operating on three basic principles, as indicated below:

1. *Specialization.*—Within each industry, the reporters and investigators specialize on a limited group of concerns. This gives them an opportunity to become familiar with the fundamental conditions as they exist in the unit they are reporting on. It also allows them to become personally acquainted with the important individuals in the unit and to obtain a fairly thorough knowledge of the operations of the unit as a whole.

2. *Centralization.*—Each department aims to serve a large percentage of the concerns selling to the trades on which the department reports. Inquiries, therefore, reflect the activities of those concerns and are frequently a first indication of a situation which may not otherwise be detected until a much later date.

3. *Interpretation.*—The company feels that financial statements, ledger experiences, information from banks and other factors which enter the complete investigation of an account have a practical significance which may be lost, unless there is a definite understanding on the part of the investigator that what he is doing leads to a definite conclusion regarding the account.

CREDIT CLEARING HOUSE

Another institution clearing information on an extensive scale but confined chiefly to the retail dry goods trade is the Credit Clearing

House. This organization was established in 1888 in St. Paul, Minn., as a local enterprise but in 8 years spread to nation-wide proportions. Its business consisted chiefly of two divisions—one dealt with the collection of past-due accounts, and the other engaged in what has been termed a mercantile reporting business. In 1923, the first function was undertaken by a separate company known as the Credit Clearing House Adjustment Corporation which is still, of course, closely allied to the parent organization.

One of the reasons for the division of business into two separate companies resulted from the fact that both functions had grown to such large proportions that it was thought certain advantages could be gained by a separation of the two divisions of the old business into two separate corporations.

Old Method of Operation.—Until about 1912, the Credit Clearing House engaged in furnishing commercial reports based on a ledger interchange system. It is said that this company was an originator of ledger interchange, such as is now made available by credit interchange bureaus, trade credit bureaus, and other similar organizations. It operated very much like other agencies specializing in ledger information. It furnished reports consisting primarily of ledger experiences submitted by creditors, with a summary, in percentages, of the current investigation to which were added in a similar manner all previous clearings. Each member was required to register with the agency the names of his customers, and obligated himself to report his experience whenever one of his accounts became the subject of an inquiry. In return for his contribution a copy of the report summarizing the data thus assembled was furnished each contributor. To keep absolute accuracy each member specifically agreed to substantiate all or any of the items submitted should he be called upon to do so.

While the information gathered consisted primarily of ledger figures, subjects occasionally furnished their financial statements. These were added to the report without any attempt at analysis and interpretation. In addition, the Credit Clearing House supplied its subscribers with derogatory information similar to that given by general mercantile agencies.

Development of the Credit-checking Service.—Beginning with about 1912, the Credit Clearing House commenced to withdraw from the field of furnishing ledger interchange information and by 1914 it had perfected a new kind of service which was in a measure the outgrowth of the older ledger interchange system. Prior to that time it was discovered that a great many credit men, after receiving ledger interchange reports, would still wish advice and counsel that would assist them in arriving at a decision as to whether or not an order in question should be accepted on

a credit basis. Subscribers gradually began to call upon the Credit Clearing House for advice and counsel. The demand became so great that a special department was established to give subscribers the benefit of their judgment concerning the interchange reports. This service of supplying advice was gradually enlarged upon until in the early twenties it superseded all other services previously rendered by the organization.[1]

Credit Checking.—Credit checking is a service which calls for a decision by the Credit Clearing House which renders an opinion as to whether or not a given order should be accepted and shipment made on a credit basis. Under this system the subscriber calls the credit-checking service when he receives an order from one of his customers. He is then advised of the disposition that should be made of the specific order. Such advice or recommendation may be issued in some twenty different ways, all of the various forms of recommendation being simply variations regarding the main decision as to whether to ship or to decline the order.

In 1924, the Credit Clearing House began writing a new form of contract for the credit-checking service, providing a guarantee to clients in case they suffer losses from bad debts because of error in advice on the part of the Credit Clearing House. Accordingly, a guarantee fund was established in connection with this new contract. This fund was accumulated through the deposit of a certain percentage of the money received from subscribers who purchased that particular form of contract. An initial deposit into the fund was made by the company itself. It was estimated that this fund would provide sufficient money to pay all losses accrued to holders of guaranteed contracts. Obviously, this "guaranteed credit checking," as the service has sometimes been called, was in some respects a combination of credit insurance and credit-checking service, although from a technical point of view it could not be regarded as an insurance policy. The guarantee feature was finally discontinued in 1926.

Credit checking is built on the principle that by centralizing purchases and by recording all of the orders placed by a given merchant, it can be more accurately determined whether or not the merchant is meeting his obligations in a manner that would entitle him to credit on his purchases.

The credit investigations of the Credit Clearing House are made in the usual manner by requesting a statement of financial condition, with references. After the information is received, it is then referred to one of the credit men who analyzes the statement of the merchant and

[1] Much of the information concerning the Credit Clearing House and its activities was obtained directly through correspondence with Kenneth G. Silliman, Director of Service, R. E. Zilske, executive vice-president, and Mason Barlow, President of the Company, whose assistance is hereby acknowledged with appreciation.

determines his paying habits from the references submitted. The result of this analysis determines whether the merchant's account can be recommended favorably or unfavorably. If the account cannot be recommended favorably, the vital reasons for declining it are given in summary form, but in no case are figures or copies of statements submitted to subscribers (see Fig. 23).

Advantages of the Credit-checking Service.—This service obviously has its advantages and limitations. Concerns whose volume of business does not warrant the employment of a credit manager may find the service of much value. There are other firms that may not wish to establish and maintain a credit department. For all such organizations the system of credit checking supplies a real need. Again, there may

OFFICES IN ALL PROMINENT TRADE CENTRES

THE CREDIT CLEARING HOUSE

EXECUTIVE OFFICES 15 VANDERBILT AVENUE, NEW YORK N.Y.

CONFIDENTIAL

99,900-0 1-11-37-KR

IN RE: JOHN DOE, SMITHVILLE, VA.

$250 com a/c

Answering your inquiry:

We recommend that you ship this order. Current information is satisfactory.

THIS RECOMMENDATION COVERS THIS ORDER ONLY.
INQUIRE ON ALL RE-ORDERS.

R-16

IMPORTANT—
NOTIFY US IF ACCOUNT BECOMES 30 DAYS PAST DUE.
INQUIRE IF YOU RECEIVE CHANGE OF RECOMMENDATION.

THE CREDIT CHECKING DEPARTMENT.

FIG. 23.—Sample recommendation of the Credit Clearing House, used in connection with its credit-checking service. This is one of several forms of result slips used in conveying the company's recommendations.

be individuals engaged in business who are unfit, by ability or experience, to handle complicated situations, or who are utterly unfamiliar with the methods of credit management. For such people credit checking saves much time and worry, especially when an immediate ruling on a doubtful risk is urgently demanded.

Disadvantages of Credit Checking.—Probably the greatest objection to a system of credit checking supplied from without is the effect of such service upon the sales volume of the subscriber, particularly when the agreement provides for a guarantee against losses from bad debts. Under such circumstances the agency is likely to exercise great care and caution in rendering decisions on account of the risks involved. This ultraconservative attitude may cause a curtailment in the volume of business of its subscribers. The success of the agency will be proportionate to the amount of loss incurred and is not so much tied up with the volume of business done by the subscriber. Keeping losses down to a minimum is, however, only one of the functions in credit manage-

ment. The other function, that of maintaining as high a sales volume as possible, is fully as important and must not be neglected.

Another objection to credit checking is the difference in standards of various creditors. Inasmuch as the margin of profit varies with different houses, and, since the experience of different firms in connection with credit risks also varies considerably, credit standards used for the measurement of risks are bound to differ with different concerns, but, so long as orders are checked by an outside organization, they are likely to be based on a single standard for all creditors who are subscribers for the service, obviating the use of independent, intelligent judgment by subscribers.

In the third place, credit managers ordinarily desire to have all the facts on which judgments are based. Their individual interpretation of such facts might vary considerably from the interpretation given by the Credit Clearing House.

Finally, credit checking is objectionable because it tends to accentuate a situation which has already reached an acute stage, by widening the gap between selling houses and their customers to a greater extent. Lack of complete information concerning customers enhances the difficulties on the part of sellers in dealing with them. These objections to the credit-checking service apply, of course, only when credit departments are maintained by sellers in their own establishments. They have no reference to firms that are too small, unwilling, or unable to develop their own credit departments, or to those firms operating on a basis which requires an immediate decision on an order.

Other Services of the Credit Clearing House.—In 1931 the company began to add other services to that of credit checking. Whether the change resulted from the inadequacy of or disappointment with the credit-checking service it is difficult to say. The first attempt to supplement "credit checking" was by means of "Credit Analysis Reports" which make a recommendation and summarize the information in the files relative to the name in question. These reports are usually divided into two parts, the first headed "Analysis" and containing antecedents and paying habits summarized into a paragraph rather than listed individually. The second part is called "Financial" and usually gives a financial statement for at least 1 year and comparative data on total assets, total liabilities, net worth, current assets, and current liabilities.

Another form of report, introduced in 1933, is known as the "Credit Clearing House Digest." It is a compromise between credit checking and the analysis report. It is especially adapted for manufacturers and jobbers of women's and children's ready-to-wear. A recommendation is followed by a brief statement of the facts in possession of the agency, including the latest financial statement along with changes in the financial structure, method of payment, sales, and expenses.

Not only has the Credit Clearing House returned to the more orthodox methods of furnishing credit information, in modified and improved form, of course, but it has gone all the way and in 1934 issued its first rating book, which introduced a somewhat different and apparently well-conceived plan of ratings. Three symbols are used, a letter showing capital as reflected by net worth, a number indicating the working capital position of the risk, and another number summarizing the current payment experiences of creditors (see Fig. 24). In addition to the ratings proper, a special character preceding the letter in the rating that indicates capital is given to designate accounts with substantial investment in real estate or other forms of property that are not applicable to working capital. Furthermore, other symbols, usually in the form of letters preceding the name of the risk, indicate the line of merchandise carried by the subject and whether the concern is in the retail or wholesale business, and so on. The rating book is published quarterly.

KEY TO RATINGS

The rating appears in the column on the right of the name, and is figured on three points: *First*, total net worth. *Second*, analysis of working capital. *Third*, payment record.

NET WORTH

A	1,000,000 or over
B	750,000 to 1,000,000
C	500,000 to 750,000
D	350,000 to 500,000
E	250,000 to 350,000
F	200,000 to 250,000
G	150,000 to 200,000
H	100,000 to 150,000
J	75,000 to 100,000
K	50,000 to 75,000
L	35,000 to 50,000
M	20,000 to 35,000
O	15,000 to 20,000
P	10,000 to 15,000
S	7,500 to 10,000
V	5,000 to 7,500
W	3,000 to 5,000
X	1,000 to 3,000
Y	Less than 1,000

§

In some cases the symbol § precedes the rating. That is used only when an important part of the total net worth is represented by real estate equities or other assets not usually considered as working capital.

WORKING CAPITAL ANALYSIS

1st—Excellent
2nd—Good
3rd—Fair
4th—Restricted
5th—Limited

The Working Capital Analysis grades the working or operating position within the numbers 1 to 5. To arrive at one of these positions from 1st to 5th, an account is judged to be excellent, good, fair, restricted or limited in relation to the indebtedness, volume of business, trading opportunity, etc., etc.

PAYMENTS

1st—Prompt 2nd—Fair 3rd—Limited

1—Payments must be prompt or discount to get a "1st" payment rating.

2—Payments are graded "2nd" when they are not always prompt but are considered fair for the line.

3—Usually indicates slow payments.

FIG. 24.—Key to ratings used by the Credit Clearing House.

The company also furnishes its subscribers with a weekly publication, *Credit*, that contains information on purchases, payments, and conditions of indebtedness in every section in the United States, as well as other matters of interest to credit men in the trades served. Each month a list of failed accounts is prepared for the benefit of subscribers, showing the date and nature of the failure, date of the last checking on the account, the recommendation that was given at the time, and the reason for failure.

SPECIAL MERCANTILE AGENCIES IN THE PRODUCE BUSINESS[1]

As may have been gleaned from the foregoing, there are so many special mercantile agencies in different lines of business that it would be impossible to discuss all of them in the brief scope of a single chapter. It is believed, however, that a brief treatment of the two leading mercantile agencies in the produce business, in addition to the discussion

[1] Much of this information was secured from "The Special Mercantile Agencies," an unpublished thesis presented by W. C. Brown to the Ohio State University for the degree of Master of Business Administration. The survey was conducted and the work done under the direct supervision of the author of this book.

of the National Credit Office and the Credit Clearing House, will aid one in an understanding of the multifarious activities and economic significance of special mercantile agencies.

Produce Reporter Company.—This company was established in 1901 and its first Blue Book giving ratings on names listed was published in 1904. Its headquarters are in Chicago, and it reports on dealers in fruits, vegetables, and other food products in the United States, Canada, and Cuba. Information is collected from Blue Book users, the trade at large, and from reports of trained investigators, representatives, district managers, and correspondents. Other facts are secured in actually handling cases of adjustments, inspections, collections, and arbitrations. In addition to the usual information collected by special mercantile agencies, facts are obtained on rejections, claims, adjustments, and packing.

The information is furnished to subscribers, first, through the rating book. The rating book is kept up to date by means of Credit Sheets mailed each week, containing important changes in ratings, new names, slow "pays," unwarranted rejections, bankruptcies, all other vitally important information. These sheets are consolidated into Supplements three times a year and furnished to subscribers. Confidential reports supplement and elaborate the Blue Book ratings, giving antecedents, trading record, and financial data. The first 50 reports of this type are included in the original subscription price, the cost of each additional report being $1. Special Advance Reports are supplied to members who have submitted a list of names on which they wish to keep informed by telephone, telegraph, or mail. Exchange Bulletins containing items of interest concerning the market for various produce items and an interpretative summary of political and economic trends affecting the industry are mailed each week to subscribers. Business opinions are offered regarding questions of trade practice, drafts are supplied for collection purposes, and the facilities of several departments are made available to members, for a nominal fee, in collecting accounts, in obtaining a news service, in making adjustments where a carload of merchandise is rejected, and in inspecting the grading and condition of produce as a basis for adjusting disputes. The arbitration board settles misunderstandings and the traffic service handles traffic matters including claims against the carriers.

A "trading membership," which can be obtained only by outstanding shippers, receivers, jobbers, and carlot buyers whose reputation for reliable dealings and financial and moral integrity are well established, entitles the holder to use of the "Gold Standard" seal which gives the user prestige in the trade. Furthermore, such members are shown in the Blue Book in prominent type.

The Packer Produce Mercantile Agency.—This company operates much like the Produce Reporter Company, but its membership is much broader. It serves all those having to do with the production and distribution of fresh fruits, vegetables, eggs, poultry, butter, cheese, hides, wool, furs, nuts, and other produce, and includes cold storage houses in which such goods are deposited and manufacturers of materials and supplies used in the growing, packing, shipping, and distribution of these products. A central office is maintained in Kansas City, with branches in New York, Chicago, Cincinnati, and Los Angeles. The Packer Produce Red Book was first published in 1925 and is composed of two sections. The first section contains over 200,000 names and addresses, showing for each name the financial strength, reputation for payment and ethical business methods, in what capacity the business operates, whether as a receiver, shipper, etc., number of cars shipped or bought yearly, and commodities handled. It also shows the date the business was incorporated. All this is given in brief space by means of symbols. To illustrate, a rating such as the following:

Brown & Co. (1923) 10M XX
Rec. 15 A.

would mean that the company was incorporated in 1923, has a net worth of $10,000, enjoys a fair reputation for payment and ethical business methods, is a receiver, handles 15 cars a year, and deals principally in apples. The second section of the rating book lists, by states and commodities, the growers and shippers, accompanied by the same type of information as is given in the first section. In all other respects the services of this agency are similar to those of the Produce Reporter Company.

Selected References

CHAPIN, A. F.: "Credit and Collection Principles and Practice," Chap. 13.
ETTINGER, R. P., and GOLIEB, D. E.: "Credits and Collections," Chaps. 11 and 12.
PRENDERGAST, W. A., and STEINER, W. H.: "Credit and Its Uses," pp. 152–162.

Questions and Problems

1. How do special mercantile agencies differ from the general agencies?
2. Classify the various special mercantile agencies and give examples of each type.
3. Compare the rating books of the special mercantile agencies with those of Dun & Bradstreet.
4. Some special mercantile agencies furnish only unfavorable experiences. How valuable is such service? What are the chief weaknesses of the plan?
5. What are the purposes of supplement sheets? What kind of information do they generally contain?
6. Show that specialization may be both a strength and a weakness of the special mercantile agency.

7. In what ways are special mercantile agencies superior to the general mercantile agency? In what respects are they inferior?

8. Describe the extent of service and nature of operations of the National Credit Office.

9. Point out some of the peculiar features of the National Credit Office, and appraise them from the creditor's point of view.

10. Describe the nature of the credit-checking service, such as rendered by the Credit Clearing House.

11. How do you explain the relative success of the credit-checking service in the dry goods field? Would it be equally successful in other lines of business? Give reasons for your answer.

12. As a credit manager for a flour mill selling its products to wholesalers, bakers, and retailers, what would be your attitude toward a credit-checking service for your company? Explain.

13. If you were in the lumber and millwork business, would you subscribe for the services of a special mercantile agency in preference to those of a general agency? Explain your decision.

14. What special mercantile agencies are located in your city? State?

CHAPTER XIII

DIRECT INTERCHANGE AMONG CREDITORS

Need for Ledger Experience.—Information secured from the mercantile agencies intends primarily to answer the query regarding a customer's ability to pay his bills at maturity. It does not purport to determine satisfactorily his willingness to do so as evidenced by the manner in which his current obligations are actually being met, although substantial progress is to be noted in that direction. It is true, to be sure, that trade information alone is sometimes not a sufficient basis for the extension of credit, for numerous instances can be cited of unreliable merchants, who have deliberately developed a good credit standing by meeting their current obligations promptly and in a satisfactory manner solely for the purpose of ultimately utilizing that preferred credit position for questionable and improper ends. Again, merchants are to be found whose current obligations are discharged with great promptness but whose antecedents call for extreme care and caution in dealing with them on credit terms, since past questionable practices may be repeated to the detriment of the creditors. On the other hand, unfavorable reports concerning a debtor's paying habits, unless distinctly inferior, should not entirely preclude the establishment of business connections on a credit basis. Unfortunately, there are still many traders whose financial and moral responsibility is proved beyond the shadow of a doubt but whose manner of meeting their bills by reason of carelessness is apparently unsatisfactory. Were a report on trade experience to be followed blindly, much profitable trade would necessarily be diverted to competitors who are more awake to the possibilities of ultimately developing such merchants into prompt-paying customers.

Notwithstanding all of these limitations and deficiencies, trade information is regarded, in the judgment of an ever-growing number of experienced credit managers, as the most valuable basis for credit decisions available to manufacturers and jobbers who sell on time. Most of these merchants are at present participating in some form of system whereby ledger experience is secured. Also, it is widely recognized in the business world that a customer's record of purchases and payments, assuming completeness, is frequently of much more help in intelligently analyzing credit than the combined data of the rating books and agency reports. The degree of freshness and reliability of the information thus secured is one that especially recommends its widespread use and partially

accounts for its tremendous development, for it is generally conceded that knowledge of a trader's current activities as reflected in the record of his present purchases and payments is far more valuable than his antecedents or even capital resources.

Securing References.—To ascertain who the creditors of a merchant are, several means are available to the interested party, most of which may be utilized simultaneously with no little profit.

The simplest way is to ask the debtor himself for references, including names of merchandise creditors. The list thus furnished, however, is likely to be limited and of relatively little value, save for the leads which it may contain, for too often, and naturally so, customers select only the names of those whose attitude is highly favorable.

The nature and type of the business in which the debtor is engaged ordinarily suggest types of selling concerns to whom he is probably known. For instance, were a dry goods name being investigated, it would be safe to assume that some of the well-known houses handling knit goods, notions, gloves, hosiery, and underwear would have dealings with the risk. A third and common method is to secure supplementary lists of references through traveling salesmen or traveling credit representatives. Banking houses may quite readily discover the names of concerns selling the subject in question by glancing over canceled checks, if the merchant under investigation is one of the bank's own accounts. Canceled "trade checks" constitute one of the most important sources of securing references and are highly valued by banking institutions.

METHODS OF DIRECT INTERCHANGE

Merchants, manufacturers, and jobbers, to secure the judgment of a trader's creditors as to his business standing, in a way other than through the mercantile agencies, have either associated themselves for the purpose of providing some sort of a system by which ledger experience may be gathered and cleared for the benefit of the members, or have cooperated to this end without the intervention of an intermediary. The former method forms the topic to be discussed in Chap. XIV. For direct interchange among credit grantors, several ways are open to those seeking information:

1. The inquiring creditor may obtain ledger experience orally:
   a. By personal contact with the creditors in question.
   b. Through the agency of a credit department investigator.
   c. Through trade group meetings.
2. The end of securing ledger information direct from credit grantors may also be attained through correspondence.

Personal Contact.—The simplest yet perhaps the least satisfactory means of credit interchange among creditors is through personal contact

of the inquiring party with the credit managers who are known to have had experience with the subject of the inquiry. This method often results in a multiplicity of investigations, especially when the credit risk is undergoing changes the probable effect of which is to weaken his financial condition. Besides, too much valuable time of the occupied credit manager would have to be devoted to the process of calling for or furnishing credit information were this method to be widely adopted.

The Credit Department Investigator.—Practically all banking institutions of substantial size, and many large commercial houses as well, have found it advantageous to use the services of one or more men whose principal duty it is to assist the credit manager in obtaining ledger experiences and opinions of other creditors by going after the information instead of waiting for it to come to them. The office of this investigator may also be used for the purpose of collecting data concerning the status of lines of business in which his concern has a special interest. Investigators usually confine their activities to local houses and visit mercantile establishments and banking institutions to whom they think the subject of the inquiry may be known. Banking houses employ credit department investigators also for the purpose of interviewing commercial-paper brokers with a view of selecting desirable names and eliminating those which prove to be inferior. In many instances brokers are not used; hence, the most important interview is with banks who have had dealings with the house in question. Information secured from banks is sometimes the only available or reliable supply open to the investigator. These investigators are also employed to a large extent whenever revisions of folders are made.

Information Secured by Investigators.—The points covered in making an investigation vary naturally with the type of creditor interviewed. Should the investigation be conducted in trade circles, the following information is generally sought for:

1. Age of the account. In this connection it should be borne in mind that the longer the account has been on the books, the more valuable the information obtained becomes.

2. The highest recent credit extended the subject of the inquiry. This denotes the credit manager's opinion of the risk in question.

3. Manner of payment and terms of sale. Knowledge of these facts is an excellent indication of the desirability of the applicant's trade.

4. Current status of the account, representing the state of its activity, amount of indebtedness, and the like.

5. Opinion of the creditor regarding the financial responsibility and personnel responsible for the management of the subject's business. This is of much value, particularly when supported by intimate actual knowledge.

6. Trade abuses, such as cancellation of orders without cause or returning goods upon pretext that defects have been discovered, and all other practices which reflect moral turpitude and general corruption.

As in cases of interviews with merchants, no definite sets of questions should be religiously adhered to in interviewing bankers, for the risks differ so widely as to require varying degrees of knowledge. Nevertheless, a few significant points may be profitably suggested. These are:

1. Age or length of the account.
2. The line of credit extended.
3. Highest amount extended.
4. Current indebtedness.
5. Character of balances maintained, for consistently low cash balances usually reflect an impaired cash position and lack of working capital. On the other hand, consistently high cash balances are evidence of inactivity and dullness.
6. The degree to which the subject is dependent on the bank. This knowledge can be gained from a determination of whether or not the concern "cleans up" its borrowing, and for how long. Since commercial banks, as pointed out in an earlier chapter, base their loans on seasonal demands, they naturally expect borrowers to be off their books for at least one month during the year. Failure to do so, except during periods of depression, denotes a high degree of dependability on the bank for necessary working capital.
7. General opinion of the management and quality of the account.

Trade Groups.—A highly convenient way for creditors selling in the same market to exchange ledger and other valuable facts is afforded by the meetings to be described presently. These gatherings are usually restricted to members of the respective local credit men's associations, each of which conducts one or more meetings at frequent intervals, usually weekly or semimonthly. Thus, all creditors selling to grocers, bakers, general stores, and allied lines of trade form a provisions division, consisting of wholesale grocers, meat packers, produce dealers, etc. In the larger cities the Credit Men's Association may have organized as many as a dozen or more trade groups, such as women's wear, dry goods, furniture and hardware, printers and stationers, etc.

The purpose of group meetings is to offer a ready means of exchanging information respecting applicants for credit, slow-pay customers, and all accounts which show abnormal and hitherto unexpected developments. Each of the participants turns in to the group chairman the names of the accounts on which further information is sought, stating the reason for his action. As the name of the inquiry is called off, all those who previously have had experience with the subject voluntarily relate their experiences. In some cases every member receives a number to report by. Where the trade divisions are large,

a limit is placed on the number of delinquent accounts or first orders that may be brought up by any one member. It should be noted that not only ledger data enter into the discussion, for an extremely important phase of the work is the exchanging of confidential facts gained through personal contact by some of the participants with the risk in question, involving at times a most intimate knowledge of strictly personal affairs that may be either favorable or derogatory. Many other important actions are sometimes taken during these gatherings. Thus, it is not uncommon there jointly to arrive at a decision to place an account in the hands of the adjustment bureau, or to throw a debtor into bankruptcy, or to take other measures which require concerted action.

Supplementary Features of Trade Groups.—While the interchange of credit information is the basic service of trade groups, these gatherings also serve other useful purposes. They are often used as a medium for bringing about much needed standardization in credit practices; for the regulation of trade abuses; the concentration of claims for collection, investigation, prosecution, and adjustment; for the promotion of educational and research work; and for such other matters as may be deemed desirable to discuss. They truly afford an excellent means of elevating the work of the credit manager, even to a higher plane from the standpoint of both efficiency and ethics.

Advantages of Oral Interchange.—Speed in obtaining the desired facts is the principal advantage of this sort of investigation. The value of quick action in passing upon a risk is deeply appreciated by credit managers and needs, therefore, no especial emphasis. A second advantage consists in the freshness of the information thus secured. The consensus of opinion of other creditors constitutes no negligible aid in arriving at a decision respecting a doubtful account.

A third advantage is the superior quality of the information usually obtained through oral investigation. Facts which are communicated sparingly for general circulation are often divulged verbally to the credit manager or his representative. Other information which discretion would forbid appearing on paper may be imparted occasionally in a similar manner. Assuming confidence in the inquiring party, the interview attains the maximum of confidential interchange, the benefits of which, because of the reciprocity commonly practiced, inure to both parties to the interview. Finally, personal contact among credit men tends to foster and encourage cooperation, which is, in a sense, the life blood of credit work. It causes them to appreciate more keenly the hopelessness of individual effort on the one hand and the benefits derived from concerted action on the other.

Objections to Oral Interchange.—Foremost among the disadvantages is the multiplicity of investigations. A widespread adoption of this means of securing credit data would necessarily place a heavy burden on

the valuable time of credit managers and cause unnecessary duplication. Again, when many inquiries are made concerning a credit risk, especially when that party is not in a particularly strong financial condition, suspicion of other creditors is likely to be aroused, thereby unduly embarrassing the subject of the inquiries. Then, too, the system lends

Kindly give us below YOUR EXPERIENCE with

Name_____ **Business**_____

P.O._____

From whom we have_____ **order for $**_____
(Indicate whether first order)

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

APPROVED AND ADOPTED BY
NATIONAL ASSOCIATION OF CREDIT MEN

To_____

	MANNER OF PAYMENT ANSWER—YES OR NO	
Sold since_____ **To**_____		
Terms _____	____	Discounts
Largest amount owing recently . . . . . .$_____	____	Prompt and satisfactory
Total amount now owing, . $_____	____	Slow but collectible
Amount past due, ... $_____	____	Slow and unsatisfactory
Other information_____	____	Days slow
_____	____	Accepts C. O. D.'s promptly
_____	____	Settles by Trade Acceptances
_____	____	Account secured
_____	____	Notes paid at maturity
_____	____	Makes unjust claims
_____	____	Collected by attorney

RETURN THIS TO US.

FIG. 25.—Form used for direct interchange of ledger experience among credit grantors.

itself to abuse, inasmuch as investigations may be conducted, not because of an existing interest in the account, but with a view to determining whether or not the subject's trade should be solicited.

Interchange by Correspondence.—Expediency often demands direct interchange of ledger experience among creditors by correspondence. To facilitate and encourage the system which makes for safe clearance of credit risks, the National Association of Credit Men has approved and

adopted a special form, and in addition has drawn up a number of rules for the strict observance on the part of both receiver and giver of credit information. Most of these rules are printed on the back of the forms.

The form used for direct interchange among creditors as recommended by the National Association of Credit Men consists of duplicate sheets containing identical matter, the first sheet being filled out by the maker of the inquiry, containing the ledger and other experience of the inquiring house. The top and bottom lines of this sheet contain the words, "We give you below Our Experience with," and "Retain This For Your Files. Give your experience on attached slip," respectively; whereas the top and bottom lines of the duplicate sheet contain the words "Kindly give us below your experience with," and "Return This to Us," respectively. In all other respects the two sheets are identical (see Fig. 25).

Objections to Direct Interchange.—Notwithstanding the advantages gained through close contact between the members of the Credit Men's Association which the direct interchange system induces, nevertheless many significant objections are to be found. Foremost among them is the tremendous multiplicity of investigations inevitably resulting therefrom. Considerable time, for both givers and receivers of information, would be required were this widely adopted as a means of securing ledger experience. The system is both burdensome and inconvenient, except when used sparingly to supplement information secured from other sources.

In the second place, numerous inquiries concerning a risk, particularly when in weak financial condition, may arouse undue suspicion in the minds of creditors inquired of, to the detriment of the subject under investigation, and ultimately prove injurious to themselves. In the third place, the system lends itself to abuse. No expense being involved in the matter, many unscrupulous credit managers are likely to take advantage of the situation and make indiscriminate investigations not only of existing accounts, but also of prospective customers.

Selected References

BREWSTER, S. F.: "Legal Aspects of Credit," Part IV, Chap. 17, Ronald Press Company, 1923.

MUNN, G. G.: "Bank Credit," Chap. 6.

PRENDERGAST, W. A., and STEINER, W. H.: "Credit and Its Uses," Chap. 8.

PRUDDEN, R. F.: "The Bank Credit Investigator," Chaps. 9, 10, and 11.

STEINER, W. H.: "Mercantile Credit," pp. 59–65.

Questions and Problems

1. What are ledger facts? Why should a credit manager be especially interested in such facts?

2. On which of the factors in the selection of credit risks do ledger experiences have a special bearing?

3. Each of customers A, B, and C buys approximately the same amount of merchandise from your house. Your terms are 3/10, net 60 days. A discounts his bills, B pays at maturity, and C is 30 to 60 days slow.

a. Which of these customers is the least profitable to your house? Can you prove your conclusion by the use of figures?

b. Which of the customers is entitled to preferential treatment from your firm? Why?

4. You are in receipt of a first order from the Blank Company, located about 125 miles from your city. You are desirous of obtaining the experiences of other creditors who have had dealings with the prospective customer. How can you obtain the names of such creditors?

5. What constitutes a trade group for credit interchange purposes? How valuable are trade group meetings?

6. To what extent would you deem it advisable to increase the number of trade groups?

7. Would your answer to the above question be influenced by the size of the local association of credit men? What other factors may influence your decision?

8. List all the methods available for the interchange of credit information among creditors without the intervention of any outside agency.

9. Should direct interchange among creditors be encouraged or restricted? Explain.

10. What degree of control is now being exercised over the direct exchange of experiences among creditors, and by whom?

11. How important a position would you assign to the direct interchange method among the various creditors?

12. Point out the principal advantages and weaknesses of the direct exchange of ledger experiences among credit managers.

CHAPTER XIV

CREDIT INTERCHANGE BUREAUS[1]

Historically, direct exchanges of credit information among creditors came first, but, as shown in Chap. XIII, this method has its weaknesses and limitations. To obviate the difficulties incident to the direct exchange of ledger experience among credit grantors, a number of intermediaries have developed. While trade opinions or ledger experiences were always obtainable to some extent from the mercantile agencies, few organizations existed prior to 1900 with the sole object of collecting quickly and with a minimum of effort complete ledger figures and making them conveniently available to their respective members or subscribers. The greatest development of such intermediaries, specializing in the handling of ledger information, took place since 1915. At least two modes of securing ledger experience through some sort of a specialized bureau maintained cooperatively are at present at the disposal of the alert credit manager:

1. The credit interchange bureaus maintained by local associations of credit men.

2. Trade credit bureaus, reporting on a single line of trade or on a limited number of allied trades and maintained by trade associations.

CREDIT INTERCHANGE BUREAUS OF THE NATIONAL ASSOCIATION OF CREDIT MEN[2]

Early History.—The early organizations of this type were known as "reference bureaus," probably because they rendered no reports on creditors' experiences. When a member wanted information he called the bureau, secured the names of other creditors, and by direct communication obtained the necessary ledger facts. The first *bona fide* credit interchange bureau to have assumed the responsibility of soliciting information from creditors and issuing it to interested members in the form of reports is said to have been established in 1901.[3] Since that time such bureaus were being organized by different groups of business men

[1] The term bureau as used in this chapter refers only to cooperative enterprises specializing in ledger information and does not include the numerous agencies similarly functioning.

[2] Much of the information for the revision of this chapter was obtained through the courtesy of R. A. Colliton, Director of the Credit Interchange Bureau Department of the National Association of Credit Men.

[3] YOUNG, R., "Industrial Credits," p. 25.

or by trade associations to meet the growing need for such information on the part of creditors. For some years these bureaus operated on a local-market basis, but it was discovered that information confined to a single market or territory was not sufficient. Accordingly, in 1912 a central bureau was organized in St. Louis to enable the various bureaus, though independently operated, to exchange their reports and experiences and to make the clearances more valuable because of the wider area covered in the investigation. In 1919 this central bureau was taken over by the National Association of Credit Men, and in 1921 it began to function as a unit of the Association system under the management of the Credit Interchange Bureau Department. At first only 15 bureaus participated in the national system, but now there are no less than 55 such bureaus covering most of the major and minor markets of the country, and the tendency is to develop a single medium for the cooperative exchange of ledger information through some of the trade credit bureaus joining in the system of the National Association of Credit Men.

Organization and Purpose.—The purpose of the Credit Interchange Bureau system of the National Association of Credit Men, as set forth in some of the charters, is to provide an impartial medium between debtors and creditors and between creditors themselves, to establish a system whereby those who are interested in any accounts may freely and unreservedly interchange the facts contained in their ledgers: (1) without the necessity of direct reference, each to the other; (2) without divulging the information under their own name; (3) and receiving, in exchange for data contributed by them, a summary of experiences of all others interested in the account.

Each bureau is an independent corporation under the supervision and control of the officers of the local Association of Credit Men, is not organized for profit, and has charges for its services so fixed as to cover merely the cost of operation. In a few cases the operation of the bureau is under direct supervision of the National Association. All these bureaus, together with the Central Credit Interchange Bureau maintained at St. Louis, are under the supervision of a committee of the National Association of Credit Men and the manager of the Credit Interchange Bureau Department of the national organization. Each bureau is inspected annually by the manager of the Credit Interchange Bureau Department, and, in the event of emergencies or complaints on the part of one or more of its members, a special inspection may be conducted. The national office also retains the power to recommend to the local board of directors the dismissal of its bureau manager, under penalty of expulsion from membership in the National Association of Credit Men in case its recommendation remains unheeded unless satisfactory cause for ignoring it is duly given.

The membership of this bureau system is strictly limited to manufacturers, wholesalers, jobbers, and bankers, and the accounts dealt in are those of business firms and not of individuals.

Method of Operation.—Each member is designated by a symbol, usually consisting of a number. In a few instances the symbol constitutes a combination of a letter and number, *viz.*, D-65, the letter ordinarily referring to the trade division in which the member is classed. The tendency, however, seems to be in the direction of the former practice. It is needless to say that the key bearing the code numbers is carefully guarded so as to preclude identity of concerns reporting. Each individual firm, however, is notified of the code by which it is to be designated.

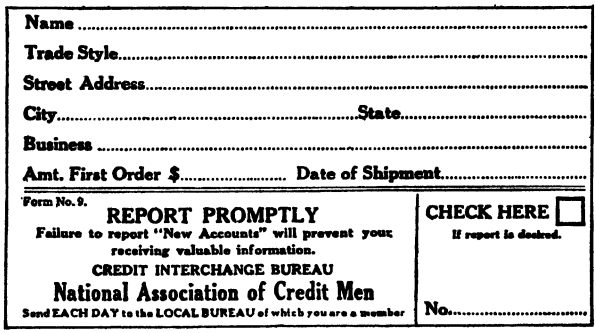

Name .....
Trade Style.....
Street Address.....
City.....State.....
Business .....
Amt. First Order $..... Date of Shipment.....
Form No. 9.
REPORT PROMPTLY
Failure to report "New Accounts" will prevent your receiving valuable information.
CREDIT INTERCHANGE BUREAU
National Association of Credit Men
Send EACH DAY to the LOCAL BUREAU of which you are a member
CHECK HERE ☐
If report is desired.
No.....

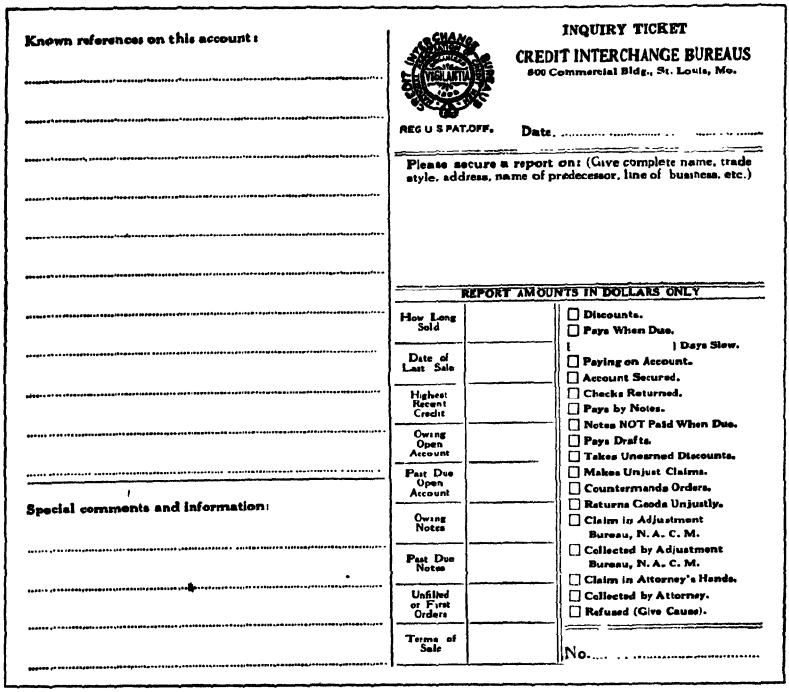
FIG. 26.—Report of a "new account" sent to the bureau.

One of the first requirements of new members is to file with the bureau a complete list of customers, so that a card may be made out immediately for each subject. These cards are arranged alphabetically in a customers' list file, and contain the name and address of the account and the symbols of the members doing business with him. To supplement the information originally submitted, members are also required to furnish records of first orders or new customers on forms provided for the purpose (see Fig. 26), for it is obvious that the prompt filing of new accounts is essential to a complete clearance. Members are also requested to supply the names of other known creditors at the time they make an inquiry.

At its inception, each local bureau is required to determine its zone of direct interest. Such a "zone of operation" usually embraces an area in which approximately 60 to 75 per cent of its members' business is transacted and may be regarded as the normal trading area of the market served by the bureau. The direct interest zone being definitely determined, the office forwards to the Central Bureau at St. Louis all names of customers who are located outside its own zone and who are dealing with its members. The Central Bureau, in turn, makes out a card for each extra-zone subject thus reported, containing the code numbers of

the various bureaus interested in him. In this manner, as will be seen shortly, the Central Bureau serves as a clearing house for the interchange bureaus of the entire system by maintaining a record of all markets, other than the local markets, of the customer, in which he is buying goods.

In addition to the customers' list card file, the bureau is provided with a report "folder file," containing master sheets, the separate items making up the master sheets, and several copies of each of the latest clearance reports. The folders are usually filed alphabetically, although



Known references on this account:

Special comments and information:

INQUIRY TICKET

CREDIT INTERCHANGE BUREAUS

800 Commercial Bldg., St. Louis, Mo.

REG U S PAT.OFF.

Date.

Please secure a report on: (Give complete name, trade style, address, name of predecessor, line of business, etc.)

REPORT AMOUNTS IN DOLLARS ONLY

How Long Sold	
Date of Last Sale	
Highest Recent Credit	
Owing Open Account	
Past Due Open Account	
Owing Notes	
Past Due Notes	
Unfilled or First Orders	
Terms of Sale	

- ☐ Discounts.
- ☐ Pays When Due.
- ☐ ( ) Days Slow.
- ☐ Paying on Account.
- ☐ Account Secured.
- ☐ Checks Returned.
- ☐ Pays by Notes.
- ☐ Notes NOT Paid When Due.
- ☐ Pays Drafts.
- ☐ Takes Unearned Discounts.
- ☐ Makes Unjust Claims.
- ☐ Countermands Orders.
- ☐ Returns Goods Unjustly.
- ☐ Claim in Adjustment Bureau, N. A. C. M.
- ☐ Collected by Adjustment Bureau, N. A. C. M.
- ☐ Claim in Attorney's Hands.
- ☐ Collected by Attorney.
- ☐ Refused (Give Cause).

No.

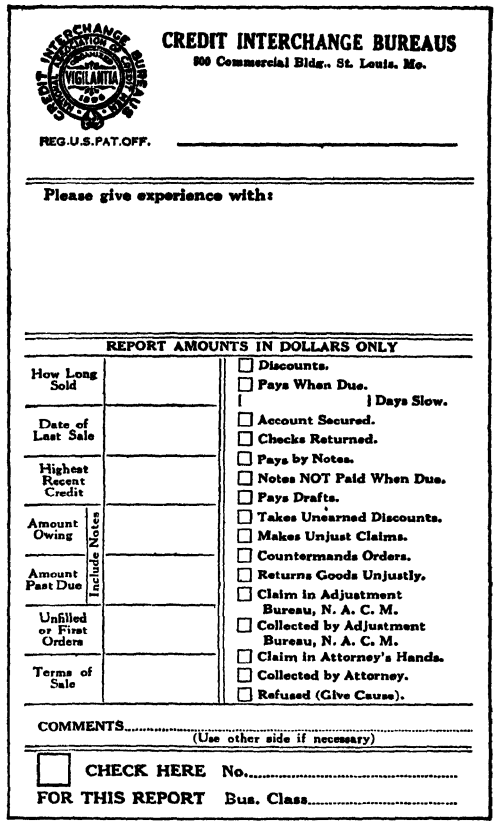
FIG. 27.—Subscriber's inquiry ticket.

a combination of geographic and alphabetical arrangement is not uncommon.

Inquiry tickets are furnished each subscriber. The use of these blank forms is restricted to current accounts and to prospective customers whose applications for credit accommodations are actually in hand. Furthermore, the inquiring party is required to submit his experience with the subject each time an inquiry is made and to list all known creditors of the risk. Every inquiry ticket is signed by placing the inquirer's code in the space provided for the purpose in the lower right-hand corner of the form (see Fig. 27).

Upon receipt of an inquiry ticket, the report file is immediately consulted and a copy of any report or reports, regardless of age, in file

at the time, is furnished immediately. Since several requests may come in for information concerning the same subject, it is customary and convenient to maintain in the folder file extra copies of all investigations. Should the last report prove out of date—over 90 days—or in the event no report is available concerning the subject of the inquiry, the customers' list card file is thereupon consulted with a view of determining from the code numbers appearing on the subject's card the names of members



CREDIT INTERCHANGE BUREAUS
800 Commercial Bldg., St. Louis, Mo.

REG.U.S.PAT.OFF.

Please give experience with:

REPORT AMOUNTS IN DOLLARS ONLY

How Long Sold		☐ Discounts.
		☐ Pays When Due.
		[ ] Days Slow.
Date of Last Sale		☐ Account Secured.
		☐ Checks Returned.
Highest Recent Credit		☐ Pays by Notes.
		☐ Notes NOT Paid When Due.
		☐ Pays Drafts.
Amount Owing (Include Notes)		☐ Takes Unearned Discounts.
		☐ Makes Unjust Claims.
		☐ Countermands Orders.
Amount Past Due		☐ Returns Goods Unjustly.
		☐ Claim in Adjustment Bureau, N. A. C. M.
Unfilled or First Orders		☐ Collected by Adjustment Bureau, N. A. C. M.
		☐ Claim in Attorney's Hands.
Terms of Sale		☐ Collected by Attorney.
		☐ Refused (Give Cause).

COMMENTS.....
(Use other side if necessary)

☐ CHECK HERE FOR THIS REPORT No.....
Bus. Class.....

FIG. 28.—Subscriber's reply ticket.

reported to have dealings with him. As soon as these code numbers are ascertained, a "subscriber's reply ticket" is sent to each of the members selling to the subject (see Fig. 28). A similar form is sent to nonsubscribers known to have dealings with the risk, possibly because such nonsubscribers have been given as references, with the promise that a copy of the completed report will be furnished in return for their respective contributions. In all cases, the name and address of the subject under investigation are filled in by the bureau.

When the reply tickets from creditors in the local market are returned to the office, the information is copied and tabulated on a master sheet, usually with duplicating ink, by means of which a sufficient number of copies may be made on a ditto machine. Upon completion of this task, a copy of the preliminary report is mailed to the member making the inquiry.

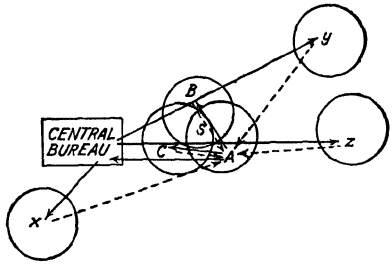
To complete the investigation, additional ledger facts must necessarily be secured from creditors located outside the bureau's own zone of operation. To accomplish this, two additional steps must be taken. Each bureau is furnished with a zone map from which it can readily be ascertained whether or not other bureaus consider the subject of the inquiry as residing within their respective zones, for zones of direct interest are often overlapping. An "Interoffice and Central Bureau Inquiry Ticket" is thereupon forwarded to each of the bureaus within whose zones the customer in question is located. These bureaus assemble the information in their respective territories in a fashion similar to that described in previous paragraphs, and the filled-in forms are mailed direct to the inquiring bureau just as received from the various reporting houses, without any attempt on the part of the answering offices to tabulate the data assembled, thereby resulting in a substantial saving of expense and labor, and inducing prompt replies.

In order to determine the extent of a subject's activities in markets other than those situated within the several zones in which he is located, an "Interoffice and Central Bureau Inquiry Ticket" is addressed to the Central Bureau at St. Louis, whose function it is to determine from its card file the various bureaus reported to have dealings with the customer inquired upon. As already indicated in another connection, the Central Bureau acts as a clearing house for information from offices outside of whose zones the given customer resides. An interoffice ticket is then forwarded by the St. Louis office to each of the bureaus whose code numbers appear on the customer's card, requesting a clearance within their respective zones for the benefit of the inquiring bureau, to which the information as received from the various reporting firms is mailed direct by the respective answering offices.

In the event a preliminary report has already been issued, supplements to the original are subsequently made up of the additional experiences as they are received from outside bureau points and mailed to the inquiring member. When all information has been collected, a final report is prepared and furnished the inquiring member, and a free reciprocal copy of the final report is also furnished each contributor of ledger data. Thus the credit interchange clearance becomes an up-to-date account of the risk's buying and paying habits with all his creditors whose identity

it has been possible to discover through bureau members or through references supplied by the inquiring member and other members.

In order to comprehend clearly the modes by which clearances are made and reports compiled in response to an inquiry by a member, the following diagrammatic illustration is submitted:



In this illustration *A* represents the bureau receiving an inquiry from one of its members concerning the subject *S*, who happens to be located within three bureau zones as delineated by the circles. The solid lines indicate the routes followed by requests for information mailed by *A* and the Central Bureau at St. Louis, respectively, while the broken lines show the routes followed by the replies to the inquiries (see also Fig. 29). If a copy of a previous report is in file, the bureau which clears an inquiry communicates directly with the other bureaus shown on the report.

Contents of a Credit Interchange Report.—The ledger facts gathered from the various sources described are tabulated by geographical units, under each of which the proper reporting firms are listed more or less indiscriminately. The report gives in the first column the line of business of each contributor. Then follow the individual experiences, showing length of time sold the account, date of last sale, highest recent credit extended, amount now owing, amount past due, whether there are unfilled or first orders in hand, terms of sale, manner of payment, and comments. Under "manner of payment" three classifications are to be found, into which all customers may be conveniently divided. These purport to show whether the subject discounts his bills, pays promptly at maturity, or permits his accounts to lapse into slowness. If slow, the extent to which that is true is indicated, usually in days.

Changes in payment and similar data of material significance, either favorable or derogatory, are generally included in "comments." This item, consequently, discloses whether claims against the subject have been placed in the hands of an attorney or a collection agency, whether the subject returns merchandise unjustly, whether further credit has been refused, and the like (see Fig. 30).

Interpretation of a Credit Interchange Report.—Unlike some of the agency reports, credit interchange reports never present any analysis

or interpretation nor do they offer any recommendations or express opinions. They merely present the facts as recited by creditors, arranged in an orderly manner for a quick and intelligent appraisal. Since they do not present anything but an uncolored and impersonal statement of experience of contributing creditors, it becomes essential for the individual credit executive to analyze and interpret the contents as a basis for action. In the paragraphs that follow an attempt will be made to point out the

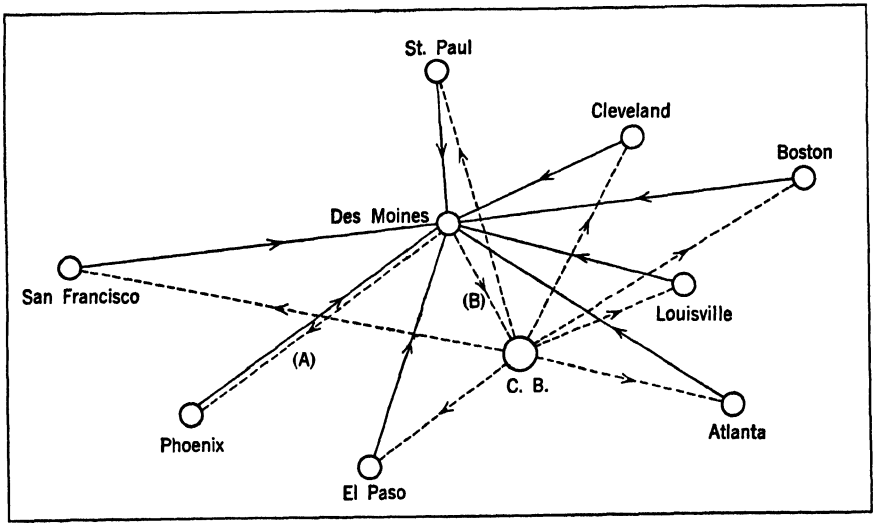


FIG. 29.—Example illustrating the regular procedure in making a clearance by the credit interchange bureau. (*Courtesy of the National Association of Credit Men.*)

Illustration of the procedure followed in clearing an inquiry for the Des Moines Bureau on a subject buying in the markets shown on the chart, and on which there had been no previous inquiry.

(*A*) The subject of inquiry is in Arizona. Phoenix is the zone of operation Bureau. Therefore, Des Moines sends an inquiry direct to Phoenix. (*B*) Des Moines notifies Central Bureau of the inquiry. Central Bureau then notifies all other interested Bureaus. These Bureaus send information they gather from members direct to Des Moines.

valuable information that is contained in each column of the report. Additional facts can be gained when each column is read vertically, and horizontally in conjunction with one or more of the other columns.

Business Classification.—From the data in this column, the wide-awake credit manager may visualize the kind of business in which the risk is engaged and the proportionate composition of his stock of goods. An opportunity is also afforded to study the distribution of purchases between various markets and the reasons therefor. Under each market heading is a code date which establishes the time on which members in that market were canvassed for information. For example, in the

specimen report shown in Fig. 30, Louisville is shown as the first market. The first section of the number appearing under its name, *viz.*, 322, indicates that the creditor supplied the information on or before Mar. 22,

CREDIT INTERCHANGE BUREAUS

NATIONAL ASSOCIATION OF CREDIT MEN

Executive Offices: One Park Avenue, NEW YORK, N. Y.
Central Bureau: 214 N. Sixth Street, ST. LOUIS, MO.

REG U. S. PAT. OFF.

The accuracy of this Report is not guaranteed. Its contents are gathered in good faith from members and sent to you by this Bureau without liability for negligence in procuring, collecting, communicating or failing to communicate the information so gathered.

REPORT ON:

ACTUAL REPORT - NAME & ADDRESS DELETED APRIL 5, 1937.

BUSINESS CLASSIFICATION	HOW LONG SOLD	DATE OF LAST SALE	HIGHEST RECENT CREDIT	AMOUNT OWING (INCLUDING NOTES)	AMOUNT PAST DUE (INCLUDING NOTES)	UNFILLED OR FIRST ORDERS	TERMS OF SALE	MANNER OF PAYMENT: DISCOUNTS	PAYS WHEN DUE	PAYS SLOW	COMMENTS
LOUISVILLE											
322-432											
MISC	Yrs	date	1911	1108				x			
PHILADELPHIA											
323-601											
MISC	1-36	3-37	50				2-15-30	x			
CNF	S.T.	3-37	173	172				x			
F.P.	Yrs	3-37	272	75				x			
CNF	9-35	10-36	58					x			
F.P.		3-37	600	476			10	Satisfactory			
TOB	Yrs	3-37	1435	1015			2-10-30				
CIG	8-34	3-37	2414	1615	1075	Feb.a/c	2-30	x usually			
CIG	Yrs	3-37	5000	5000			2-30	x			
NEW YORK VIA 9											
CNF	Yrs	3-37	4832	800			2-10-30	x	Takes unearned discounts		
CNF	8-34	3-37	1599	269			2-15-30	x			
F.P.	Old	3-37	20	6			2-30-31	x			
CNF	Yrs	3-37	988	702			2-15-30	x			
CNF	9-34	3-37	403	117				x			
CNF	9-34	3-37	500	335			2-10-30	x			
CENTRAL NEW YORK											
330-628											
CONF	Yrs	3-37	650	300			2-10-15		x		
PITTSBURGH											
324-681											
CNF	1 sale	9-36	25				2-10-30		x		
NEW ENGLAND											
325-299											
SUP	Yrs	3-37	137					x			
CONNECTICUT											
325-148											
CONF	Yrs	3-37	250	30			2-15	x			
				12020	1075						
BU 6 MJH											

FIG. 30.—Credit interchange report issued by the Interchange Bureaus of the National Association of Credit Men.

the creditors in the Philadelphia market, which is listed second, contributed the information on or before Mar. 23, and so on. The distribution of the subject's business among certain markets may have a bearing

on his buying ability, unusual sources of supply, whether the stock as reflected by his buying is likely to be broken up and of little value or orderly and of high salability. Purchases of regular merchandise from distant sources may indicate inability to buy on credit from local markets, or may reflect lack of business ability or inexperience. Finally, the facts in this column are of great significance in appraising the information in several of the other columns.

How Long Sold.—The length of time sold a customer has a significant bearing on the relative merit of a contributor's experience. Other things being equal, the value of the comments, as well as that of the statement concerning manner of payment, varies in direct proportion with the length of time over which dealings have extended. It also shows the degree of confidence creditors have in the subject. If an established business concern has been making first purchases from many creditors within a recent period it may indicate refusal of credit by former suppliers or preparation to defraud creditors.

Date of Last Sale.—Date of last sale or last shipment tends to disclose the customer's current buying activities. Unusual buying activity serves as a danger signal, calling for an immediate inquiry into its causes and purposes especially when it is shown in the How Long Sold column that the risk has recently bought from many new sources. The date of a last sale also denotes the recency of the information contributed by the house, thereby aiding in the exact determination of its relative value. This column sheds light on the manner-of-payment columns by indicating the trend of the account.

Highest Recent Credit.—The highest credit extended reflects the opinions and confidence of other creditors respecting the subject, and serves as a valuable guide, particularly when the experiences appear extensive from the standpoint of both time and sales volume. To ascertain the degree of confidence this column should be compared with the terms of sale and paying record. Slow payments may necessitate a high credit; extended terms have the same effect.

Amount Owing.—Obviously, one of the most important columns is that displaying the amount owing. Without a knowledge of a concern's aggregate indebtedness as revealed roughly under this heading, credit managers may be led to extend credit unwisely, because of the influence exerted by the action of other creditors in extending large lines to the firm in question. Checking the amount owing against the accounts payable item of the firm's balance sheet, if submitted by the subject, will tend to uncover fraudulent intents and designs, if any, prior to making shipment. Since the credit interchange report seldom covers the total indebtedness of the risk, the amount owing, as shown on it, should be much below the figure given on the balance sheet for

approximately the same date. When compared with the highest credit extended, the total amount owing indicates whether the subject is owing the maximum accommodations or is well within limits, considering seasonal and other variations. The trend is shown by comparing several reports on this item.

Amount Past Due.—If the ratio of past dues to amounts owing is high, the risk should be regarded with suspicion, and vice versa. Once an account lapses into slowness, the firm is in all probability weakening financially, particularly with regard to its working capital. Then there is the possibility of a past-due account becoming a partial or total loss.

A single amount past due may indicate that the account is in dispute, but when many suppliers report the account to be slow the information should then serve as a danger signal. Of special value is the ratio of the amount past due to the amount owing, for it indicates the probability of collecting an account on time. Thus, if the amount past due is $50,000 and the amount owing is $200,000, when the past-due amount is deducted from the amount owing we arrive at the amount currently collectible, or $150,000. By dividing this last figure by the total amount owing we obtain an index showing a 75 per cent collectibility. Consequently, a creditor selling to such a customer on 30-day terms may not expect payment until at least 10 days after due date, and a creditor selling on 90-day terms will find the bill past due at least 30 days after maturity. The data presented under manner of payment will corroborate the conclusion reached by this method.

Sometimes a relatively small amount owing may be shown, and yet the account may be in bad condition. This may be due to the fact that the majority of the bureau members reporting have collected their accounts and ceased to sell to the risk. For this reason, it is important to view this column in the light of the data in the column on date of last sale. If the above is substantiated and the manner of payment is unfavorable it may then be concluded that the risk's major indebtedness is to nonmembers who have not been privileged to secure the information that led members to stop selling to the subject.

Unfilled or First Orders.—The amount and number of first orders show the extent to which new credit is sought by the customer. If unusually large, except where the subject is just beginning in business or where justified expansion is known to take place, a thorough investigation into the causes should be conducted prior to accepting the order. In the course of such an investigation it is essential to ascertain whether the subject is shifting his purchases to a new set of creditors in order to elude settlement of his accounts, or whether he is stocking up with merchandise preparatory to making an assignment or voluntarily going into bankruptcy. The report itself may unmistakably reveal these

intentions, when properly interpreted. Thus, when many new accounts are opened at the time that the past dues to old accounts run high, it is perfectly obvious that the subject is attempting to elude payment of his bills.

If any large number of first orders are revealed while at the same time large amounts of past dues are shown, it becomes evident that the customer is allowing his old accounts to lapse into slowness and is endeavoring to obtain additional credit in new markets.

A large number of unfilled orders may indicate that creditors are withholding shipment pending investigation. In arriving at this conclusion the type of business should be taken into consideration. In many businesses it is customary to order months in advance with the understanding that shipment is to be delayed.

First and unfilled orders should be taken into consideration in arriving at the aggregate potential indebtedness and present buying activity. To distinguish between unfilled and first orders, this column should be read in connection with that displaying the length of time sold the risk under consideration.

Terms of Sale.—From the terms of sale, the credit manager, knowing the customary terms prevailing in the various trades, shown in the first column of the report, should be able to ascertain the extent to which confidence is reposed in the subject by other creditors. An inferior or doubtful risk seldom receives goods on regular terms. He is usually required to purchase on a C.O.D. or C.I.A. (cash in advance) basis. On the other hand, exceptionally good risks may be favored with better terms, involving a longer credit period or a larger cash discount, or both.

Manner of Payment.—The manner in which a merchant takes care of his bills is an excellent indication of his financial responsibility. The significance which the manner of payment has on a concern's credit standing and on the successful management of the seller's house has already been discussed fully in another connection. Suffice it to state that slow-pay risks accustomed to take overtime are extremely troublesome. Some of these accounts may be perfectly safe, but because of carelessness they are chronically and habitually slow; others are apt to become in time poor-pay customers, requiring suits or other drastic measures to enforce payment.

The number of slow-pay customers is quite large. They vary from those just noticeably slow to those very slow, the former meeting their obligations with fair promptness, whereas the latter delay payment until actually threatened with drastic measures. Hence, the importance of knowing the degree of slowness.

Another thing that needs watching under this heading is the size of accounts which are discounted or paid when due. Some unscrupulous

merchants make it a practice to meet their obligations on a few small accounts with great promptness in order to use them as references and otherwise to make a favorable showing. Again, prompt payment of small accounts at the expense of the larger debts frequently represents a situation where the debtor is at least temporarily confining his buying to amounts considered essential to the operation of his business, for which prompt settlement must be made.

Advantages of Credit Interchange Bureaus.—The credit interchange bureaus furnish ledger information the reputation of which for freshness and reliability is already well established and recognized by many experienced credit managers. Files on subjects of inquiry are revised at frequent intervals, usually about every 90 days—a feature peculiar to the system. Moreover, reports are furnished within a short time after receipt of the inquiry. This, of course, depends upon the availability or lack of clearance reports on file; also upon the extensiveness of the investigation to be conducted. In any event, preliminary reports can be rendered within a surprisingly short period of time. And even a clearance on a national scale seldom consumes more than ten days to two weeks.

One of the paramount advantages of the system lies in the scope of its activities, with respect to both territory and lines of trade. The service is national in scope, making it possible for a credit grantor located, say, in Cleveland, to learn through its reports how a customer residing in Nashville is paying his creditors in New York, Philadelphia, St. Louis, Chicago, and elsewhere. As trade expands and as the number of bureaus increases, this service will, no doubt, assume still larger dimensions, thereby permitting of more intensive cultivation. The service not only knows no restrictions as to area, for the same is true with respect to lines of trade. All kinds of business are covered in their investigations, so that complete data respecting merchants handling more than one line can be accurately communicated.

Of no little importance is the reciprocal feature underlying the system. Because of it, a further and rapid spread of the scope of its operations is more than assured, resulting in larger membership, wider area, more complete, and, consequently, more valuable service. Furthermore, the information in its files is frequently revised and, through the gratuitous reciprocal reports guaranteed by the system, subscribers are aided substantially in watching accounts, changes in buying habits, and methods of payment. Again, the system affords an automatic mode of keeping subscribers' files fresh and up to date, for, when an inquiry respecting a customer is received by a member, it often serves as a signal calling for a rechecking and revision. In this manner, the latest credit facts are compiled and recorded in the appropriate files.

Ever since the inauguration of the Credit Interchange System steady improvement has been made in its operating procedure. It is now marked by much greater accuracy than during its earlier stages, reports are more complete, and less time is required to complete a clearance and otherwise to serve subscribers. Furthermore, the territory of its operation has been materially enlarged, for even though the total number of bureaus is but 55, attention should be called to the fact that some of the smaller bureaus have been absorbed and amalgamated within recent years with the larger neighboring bureaus.

A further indication of the strength and usefulness of the interchange system maintained by the National Association of Credit Men lies in the increasing use of its service by members, and the tendency to adapt the service to the changing needs of the membership. A good illustration of the latter point is the establishment of the Trade Group Department in 1926 which covers every credit activity related to given trades.[1]

The industry groups, of which there are more than 500, are divided nto three classes: local, district, and national. The local groups operat- ng within a limited area are served by a combination of interchange service and periodical group meetings. District and national groups are furnished with periodical consolidations of ledgers in substitution for the periodical group meetings. Various schedules are submitted, by the group members, on proper forms which are then consolidated and distributed for ready reference. Each group handles the trade abuses and unfair practices peculiar to its trade, and in some instances special clearances are prepared for specific groups containing the type of information in which the members of the given group are especially interested.

Objections to Credit Interchange Bureaus.—Notwithstanding its numerous advantages, the bureau system has often been criticized; most of this criticism the reader will concede to be unjustifiable. Some critics claim that the bureau tends to substitute impersonal contact for direct interchange among members. This is, it must be asserted, only partially true. The effectiveness of the system causes it, no doubt, to take the place of the other and cruder methods, as far as regular ledger experiences are concerned. Direct interchange, however, can still be profitably utilized for the sake of acquiring information which normally does not appear in print and which may decide conclusively the turning point in a given case.

A second group of critics claims that the bureau membership will never attain such dimensions as to become of real importance. In support of their view they point to a large number of credit managers who refuse to subscribe for the service because they feel that it will be necessary for

[1] VAUGHAN, J. E., "National Clearance System," *Credit Monthly*, October, 1927.

them to give more information concerning their trades than that received. Again, some credit managers are loath to divulge information respecting a customer who is temporarily embarrassed for fear of causing undue injury to him. Refusal or neglect to furnish all facts necessarily limits the scope of the report, and fails to disclose the exact standing of the subject.

In reply to these critics it may be observed that their arguments run against the current of actual conditions. The probable growth and development of these bureaus are not matters of library philosophy but lie in the realm of actuality. Great and consistent progress is to be noted from the very inception of the enterprise. To be sure, it is still far from having attained completeness and perfection, but, if the future growth is to be judged by the progress made heretofore, the prospects are exceptionally bright.

Cost of Credit Interchange Service.—To acquire a membership in a Credit Interchange Bureau, a certain minimum number of reports must be subscribed for. The sum paid for these, as well as additional reports, varies with different bureaus. Some charge a flat rate of $1 per report; others employ a sliding scale, on the theory that the work is done on a decreasing cost basis, hence the larger the initial number of reports subscribed for the smaller the charge per unit. The tendency, however, is toward the adoption of a uniform charge of $1 per report. In this connection it should be observed that, notwithstanding the charge of $1 per report, the actual cost is considerably reduced by the large number of free reciprocal reports furnished members by the bureau, so that in many instances the *real* cost of each report may not exceed 10 cents, a feature offering no inconsiderable inducement to the credit manager.

When to Secure a Credit Interchange Report.—Leading credit executives who have studied the problem seem to feel that a credit interchange report should be obtained every time a new account is investigated, when an unusually large order is received or when a number of direct inquiries on a customer are made; likewise, when a change in a customer's method of payment is first observed, especially if it is derogatory. When receivables are analyzed at the end of the month, a report may be useful on slow accounts prior to determining on any special collection measures. Some credit managers prefer the automatic revision service recently established by the system, especially on the principal outlets or doubtful accounts. Under this plan, a list of such customers is submitted to the bureau with the request that reports on them be furnished every 3, 4, or 6 months as requested. This enables the credit executive to keep a close watch on the affairs of the customer concerning whom there is some doubt and to make sure that he is securing a fair portion of the business from the good accounts.

TRADE CREDIT BUREAUS

Types of Trade Bureau.—Various trade associations and boards of trade have established their own credit bureaus. These are operated and managed in conjunction with the organization to which they form an adjunct. The purpose of these organizations is essentially the same as that for which bureaus have been founded by local Credit Men's Associations, *viz.*, to facilitate the exchange of information among credit grantors and to aid their members in guarding against extending accommodations to parties unworthy of credit.

From the standpoint of methods employed in conveying information to members, all trade bureaus may be divided into two classes, although many minor gradations will be revealed upon closer analysis. One group merely furnishes the names of concerns dealing with the risk to the inquiring member for his own independent investigation. The other class of bureaus conducts the investigation and renders complete reports.

Advantages of Trade Bureaus.—There is apparently nothing to recommend trade bureaus operating under the incomplete system, save its cheapness. But the value received is no greater, proportionally, than the amount paid for it. For the trade organizations operating under the complete-report plan, however, many praises are sung by their adherents. Obviously, different trades are interested in different items, largely depending upon the peculiar practices characteristic of the respective lines of business. A millinery jobber, for instance, in analyzing a report, lays chief emphasis on returned merchandise and seasonal variations in purchases, whereas in other trades the emphasis may be shifted to modes of settlement, whether by promissory notes, drafts, and the like. It is the special type of information that generally appeals strongly to various trades, although on many occasions little difference is to be discovered between trade bureau reports and those issued by Credit Interchange offices of Credit Men's Associations.

Limitations of Trade Bureaus.—These organizations often restrict their field of operation to a single class of persons or firms, such as jobbers or manufacturers exclusively, or else limit their activities territorially. In either of these cases, they are considerably handicapped in the compilation of reports, which are of necessity incomplete and, consequently, fail to reflect accurately the customer's standing. Furthermore, trade credit bureaus are at best limited to a single line of business. So long as exclusive trade shops are under investigation, so long are the results likely to prove satisfactory. When an investigation pertaining to a store handling several distinct lines of merchandise is conducted, however, obviously the information secured from only one group of sellers is totally inadequate as a basis for a credit decision.

Selected References

CHAPIN, A. F.: "Credit and Collection Principles and Practice," Chap. 14.
PRENDERGAST, W. A., and STEINER, W. H.: "Credit and Its Uses," Chap. 9.
YOUNG, R.: "Industrial Credits," pp. 24–31.

Questions and Problems

1. Compare and contrast interchange bureaus, as a source of credit information, with the direct method of interchange used by creditors.

2. The Association of Credit Men of Bigtown resolved to organize and establish a credit interchange bureau which is to be affiliated with and form a part of the bureaus operated under the supervision of the National Association of Credit Men. You were selected bureau manager. Outline the various steps that you would take in organizing such a bureau on a working basis. How would you determine your "zone of operation"?

3. What records and files would you deem essential in the operation of your bureau?

4. One of your members, a manufacturer of shoes, sends in a Subscriber's Inquiry Ticket, requesting a report on X who is located approximately 50 miles from your city. What would be the first step in the procedure of furnishing such information to the subscriber?

5. Assuming that a new credit interchange clearance must be made concerning X, what steps should be taken in securing such a clearance?

6. Show by diagram how the data for the above credit interchange report will be gathered.

7. Just how many reports would an inquiring member receive about a subject:

a. Under the regular service?

b. Under the automatic revision service?

8. Under what circumstances should a creditor ask for a credit interchange report?

9. In the interpretation of credit interchange reports, can you point out specifically the interdependence existing between the various columns of the report and the necessity of reading any one column in the light of information contained in other columns?

10. Distinguish between credit bureaus maintained by trade associations and those operated by associations of credit men.

11. From the standpoint of creditors, which of the two types of credit bureaus is superior and why?

12. Assume that your company is the smallest of a given number in the same line of business who are members of the credit interchange system. Inasmuch as you represent the smallest organization, the larger competitors will receive more orders and thus make more inquiries for reports to which your company will have to contribute. From a practical business viewpoint, should you remain a member of the bureau? Discuss.

13. In what way is the interchange system adapting itself to the changing needs of its membership? Give specific examples.

14. Analyze the report shown in the text (p. 231) and each of the following credit interchange reports and decide whether the risks are acceptable, indicating the approximate credit limits you would place on each account.

REPORT ON: (Actual report—name and address deleted.) APR. 13, 1937

Business classification	How long sold	Date of last sale	Highest recent credit	Amount owing	Amount past due	Unfilled or first orders	Terms of sale	Manner of payment			Comments
				Including notes	Including notes			Discounts	Pays when due	Days slow	
CHICAGO											
330-232											
WR.AP.	Yrs.	9-36	93	26	26	87	REG			3 Mos.	
GN.M.	Yrs.	5-36	229				2-E.O.M.			63-160	
F.P.	Yrs.	12-36									
F.P.	4-36	6-36	29				2-10-30			20-75	
SIOUX CITY	& SIO	UX F	ALLS								
331-203											
MTS	Yrs.	3-37					C.O.D.				
D.G.	Yrs.	8-36					C.O.D.	Checks	return	ed	
PROD	5 Mos.	3-37	25	20	20		WKLY.			15-30	
D.G.	Yrs.	3-37	423	166	166		30			60	
LITH	1 Yr.	9-36					C.O.D.				
GROC	4 Yrs.	2-37	160				C.O.D.	Too slo	w		
CDY	Yrs.	3-37	75	36			2-10-30			20-30	
GROC	6-36	3-37	83	12	12		WKLY.		x	Checks	returned
ST. LOUIS											
331-615											
CLO							C.O.D.				
MINNESOTA											
331-614											
GN.M.	Yrs.	12-37	190				60-CASH			90-150	
KNTG	Yrs.	1-37	331	281	281					30-90	
SHOE	Yrs.	10-36	215				2-30-45			9 Mos.	
OMAHA & NE	BRAS	KA									
331-219											
HATS								Collect	ed by	attorney	1937
MILL	Yrs.	3-37	159	97			30		x	few	
COMM	Yrs.	3-37	759	652	510		WKLY.			60	
CENTRAL IO	WA										
331-316											
GROC	Yrs.	12-36	2,000	699	699		C.O.D.	Checks NOT p	return aid wh	ed—Pays en due	by notes—Notes
MDSE	Yrs.	3-37	732	400	395					1-6 mos.	
GLV	Yrs.	12-36	71	71	71		2-10			90-150	
				2,460	2,180	87					
BU 3 HK											

REPORT ON: (Actual report—name and address deleted.) OCTOBER 11, 1937

Business classification	How long sold	Date of last sale	Highest recent credit	Amount owing	Amount past due	Unfilled or first orders	Terms of sale	Manner of payment			Comments
				Including notes	Including notes			Discounts	Pays when due	Days slow	
OMAHA & NE BRASKA											
927-52											
PACK						85					
BIRMINGHAM											
930-355											
PAPER	Yrs.	6-37	160				30	x			
PACK	Yrs.	9-37	900	900			30		x		
TOB	Yrs.	10-36	109				30		x		
PACK	Yrs.	9-37	2,500	1,500			30		x		
COFF	Yrs.	9-37	300	267			30		x	10	
GRO	Yrs.	9-37	750	535	535		30			20-30	
PROD	Yrs.	6-37	31				30		x		
MLNG	Yrs.	9-37	384	336			30			60	
MLNG	5-32	8-37	1,192	44			30		x	Postdated checks	
PROV	Yrs.	9-37	200	150			30		x		
PROV	Yrs.	9-37	600	395	153		30			30-60	
MEMPHIS											
1001-1005											
COFF	1 Yr.	8-37	190				30	x	x		
HFGS	6-33	9-37	127	70			60		x	30	
PHILADELPHIA											
930-777											
F.P.	1935	8-37	184	184	184		30		x	20	
F.P.	5-34	9-37	1,306	1,306	98		30			20	
ATLANTA											
930-31											
FLOUR	1 sale	5-37	165				2-10-30		x		
LOUISVILLE											
930-208											
FLOUR	10-27	9-37	700	72			30		x	30	
				5,759	970	85					
BU 16 EK											

CHAPTER XV

SALESMEN, ATTORNEYS, AND BANKS

Of increasing importance in modern business is the ever-growing tendency toward large-scale production and equally large-scale management. The portion of the twentieth century that has just rolled by has witnessed numerous and tremendously significant combinations and consolidations, both vertical and horizontal. Similarly, individual plants and mercantile houses have gradually and consistently expanded until they have embraced the entire national market. Because of these developments, purchasers have become farther removed geographically from their selling houses, necessitating the substitution of a most indirect contact with the trade for that of personal acquaintance. To say that such a substitution is unsatisfactory is putting it mildly. Although practically all the departments of a selling house are handicapped because of the distance separating them from the customers, none suffers quite so much inconvenience as the credit department. A personal interview with the prospective buyer is no longer feasible, and an examination, by the credit manager, of an applicant's place of business, stock of goods, store policy, and the like, prior to rendering a decision, is seldom practical. For these reasons alert credit dispensers, recognizing these limitations, usually consult those representatives who have the opportunity of meeting the customer personally. These representatives are salesmen, attorneys, and banks.

Salesmen as Credit Reporters.—Probably the oldest source of credit information was the report submitted by the salesman who visited the customer in his place of business. And even yet the salesman's report is given first consideration, for it logically comes first, in chronological order, as a source of information, because it accompanies, as a rule, all first orders from new trade. The salesman is in many instances the only representative of his firm who may ever have the opportunity of establishing relations through personal contact with the customer. He is the man on the ground and is, therefore, in a superior position to render particularly valuable services to his credit department.

Reluctance of Salesmen to Furnish Credit Reports about Customers.—That the salesman is in an exceptional position to render valuable assistance by reporting facts based on personal observation remains undisputed. Whether or not he is willing to supply such information

and the extent to which the credit department is justified, as a matter of good business policy, in requiring him to serve as its agent, are entirely different matters. Both salesmen and sales managers are divided on this question, although much progress has been noted in recent years toward closer cooperation between salesmen and credit men.

As a rule, salesmen are reluctant to make credit reports about their customers. They feel that their chief mission is to sell goods, and to this end they ought to devote all their time. To compel them to spend part of their time on credit work tends to detract materially from selling efficiency. Furthermore, a salesman's time is valuable. He spends but a limited number of hours each day face to face with customers and prospects. Thus his selling time must not be diverted to other channels. Credit reports can be obtained at much less cost. Third, credit work differs greatly from selling. The salesman is a constitutional optimist, hence he is a poor judge of the qualities that make a good credit risk. In this latter work he is often awkward and apologetic owing to his friendly relationships with customers. Any additional function which in any way conflicts with his main purpose, no matter how remotely, is extremely distasteful to him and he is more than likely to resent it or else assume an attitude of indifference regarding the thoroughness with which it is performed. This is especially true when the method of compensation is based on the volume of sales, as when employed on a commission basis alone or possibly a combination of commission and salary. Under such circumstances, salesmen do not wish to be hampered by anything which apparently has no immediate favorable effect on the amount of sales, and are naturally loath to offend or embarrass a prospective customer by asking numerous questions regarding his financial responsibility for fear of driving away trade to a competitor.

Again, prompted by selfish motives, salesmen are prone even to assume an antagonistic attitude toward the credit department, which, in their opinion, requires their assistance in handling accounts without reciprocating by helping to sell goods. Such an attitude undoubtedly discloses one of the inefficiencies of modern business organization, where, because of the specialization in functions on the part of different departments, the main purpose of the entire machinery is frequently lost sight of and each employee, consequently, considers himself as a department instead of company representative.

Why Salesmen Should Cooperate with the Credit Department.—The credit department is fully justified in insisting upon the salesman's cooperation, and the progressive salesman can be readily convinced of the wisdom of such an attitude. No sale is complete until the money is collected, hence credit is in this sense really a part of selling. There is no denying that the salesman's chief task is to sell, but he must do so in

accordance with certain policies and in line with the wishes of his superiors. That is why his nonselling duties are sometimes larger in number than those directly concerned with his selling work. After all, the salesman must be disabused of the idea that he is working solely for the sales department; he must be shown that he is employed by the firm so that his interests should extend beyond his immediate bailiwick.

The fallacies of the salesman's opposition can be pointed out in still another way. If the credit manager in his dealings with customers bears in mind, as he should, the idea of business promotion, and thus treats them considerately, he thereby aids the salesman in retaining the good will of his trade. Nothing can be of greater value from the standpoint of the salesman than the securing of a quick decision on an order in hand. But to render a credit decision quickly, information respecting the risk's financial responsibility must be readily available. It, therefore, behooves the salesman, in his own interest, to remove all obstacles which may cause undue delay in reaching a credit decision.

It is a relatively simple matter to secure an order from a dealer with a poor credit standing. When such an order is later turned down by the house, all sorts of explanations must be made which inevitably result in ill will. Moreover, the higher the credit standing of an account, the better the sales potentials. Thus, it is to the salesman's benefit to delve into the customer's credit responsibility and to make every effort to improve his standing. In helping his customer with the manifold problems, as he should, the modern salesman is forced to deal with credit matters. For this reason alone, a salesman should be trained to do some credit work. So many salesmen are awkward and incompetent in this regard because of the improper attitude of sales executives and deficient training of the sales force. Again, a salesman is usually required to make only one report on a customer, *viz.*, when a first order is secured. Thereafter, he is seldom called upon to make another investigation unless the customer's account becomes decidedly unsatisfactory, and a thorough revision of the files is made necessary. It does not seem, therefore, unreasonable to require his assistance in this regard.

Salesmen's Credit Reports.—In view of the foregoing, it is apparent that good judgment calls for a limited amount of information from the salesman. In justice to him, only those facts should be called for which cannot be obtained through the aforementioned channels. He should not be asked to furnish the sort of information which requires an exhaustive investigation and is, therefore, likely to cut heavily into his time and also arouse the customer's suspicion. Any deviation from this principle invariably results in purchasing data at a price beyond its value, because of the antagonism toward the credit department arising from the embarrassment of customers and consequent loss of sales.

The salesman sees the merchant in his setting and is probably familiar with local conditions. Because of these facts he is in a position to furnish the following information:

1. *Kind of Business.*—To a wholesale grocer, for example, it is important to know whether or not the buying merchant handles fresh meats and fresh fruits and vegetables, for these commodities profoundly affect the rate of stock turns and the cost of doing business. A disclosure of the exact nature of the business is readily procurable from this source, since it calls for a minimum of observation and no direct questioning whatever.

2. *Condition of Store.*—This involves a consideration of stock arrangement, window and store display, efficiency of the organization, and the manner in which customers are served. All of these are easily within the range of a salesman's observation, yet they are important. Gross neglect of any of these factors on the part of a store may eventually precipitate failure.

3. *Condition and Value of Stock.*—The salesman can at a glance ascertain the extent to which the merchandise inventory is out of date, which, in turn, determines the probable rate of stock turnover. He also knows the customer's buying habits, and if reckless in his buying habits he is likely to prove equally careless in his manner of payment. Again, casual observation of the prices at which merchandise is marked will reveal through the apparent gross margin the profitableness of the business. Whether or not the stock is well kept is also significant as an indication of merchandising ability. Many houses also require their salesmen to estimate the value of the stock. The author's experience with estimates submitted by various business men leads him to believe that, unless made by the sophisticated and with considerable care, they constitute mere guesses and as such are practically worthless. To be sure, the proprietor may be consulted regarding this figure, which when properly discounted, may serve as a better, though still extremely rough, indication of the value of merchandise inventory.

4. *Location.*—With greater knowledge of scientific management, the conditions affecting the location of a business are becoming increasingly important. As a result, the progressive merchant, in selecting the site for his business, studies and analyzes all the factors which make for a good location. Among others are its relation to the business center in case of shopping goods; available transportation facilities; the number of passers-by; the character of passers-by; the side of the street, whether shady or sunny in the afternoons; the location with reference to prevailing winds, environment and other similar factors. The grouping of businesses is also significant and has a direct bearing on the probable success or failure of the concern in question. On visiting his trade, the salesman

ought to be in a position, after proper coaching, to observe the aforementioned factors and on that basis arrive at a correct conclusion respecting location.

5. *Local Conditions.*—The salesman is in a position to keep the credit department informed of these conditions which have a material effect upon a customer's business. Industries may be removed or shut down, crops may fail, the character of the local industries may be such as to offer only temporary employment, streets in the vicinity may be temporarily torn up, employees of transportation facilities may strike, traffic may be diverted to other streets, and the like.

6. *Habits and Reputation.*—Next to attorneys, probably no one is better fitted than the salesman to gather information concerning the customer's reputation. By direct questioning, assuming confidence on the part of the merchant, and through incidental inquiries in other directions, he will learn whether the customer uses intoxicating liquors, or gambles; and he will also learn the kind of reputation he enjoys locally as a merchant and as a citizen.

7. *Capital Resources.*—Most houses require their salesmen to furnish figures regarding a risk's capital investment in and outside the business in which he is engaged. Since, however, this information is readily procurable from other sources, it is questionable whether a salesman should be burdened with the task of acquiring it.

8. *References.*—Since a salesman's report usually accompanies every first order, it is essential to secure some reference to both banks and mercantile establishments with whom the risk has dealings. These references may be obtained directly from the merchant or indirectly through inquiries directed at salesmen of other houses and other local merchants with whom connections are well established.

Form of Salesman's Credit Report.—Although many forms of salesmen's credit reports have been suggested on various occasions, few appear to conform to the principle enunciated in a previous paragraph, primarily because of the excessive mass of information they purport the salesman to furnish. A reasonable form of report should be confined to the following (see Figs. 31 and 32):

1. Date.
2. Name and address of firm.
3. How long in business.
4. Kind of business.
5. Condition of store.
6. Estimate of value of stock.
7. Is stock well kept?
8. Buying habits.
9. Location.

10. Competition.
11. Local conditions affecting the business.
12. Capital resources.
13. Firms bought from.
14. Banks dealt with.
15. Remarks concerning experience, habits, and reputation.

New Account Report

Charge to

Individual Name

Post Office R. R. No.

Store Located at

Ship Freight and Express to

Route Shipments via

Located on Railroads or Electric Lines

Kind of Business

How long in Business

Formerly located at

Banking Connections

Stock, large or small How kept

Value of stock Fixtures Real Estate

Mortgaged $

Has been buying from (Three or more names)

General Information

Date Salesman

NOTE: This Report must be completed and mailed with each new account.

FIG. 31.—Salesman's report on a new account used by a hardware wholesaler.

Value of Salesman's Credit Report.—The extent to which the credit data submitted by a salesman should be relied upon depends, in large measure, upon his ability, assuming willingness on his part to do so, to size up a situation and arrive at correct and reliable conclusions. If he is a keen observer and, in addition, possesses knowledge of what constitutes good business methods and policies, greater reliance can be placed on his reports than when his opinions are merely a result of sheer guesswork. Another factor determining the strength of his reports is the extent to

which he permits himself to become biased by his desire to roll up volume. In the very nature of things, salesmen are prone to be somewhat over-optimistic and may thus allow their judgment to become clouded by their enthusiasm.

FIRST ORDER APPLICATION TO

CREDIT DEPARTMENT

To Salesman:-

This report is to be sent in with each first order obtained from a new customer.

Date_____ 19____

Name_____

Street Address_____

Town and State_____

Age_____ Married or Single_____

What in your opinion is a reasonable line of credit for this account?

_____

Kind of business_____

How long in business?_____ Ability_____

Is location favorable?_____

Capital invested $_____

Avg. value Stock, Fixtures, etc., $_____

Condition of stock_____

Real Estate owned?_____

_____ Value_____

In whose name?_____

Mortgaged for_____

Ever failed?_____

Banks with (Name)_____

(Location)_____

Who are the principal merchandise creditors?

Name *Complete Address*

_____

_____

_____

_____

_____

Local reputation as to Honesty_____ Promptness_____

_____ Salesman.

Salesman must report any future unfavorable information promptly, using this form.

Use Reverse Side for Additional Information.

FIG. 32.—Salesman's new account report used by a meat packing concern.

A third factor consists in the willingness of the salesman to cooperate with the credit department which, in turn, depends upon the treatment accorded customers and salesmen by the latter. Lastly, it is comparatively safe to assume that, when answers are required to a limited

number of points, the results will be more satisfactory. Irrespective of all the factors mentioned, it should be borne in mind that, after all, a substantial part of the salesman's report is essentially in the nature of opinions which are, therefore, of no higher quality than that of the person giving them.

In addition to reports, salesmen are in many houses required to review, with the credit manager, the customers' list periodically, usually twice a year. This contact affords an opportunity to secure additional pertinent data pertaining to the accounts under discussion and to make the salesmen realize the necessity for cooperation if larger sales are to be made. These contacts should always be encouraged, for they result in the establishment of close and more helpful relations between the two departments thus represented.

Attorneys as Credit Reporters.—Not unlike a salesman, an attorney residing in the town of the debtor or prospective customer is favorably situated as a collector and distributor of credit information. His profession tends to bring him in close contact with the business and business men in his community. Like the salesman, he sees the subject in his setting, knows him personally, perhaps, and sees his place of business. Besides, an attorney invariably has a large circle of business and social acquaintances; this gives him an added advantage in the collection of credit data and opinions. Again, his daily routine in matters of litigation affords him an extensive field of information valuable from the standpoint of the credit grantor. Moreover, his special training often qualifies him to judge business conditions accurately.

Many concerns confine their practice of asking for attorney reports to towns of less than 15,000, on the theory that in the smaller communities an attorney's profession is more apt to bring him in personal contact with the business men in his locality—a feature that is considered essential to the making of reliable reports. In the large cities, however, many law firms have found this source of revenue sufficiently lucrative to warrant the installation of a special commercial department for the purpose of gathering, filing, and disseminating credit data relative to local firms. These attorneys also assist in collecting claims for out-of-town creditors against local debtors. This phase of their work will be discussed in a subsequent chapter.

Attorney Directories.—To aid in the selection of responsible attorneys, lists bearing the names and addresses of attorneys who have expressed a willingness to serve as collectors of overdue accounts, and, incidentally, as credit reporters, are available for business houses, banks, and collection agencies. These lists are prepared by various publishing houses, which usually charge each attorney a small annual fee for representation. These lists are then placed in the hands of houses and agencies likely to

be interested. In many cases no charge is made for the lists thus furnished, in which instances the publishing company relies entirely on the listing fees received from attorneys. In other instances, substantial charges are made for the lists and credit report forms which may accompany them.

In compiling attorneys' directories, the aim of the publishers is to secure in each community the name of one or more reputable attorneys from among those seeking commercial business. Due to the laxity respecting requirements for admission to the bar in some states, the selection of reputable attorneys is not always an easy task. If names of undesirable and inefficient attorneys appear on the list, however, they are apt to be weeded out in time, inasmuch as the practice followed in selecting attorneys for listings is to make little investigation at first but to eliminate all those names about which complaints are registered by business concerns. In this manner, comparatively good lists are made available by publishing houses whose experience in compiling attorneys' directories extends over a period of years.

Attorney Credit Reports.—For the most part, the information secured from attorneys parallels that obtained from salesmen, with the exception of two items (see Fig. 34). These are:

1. *Claims and Lawsuits.*—It is a rather simple matter for an attorney to obtain knowledge of lawsuits instituted against a subject, and, once obtained, to follow the progress and outcome of such action. Court records are available to this end and in most communities all proceedings are published daily and distributed among those concerned with legal matters. Then, too, the attorney is often called upon to represent other selling houses in the collection of claims against the subject of the inquiry.

2. *Status of Subject's Real Property.*—Many attorneys are thoroughly acquainted with property values in their respective communities. Some of them are experts in this respect. Hence the valuation submitted in this manner can be used by the credit grantor in checking the figures presented by mercantile agencies or the merchant himself. Furthermore, attorneys can easily and accurately ascertain from the usual records the encumbrances placed on the real property of the subject.

In regard to the other items, the local attorney is inferior to salesmen in some respects and superior in others. Although it is relatively easy for the average attorney to know whether or not a business is located in or near the shopping district, few of them possess a knowledge of the various factors determining a good location. What serves as an ideal location for one kind of business is not necessarily favorable for another. A keen analysis of all location factors calls for special training in merchandising, in which the average attorney is totally lacking. Similarly, the average lawyer is barely familiar with merchandising methods and

policies and is, therefore, no more competent to pass judgment regarding the condition of the store, buying habits, and value of the stock on hand than a casual observer. The average salesman is much better fitted to serve in this capacity.

On the other hand, the average attorney, because of his associations with various merchants in his community, is able to secure opinions regarding the business ability of the subject and is particularly valuable in giving information on habits and local reputation. The attorney frequently knows the personal and family history of local merchants

City..... 19.....

To ..... at .....

Dear Sir:-Kindly mail to us in enclosed stamped envelope full information, based on your knowledge and investigation, as to the age, character, habits, capital, responsibility and promptness in meeting obligations of

Full Name..... City .....

Street and No..... Business .....

Your prompt reply will be greatly appreciated, as Delayed Reports are of no Value.

ANSWER HERE:

Supposed net worth? $ .....

Individual Names (if a firm)? .....

Married or Single? ..... Age approximately? .....

Reputation for Ability? ..... Honesty? ..... Moral Character? .....

Ever failed? ..... Been sued? .....

How long in business? ..... Business seem prosperous? .....

Value of stock on hand (estimated) ? $ ..... Insurance? $.....

Value of real estate above homestead and encumbrance? .....

Do you know of any unsatisfied obligations, chattel mortages, judgments or claims in hands of attorneys?

.....

FURTHER REMARKS

.....

.....

.....

.....

All the facts tending in anywise to a just estimate of party's credit-worth are highly desirable. Do not under any circumstances divulge the name of the party desiring this report.

FIG. 33.—A typical attorney credit report form.

either through personal contact or through his wide circle of acquaintances and his information on these points is more valuable, particularly in smaller towns and cities, than that obtained through salesmen.

Value of Attorney Credit Reports.—Opinions differ among the larger concerns concerning the value of attorneys' reports. Some firms have used them successfully for a period of years and are, consequently, staunch supporters of the system; others use them sparingly. It is obvious, nevertheless, that, not unlike the value of a salesman's credit report, the attorney's credit data depend upon his ability to size up a situation properly, inasmuch as a large part of the report consists of mere opinions. Another factor is the willingness or diligence with which the investigation is conducted.

On the whole, a report submitted by an average attorney is far less dependable than that of an average salesman. Several reasons are advanced in explanation of this statement. To begin with, the attorney may be a friend of the subject under investigation, which is perfectly plausible in smaller towns and cities, and thus renders no unfavorable report, especially in a matter of mere opinion, or hearsay. A second reason accounting for the difference in the quality of reports of salesmen and attorneys, respectively, is the prejudice on the part of the latter against outside creditors. Reports may be colored in favor of local merchants without at the same time completely disregarding the truth. This criticism appears to be well grounded in isolated cases in small communities. Outside of extremely provincial districts, the broad-mindedness of attorneys seldom permits of such unfair discrimination. A third cause for the inferiority of attorneys' reports is the difference in credit standards of the house requesting a report and of the attorney rendering it, and hence, possibilities for misinterpreting opinions; whereas a salesman supposedly measures risks by the standards of his house, with which he should become intimately acquainted.

In the fourth place, many attorneys do not give the matter adequate attention because of the subordinate nature of the work. Unless he specializes in commercial work, the attorney is apt to consider the work of collecting claims and reporting on risks as incidental to his main practice. Another and in many instances the most important reason lies in the inadequacy of the compensation for the service rendered. The immediate remuneration is seldom commensurate with the amount of work involved in compiling a report and is, therefore, not conducive to thorough investigations and substantiation of opinion.

In opposition to these criticisms, many houses contend that, notwithstanding his local friendly relationships, the attorney specializing in commercial business can be relied upon for accuracy and completeness of statements, for, prompted by selfish motives, he is anxious to furnish reliable information in order to gain the good will of the house making the inquiry and thereby gain its collection business. The commission earned from collection work is more than sufficient to compensate the attorney for the effort expended in making a thorough investigation. Hence, many of the larger firms employ attorneys as trained credit investigators who have developed a highly efficient system for recording the data assembled. Reports rendered by these firms are necessarily very reliable.

To improve the character of the service, forms are furnished by publishers of attorneys' lists. The fewer the questions contained in the form, the more quickly the reply will be made to an inquiry, and the higher the quality of the answers. For an excellent illustration of such a

Form A

United States Fidelity and Guaranty Company
Attorneys List Department
Home Office, Baltimore, Md.

Report Blank

Report on..... of.....

Sent to.....Correspondent at.....

Date sent.....Date Received.....

DO NOT FORGET TO ENCLOSE PROPER POSTAGE—See Instructions on the Cover of these Blanks

Subscriber No. RETURN REPORT BELOW TO Privilege expires

To the Attorney: Our Subscriber, whose name or number appears hereon, is entitled to the mercantile report herein requested prior to the date of expiration above noted. Please detach this stub and preserve for future reference, so that you can advise subscriber promptly in the event of any change in the financial condition of the party reported upon after the date of your reply to this inquiry. You must not reveal to any one the fact that you have been asked for this report.

E. ASBURY DAVIS, *President* Capital paid in cash, $2,000,000

United States Fidelity and Guaranty Co.
Attorneys List Department
Home Office, Baltimore, Md

Name of Party reported on..... Date.....

Correspondent will please detach this stub and file for future reference.

CONFIDENTIAL TO BE SENT TO SUBSCRIBER Privilege expires

City.....19.....

To .....at .....

Dear Sir:-Kindly mail to us in enclosed stamped envelope full information, based on your knowledge and investigation, as to the age, character, habits, capital, responsibility and promptness in meeting obligations of

Full Name.....City .....

Street and No.....Business .....

Your prompt reply will be greatly appreciated, as **Delayed Reports are of no Value.** Subscriber No.

ANSWER HERE:

DO YOU CONSIDER WORTHY OF CREDIT FROM $ ..... TO $.....

REPUTATION FOR PAYING PROMPTLY AND WITHOUT SUIT?.. ....

IF ACCOUNT IS NOT PAID AT MATURITY, CAN COLLECTION BE MADE?.....

DO YOU KNOW OF ANY CHATTEL MORTAGE ON STOCK?..... .....

FURTHER INFORMATION AS TO REPUTATION AND STANDING IN THE COMMUNITY:

All the facts tending in anywise to a just estimate of party's credit-worth are highly desirable.
Do not under any circumstances divulge the name of the party desiring this report.

FIG. 34.—Form of attorney's credit report furnished to subscribers of the United States Fidelity and Guaranty Company service.

form see Fig. 34. Sometimes the attorney may even ignore the specific questions of the form, substituting for the detailed answers the phrase, "good for the amount named," meaning thereby that the risk's credit standing is good beyond the shadow of a doubt. Should information be needed only on one or two points, however, a letter instead of a form will probably prove more efficacious.

Methods of Compensation.—Attorneys furnishing credit reports are paid either directly and immediately a small fee, usually $1 for each report, or indirectly by the promise of, in return, whatever collection business the house may have in a given locality. As long as the inquiring house has some collections in the locality where the attorney is situated, the latter method of compensation is probably the most satisfactory, provided the claims are actually handed over in accordance with the promise made. When few collections are sent at long intervals, however, attorneys will be found loath to answer many inquiries. Still worse, the free report system is subject to much abuse, and many houses have taken advantage of the opportunity of securing gratis numerous reports from several attorneys in a given town, in return promising each whatever collection business it will have in his town. Obviously, the collections in any given community for one house can hardly be handled by more than one lawyer. Attorneys in some instances, by comparing notes, have discovered these flagrant abuses on the part of some unscrupulous credit men and have, therefore, refused to reply to inquiries or else have given offhand opinions without attempting to substantiate them. Consequently, the reports were worth no more than the price paid for them. These abuses also led to the adoption by some bar associations of a schedule of fixed rates for reporting services rendered.

Unless the attorney is actually engaged in making collections for the inquiring firm, it is by far more effectual to compensate him directly and in advance by enclosing a fee, when requesting an investigation, commensurate with the effort used in the process.

Banks as Credit Reporters.—Though freely used, it is claimed that banks do not constitute a satisfactory source of credit information. A general and widespread prejudice formerly prevailed against bank reports. Although still existing in some quarters, it no longer prevails generally.

In explanation of the inadequate and unsatisfactory reports said to be submitted by banks, several reasons have been suggested. One is that credit inquiries are handled by banks, purely as an accommodation, by a force of untrained and subordinate clerks and that it is not one of the purposes underlying the establishment of the institution. Fortunately this situation no longer obtains, at least in the larger banking houses. It is now widely recognized in banking circles that one of the four principal functions of a bank's credit department is to furnish information to

mercantile houses in reply to inquiries. Banks generally recognize the interdependence of mercantile and banking credits. If a debtor's credit becomes impaired with his selling houses, so as to preclude the possibility of obtaining merchandise on credit, his ability to meet his obligations at the bank would also probably be seriously affected, and vice versa. Bankers, therefore, realize the importance of acquiring knowledge concerning borrowers, from mercantile houses from which their principal purchases are made. To do this and induce merchants to answer inquiries fully and with frankness, they find it necessary to reciprocate. Banks now increasingly appreciate the exchange of credit experiences.

A second cause responsible for the supposed insufficiency of bank reports is based on the belief that the bank would make a flattering report regardless of the actual circumstances of the party inquired about, provided this party is the bank's debtor. The purpose of the report, it is believed, is to induce the extension of credit accommodations on the part of mercantile houses, thereby facilitating payment of the loan to the bank to the detriment of mercantile creditors. If we are at all to judge the attitude of bankers by past experience, the reasoning thus presented lies purely in the realm of classroom philosophy. In practice, the majority of bankers assume a business-like attitude toward matters of this sort.

Nevertheless, banks do not furnish the detailed information that mercantile creditors supply on request. The number of reports containing merely the bank's favorite and conventional expression, "We believe the man honest and good for his needs," is altogether too large. In explanation of this reluctance to give complete and frank reports, the following reasons may be advanced:

1. Because of their strictly confidential relations with borrowers, banks may obtain private information which they deem inadvisable to pass on to merchandise creditors, lest the confidence be violated.

2. Owing to a conservative policy, banks may receive, for greater safety required in their case, guarantees, indorsements, or collateral as security, which, if divulged to merchandise creditors, might be misinterpreted, to the detriment of the debtor. It may also be said in this connection that in the case of secured loans banks are likely to possess less information than selling houses which run greater hazards. Because of the lack of tangible security, merchandise creditors are compelled to exercise closer supervision over their accounts, resulting in a more intimate knowledge of their risks than in the case of a bank, which holds the debtor's security for its loan.

3. Banks point out the fact that merchandise creditors do not need so much detailed information as the banks generally do, because

a. Merchandise creditors work on a larger margin of profit than that on which banks operate and can, therefore, take greater risks.

b. Merchandise creditors extend smaller amounts of credit than banks do to any given debtor. Merchants deal in smaller units.

c. At any one time a debtor owes a merchandise creditor much less than he owes the bank; hence the hazard is smaller.

d. Most merchandise creditors lend their own funds, whereas banks lend funds entrusted to them by depositors. Acting in a fiduciary capacity, the banks must exercise more care and caution; hence the need for detailed credit data.

Notwithstanding all these arguments, it appears reasonable to expect banks to furnish more complete data than a mere conventional expression, if the reciprocal advantages arising from interchange of credit information are to be fully enjoyed by all parties concerned. It may be said with justice that much improvement is to be noted in this direction. Occasionally, a charge of 25 cents, to be paid in advance, may be made for each report. This practice, however, is rather limited to small-town banks which do not expect ever to obtain the advantages of reciprocity with inquiring merchants from distant cities. This charge also prevents a promiscuous use of inquiries from banks. On the whole, it may be said that the old customs that have grown up in the banking business are being gradually sloughed off as modern business-like views and methods are adopted. A constantly growing number of banks now have highly developed credit departments which are charged with the duty of supplying mercantile houses with definite and complete information concerning depositors and borrowing accounts.

Bank Credit Reports.—In requesting information from a bank, the credit manager should be careful to obtain the correct name of the bank and the particular branch, if any, with which the customer does business, together with the exact name under which the account is kept. The last-mentioned item is of especial importance in connection with personal accounts affecting retail credit. Either letters or forms can be advantageously used by the inquiring party. The advantage of an inquiry blank over a letter consists primarily in the convenience both in making and in replying to inquiries, and in the reduction of labor to a minimum.

No matter which method is employed the following points are usually covered in a bank's credit report:

1. The length of the account.

2. The approximate amount of the customer's funds on deposit at the bank. Usually these balances are said to be large, medium, or small. The bank's idea of the size of its accounts in such instances depends largely on its own size and on the kind of business it transacts. What is considered small for a large bank may, indeed, be large for a smaller institution, and vice versa. Again, a balance that may be considered

small for a large business firm's account would undoubtedly be large in the case of a personal account.

3. Amounts of loans extended by the bank to the customer under investigation.

4. The promptness with which the customer meets his obligations at the bank.

5. Whether the account is in funds when checks are presented.

6. Whether many drafts are presented to the customer through the bank and whether they are honored.

7. General reputation of the customer and whether the bank considers him reliable and worthy of credit.

Interpretation of Bank Reports.—When a bank replies that an account is small, fair, large, medium, or liberal, the inquiring party, in order to interpret the characterization properly, must know something of the size of the bank and the character of the account as already indicated in another connection. The word "liberal" is rather vague, but when used is considered complimentary to the depositor; when a bank says of its borrower "good for moderate credit," it means that limited credit is permissible. "Good for reasonable credit" indicates some confidence in the account, but bears watching. The expression "good for his requirements" usually indicates that the customer is willing and able to take care of whatever he asks and that he is not likely to ask for credit beyond a reasonable amount.

The items in the bank's report concerning cash balances maintained by the customer and notes payable to banks constitute another mode by which to gage the subject under consideration. Both of these items may be used effectively to verify similar items appearing on the financial statement submitted by the applicant. Finally, it should be borne in mind that much valuable information can be obtained by cultivating a knack for reading between the lines of a bank's report.

Selected References

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Questions and Problems

1. How do you explain the fact that wholesalers and manufacturers normally require that their salesmen submit credit reports concerning their customers?

2. If you were a salesman employed primarily on a commission basis, what would be your attitude toward the preparation of credit reports on your customers? Why?

3. Assuming that the attitude of the company's salesmen is unfavorable toward the matter of furnishing credit reports, what could the credit manager do to overcome the objections against the practice?

4. What factors tend to determine the value of a salesman's credit report?

5. If you were to prepare a report form to be used by salesmen in credit reporting, what factors would you consider in its construction?

6. In the event that a salesman's report on a given credit risk disagrees with a report secured on the same subject from an attorney, which of the two reports should be regarded as more authentic and of greater value? Give reasons for your answer.

7. Under what circumstances is it advisable to obtain an attorney report on a credit risk?

8. "The salesman's worth to his house is based not upon the volume of orders he secures, but upon the net profit he produces for his firm." Show how a credit manager can use this statement in making a friend and ally of a salesman.

9. In what respects do attorney reports differ from reports generally submitted by salesmen? In what ways are they similar?

10. Account for the fact that banks normally require more detailed information about credit risks than do mercantile organizations.

11. Assuming that banks do have detailed information about the various subjects investigated, why are bank reports often regarded as unsatisfactory?

12. The Blank Company manufactured a novelty item that required wide distribution. In the early period of its growth it confined its operations to the larger cities of the New England and Middle Atlantic states. Here it had developed good banking connections. In addition to Dun & Bradstreet, the company used also attorneys specializing in commercial work as well as banks for credit information.

With the upswing of the business cycle, increased competition, and a growing style consciousness, the company began to expand its market into the smaller towns and into the West. As the business in the new sections increased, the credit manager felt that the sources of credit information previously used were inadequate and proposed that the salesmen of the company be required to submit reports on new accounts as well as on delinquent customers. The sales manager objected, stating that the type of salesman required to sell a line of novelties was not the type that would be able and willing to prepare useful credit reports. Besides, all their time was needed for selling work.

a. Explain the basis, if any, for the sales manager's position.

b. Would you advise the use of salesmen in this instance? Why or why not?

c. If the salesmen were utilized as proposed by the credit manager, would it be necessary to give them any special training? Give reasons.

d. What method of compensation would you use if salesmen were required to furnish credit reports?

e. Assume that the sales manager's position is tenable in this case, what other sources of credit information can still be tapped by the credit department?

CHAPTER XVI

THE CREDIT RISK AND MISCELLANEOUS SOURCES

THE PERSONAL INTERVIEW

In order to draw the line sharply between the desirable and non-acceptable risks, more than a superficial knowledge of each customer is required. Much information can be gained from the various sources already treated in previous chapters. Notwithstanding the abundance of data obtainable through these sources, it is frequently desirable to establish and maintain a certain degree of personal contact with the trade.

Interviewing Customer in Office of Selling Firm.—Frequently, when a merchant is seeking a line of credit, he or his representative will visit the credit manager with a view toward establishing satisfactory arrangements with him. Here is an invaluable opportunity of which no credit manager can afford not to avail himself fully. By assuming a friendly attitude rather than that of a cross-examiner, he may lead the prospective customer to express himself on market conditions, general trend of prices, styles, and other factors directly affecting his particular line of trade. It should be the aim of the credit manager so to steer the conversation during such an interview as readily to reveal the degree of prudence, judgment, and system exercised in anticipating the demand of his clientele and in the general operation of his business. He will thus discover whether the applicant is a shrewd buyer and so selects his goods as to insure their salability, or whether he is uninformed and buys injudiciously and indiscriminately, in which case he is apt to overstock with a poorly selected line of goods. Once taken into the credit manager's confidence by an attitude of friendliness and candor, the applicant will talk frankly and freely, thereby revealing facts in regard to his capital responsibility, organization, location, present circumstances, and prospects of his business enterprise.

To avoid any possible resentment against having their credit questioned, it is the practice of many houses to ask out-of-town customers calling on the firm to meet "our Mr. Smith," instead of proposing to meet "our credit man." The credit manager not being mentioned, the customer may be under the impression that he is talking to the treasurer or auditor of the firm. He will thus converse frankly and freely, and incidentally give all the information that may be required. It should be borne in mind at all times that entering into details should be avoided

during the first or any personal interview at the seller's office, for that sort of information can be secured through the usual channels. The chief object of an interview is to permit the credit manager to size up the risk; to form a personal impression of his character and business competency; to serve as a basis for future correspondence; and to enable him to interpret more skilfully the information contained in the reports of mercantile agencies and credit bureaus.

Interview at Customer's Place of Business.—In the case of large accounts which present difficult decisions, it is well worth while for the credit manager to visit the customer at his place of business. Although it is more or less difficult and, particularly in large establishments, well-nigh impossible to meet all the customers personally, it is nevertheless essential that the credit manager arrange periodically to make credit trips around his trade area, calling on those risks concerning whose credit responsibility he is seriously in doubt.

In visiting the customer's place of business, whether it be a retail establishment, a wholesale house, or a manufacturing plant, the credit man can acquire certain data which are not obtainable through any other channel. He can thus form a personal impression of the customer's methods of doing business, general proficiency, location, arrangement of stock, and many other factors. In addition to this, the credit manager has the invaluable opportunity of sizing up the risk, as to his character and business ability, probably to better advantage than when meeting him at the credit man's office, for here the man is seen in his setting, as he naturally appears from day to day, and is, therefore, likely to be devoid of all artificial and assumed characteristics.

Traveling Credit Representatives.—Some of the larger houses find it advantageous to employ credit department representatives. These are allotted specific territories, the same as salesmen, which they are required to cover periodically with a view of inquiring into the credit standing of applicants and of such old customers as directed by the credit department. Most of the points covered by them in their investigations parallel those secured by traveling salesmen, save for the thoroughness with which the more qualified and better equipped credit specialist conducts his inquiries. In addition, these investigators inquire into the financial condition and other relevant factors determining the customer's debt-paying power.

It is needless to say that the scope of a given investigation and the degree of thoroughness to be exercised in its conduct vary considerably with the relative seriousness of the situation involved. If serious weaknesses are disclosed, the credit department representative may feel warranted in even examining the books of account. In other instances it may suffice to obtain the latest available statement of financial condi-

tion or merely to discuss conditions in general. No set rule can be profitably laid down as a guide to a determination of the scope of such an investigation, since the extent of any inquiry will necessarily have to be governed by the circumstances of the particular case.

Many houses are at present adopting the policy of sending representatives to visit large accounts which involve some serious doubt or difficulties, even though no special traveling credit investigators are employed. The effect of such a visit may be to lead to a closer and friendlier relationship based on a better mutual understanding between buyer and seller and thus result in increased volume of business, or else it may lead to a decision involving the necessity of closing the account either immediately or gradually and thereby avoiding an otherwise inevitable loss.

MISCELLANEOUS SOURCES OF INFORMATION

Among the miscellaneous sources are to be listed corporation manuals and services, the "Credit Manual of Commercial Laws," and trade and financial papers and magazines.

Corporation Manuals and Services.—Concerns which deal with railroads, public utilities, industrial corporations, financial companies, real estate corporations, and municipalities large enough to enjoy a fairly general distribution of their securities, will find a substantial amount of valuable information in the various investment and statistical manuals. While these manuals are intended primarily to facilitate the work of the investor, they can be very useful as sources of credit information. These manuals are practically unabridged encyclopedias of financial and statistical information covering a wide list of individual corporations and political units. The data in the annual volumes are brought up to date from time to time by supplementary sheets.

The publishers of the financial manuals are: Standard Statistics Company, Moody's Investors Service, Poor's Publishing Company, and the Fitch Publishing Company. The services established by these organizations which are most important for credit purposes are outlined below.

Standard Statistics Company's *Standard Corporation Records* consists of loose-leaf files containing rather complete information of all the relatively important corporations. This material is brought up to date monthly. Standard Statistics also publishes a card file for certain important companies. For each company listed in the card file there are included two cards, one containing an annual report covering practically the same information as the *Standard Corporation Records* and the other including current information of a supplementary nature. An

additional service published by the Standard Statistics Company is the *Trade and Security Service* in three loose-leaf volumes. The material covered consists of business and market analyses, earnings and financial data, sales and credit prospects, analyses of industries, and statistical data.

Moody's Investors Service publishes annually manuals classified as follows: (1) Governments and Municipalities, (2) Railroad Securities, (3) Public Utility Securities, (4) Industrial Securities, and (5) Banks, Insurance Companies, Investment Trusts, and Real Estate, Finance, and Credit Companies.

Poor's Publishing Company issues annually a set of manuals in four volumes covering: Railroads, Public Utilities, Industrials, and Governments and Municipals.

The Fitch Publishing Company issues annually *The Fitch Bond Book* and *The Fitch Stock and Bond Manual.* These volumes contain financial and statistical data and descriptions of a wide list of civil governments and business corporations in the railroad, public utility, and industrial fields.

These financial manuals, with their supplements, cover nearly all the available information pertaining to the more important corporations. The information contained for practically each corporation listed other than governments is as follows:

1. A history of the company, its growth and development.
2. Territory or market served.
3. A description of the property, physical plant, and capacity.
4. A description of the company's products.
5. Operating statistics.
6. Income account data, so far as they are available.
7. Balance sheet data.
8. Financial policies.
9. A description of all security issues.
10. Range of market prices of its securities.
11. Exchanges listed on, if any.
12. A list of officers and directors.

In addition to the manuals published by these organizations they supply many other types of services dealing with market and investment information. Most of them, however, are of little utility for credit work.

Every credit man dealing with railroads, public utilities, or industrial corporations of some size should have at his command at least one of the services referred to, for important information can thus be obtained in convenient form. Nothing reflects more fully a corporation's status than its growth in earning capacity, dividend record and policy, and its comparative financial statement. All of these facts and many others

are made readily available for the command of the alert and sophisticated credit grantor.

Trade and Financial Publications.—Much information of a general character may be secured by carefully reading one or more magazines on general business and financial conditions. Even specific information regarding the larger companies can be gained from such publications as the *Commercial and Financial Chronicle.* A credit manager should also familiarize himself with trade publications covering the lines in which he and his customers are interested. From them, items of interest respecting the trade of customers and the territories in which they operate can be discovered. These should be clipped, properly identified, dated, and filed. A thorough knowledge of economic and political conditions, particularly as applying to the trade of the risk or his location, constitutes an invaluable asset of which a credit dispenser may well be proud. The *Survey of Current Business,* published monthly by the United States Department of Commerce, the *Federal Reserve Bulletin,* issued monthly, the *National City Bank Bulletin,* and other bulletins published by leading banks are invaluable in this regard. The results of the Censuses of Business, conducted by the Bureau of the Census, for 1929, 1933, and 1935, afford a mine of valuable data for credit executives. Skill in tapping these hidden sources of information at the right time is in no small measure responsible for the success of its possessor.

Miscellaneous Sources.—On the character aspect of the credit risk postmasters, especially in the smaller towns, are a fruitful source. Certain insurance companies, like the John Hancock Life Insurance Co., provide general information of value to credit men. Character reports concerning the individuals composing a firm may also be obtained from the Retail Credit Company, the Hooper-Holmes Bureau, Inc., and others, even though they do not specialize in mercantile credit information.

"Credit Manual of Commercial Laws."—No credit manager's office is complete without this valuable annual publication of the National Association of Credit Men. The "Credit Manual of Commercial Laws" is "a compendium of state and Federal statutes, directly affecting the work of the credit man." It also contains a description of the work of the National Association of Credit Men, a number of sample forms of useful instruments, and other valuable information. It is one of the greatest credit department facilities. Questions frequently arise in analyzing and checking credits which are quickly and explicitly answered by this publication; in a word, it is a handbook which no credit manager can afford to be without.

Questions and Problems

1. What are the principal arguments in favor of interviews with credit customers and prospects?

2. Show that the personal interview is intended not only as a basis for establishing credit but is also used as a means of building good will for the creditor.

3. List the items of information that can be best secured by a personal interview.

4. In what ways is the personal interview conducted at the credit risk's place of business superior to the interview conducted at the office of the vendor?

5. Indicate the use that can be made by credit managers of the available services and data with regard to customers and prospects operating incorporated establishments.

6. Compare and contrast the "Manual of Statistics" with Poor's Manual.

7. Of what special value are trade and financial publications to the credit manager? Cite specific examples.

8. Outline the points of major importance in the discharge of credit and collection duties on which reliable data can be obtained from the "Credit Manual of Commercial Laws" published annually by the National Association of Credit Men.

9. Consult one of the manuals at the library. From it secure the names of three mercantile establishments, giving the information which the manual has about each of the three that would be of value to a credit manager.

CHAPTER XVII

SECURING BUSINESS STATEMENTS AND THE LAW

In investigating a merchant's financial responsibility and business capacity, not less than two statements are commonly resorted to, namely, the financial or property statement, and the income or profit and loss statement. Because of negligence or unwillingness on the part of the giver, a complete profit and loss statement is seldom obtained by others than banking creditors, except when extraordinary occasions arise involving the shipment of unusually large orders or the extrication of the debtor from financial embarrassment. Nevertheless, it is interesting to note that practically all standard forms of so-called "financial statements" adopted by the National Association of Credit Men, mercantile agencies, and allied institutions, provide additional space for the filling in of certain profit and loss items without which no satisfactory analysis is possible. Technically, therefore, both statements are utilized as a basis for credit. Since any such improvement in terminology, however, is generally purchased for a price beyond its value, because of the confusion arising from the conflicting associations in thought, it is deemed advisable to refer to this combination as the financial statement, property statement, or balance sheet. The difference between these three terms is essentially a technical one and depends upon whether the information is presented in the account or the report form, the term "balance sheet" technically referring to the former arrangement.

Certain authorities, especially among the accountants, even advise credit executives to get back of the balance sheet and profit and loss statement and to require detailed schedules which break down certain lump figures shown on these statements. They also suggest that debtors, especially when borrowing from banks or when substantial credits are involved, submit a budget which is in essence a statement of future operations. Such a budget should show what the progress of the business will be during the period of the indebtedness. It would indicate expected volume of sales, cost, purchases, payrolls and other important items.[1] This seems to be carrying the matter a little too far and to delve into a

[1] WELLINGTON, C. O., "Look Beyond Balance Sheets," *Rand McNally Bankers' Monthly*, Vol. 52, September, 1935, pp. 526–528; also A. STEWART, "Financial Facts Expressed in Ratios Tell Much to Credit Men," *The American Accountant*, April, 1927, pp. 24–27.

debtor's business deeper than necessary. After all, there must be some confidence in the risk in every extension of credit. Furthermore, few firms as yet operate on a budget or have the detailed information suggested. Any attempt to demand such data would result in added expenses and, under our competitive system, in a diversion of trade to others who are more reasonable in their requirements.

The Financial Statement.—In the interest of clearness, it may be well briefly to depict the business statements which constitute some of the important tools of the modern credit manager. A financial statement is but a photograph of the financial condition of a particular business at a given moment, setting forth in some classified manner its assets, liabilities, and net worth. It is a cross section of a concern's financial standing at a given time. The information contained therein may be presented in a general or detailed manner. Again, the statement may be condensed or consolidated, single or comparative.

The Profit and Loss Statement.—The income, or profit and loss, statement supplements the record shown by the financial statement by indicating the manner in which the net worth has been changed during the period covered. It may also be considered complementary to the other record because it helps to complete the story recorded therein. It shows the gross sales or income, a schedule of operating expense, the net income, annual and total surplus, or net profit for the year in case of partnerships and single proprietorships. The income statement reflects a dynamic condition, it is a moving picture, whereas the financial statement shows the condition of the business when at a temporary standstill.

Reasons for Statements.—In a credit transaction it is the right of one party to receive, and the duty of the other to give, information sufficient to enable the prospective creditor to form an intelligent opinion regarding the probable ability of the prospective debtor to discharge his obligations at maturity. Because of the present-day keen competition and attending close margins, successful business men do not extend credit accommodations without information which tends to disclose an applicant's financial responsibility with almost mathematical precision. Accordingly, from the standpoint of the credit grantor, a signed financial statement is extremely beneficial. It helps him to determine whether the risk has sufficient realizable assets in his business to warrant the belief in his ability to meet his obligations at maturity, if willing to do so.

As a matter of fact, a financial statement, while primarily indicating the financial condition of the maker, also shows the efficiency of the management and, in addition, reflects the character of the risk. In other words, it throws light on each of the three C's of credit—Character, Capacity, and Capital—but in reverse order of emphasis. Its principal bearing is on capital or the financial condition of the risk as evidenced

by the value of each item analyzed. Next, the financial statement contributes to the credit analyst's knowledge of the Capacity or management ability of the maker. Finally, it invariably reflects on the Character or business integrity of the risk by the presence or absence of any attempt to manipulate the data.

Knowing the exact financial condition of the customer, the credit grantor can exercise better judgment in fixing a credit limit and in the granting of requests for renewals and extensions. Furthermore, the incompetent risks are gradually weeded out, since they are generally unable to furnish satisfactory financial statements. Laxity on the part of credit grantors in requiring statements of such risks obviously leads to the perpetuation of such merchants in business to the detriment of the seller.

Finally, creditors can frequently prevent dishonest debtors from committing frauds, if signed statements are demanded from which the exact situation may be ascertained. Laws have been enacted in many states making it a crime for a merchant to submit a false statement in writing for the purpose of obtaining credit. Hence, the debtor who contemplates perpetrating a fraud will hesitate to issue a statement for fear of prosecution under these laws.

Many benefits equally inure to the maker of a financial statement. Reputation or character, although an extremely important factor in credit extensions, is nevertheless not the only factor. The creditor is a contributor of capital and becomes, in a sense, a partner of the debtor, and, as such, has a perfect right to demand complete information of the debtor's business resources, at all times. Hence a merchant who desires to serve his own interests should recognize that, under prevailing business conditions, the most effective way of proving his basis for credit is through his willingness to submit a statement of his financial condition.

One of the beneficial effects which the practice of requiring financial statements has on the debtor is derived from his realization of the necessity for making a good showing. Because of the material influence of the statement upon his credit standing, the debtor is forced to maintain his business in good condition, and prior to entering any hazardous undertaking he is apt to reflect on the probable effect of the outcome of such venture on the appearance of his balance sheet. A second advantage to the debtor lies in the necessity for keeping books of record. Incompetence is due in large measure not to lack of ability but to lack of information. Lack of information in the retail trade can hardly be due to anything but inferior bookkeeping methods. What they need most is accounts which actually account. Asking for a financial statement will encourage and stimulate better methods of accounting and tend to make

the conduct of business more scientific. It may also reduce the temptation of a debtor to overexpand.

Moreover, as already pointed out, the probable effect of the practice in requiring statements will be ultimately to weed out the incompetent traders to the benefit of the honest and capable merchants, thereby putting competition on a sound basis. The incompetent merchant frequently offers the meanest sort of competition. When in need of funds, he is apt to undersell the honest and capable dealer, even when required to sell below cost. The inability of these traders to submit satisfactory statements will, through the consequent refusal of credit accommodations, tend toward their complete elimination from the field of business. Furthermore, an exact knowledge of a debtor's circumstances, as afforded by the statement of his financial condition, results in the fixing of definite lines of credit which the creditor may prudently give and the debtor may prudently receive. The disaster to the buyer through accepting too much credit may be even greater than the disaster to the seller through giving too much credit. Statements are, therefore, protective to debtor and creditor alike. In addition they tend to establish confidence in the buyer, whose trade is on that account solicited by the best houses.

Methods of Obtaining Statements.—Financial statements may be obtained direct from the merchant or indirectly through mercantile agencies, interchange bureaus, and trade credit offices. Probably the largest number of creditors rely on the statements obtained through the indirect method. Statements coming through these sources are often incomplete and consequently cannot be used as a basis for careful and intelligent analysis and interpretation. It is also claimed that many statements are secured orally by the agency's reporters, owing to the reluctance of many debtors to fill out the forms submitted by the agency. Statements so compiled are practically valueless and sometimes even worse than none, on account of the extreme inaccuracies which may creep in. Then, too, the financial statements in the agency reports are sometimes entirely too old. Much improvement in this direction is to be noted, however.

In view of the foregoing, it is obvious that, if complete and otherwise satisfactory statements are to be secured, a request should be made by the creditor direct. The effect is both salutary and efficacious. In case a merchant is called upon to fill out a form furnished by his creditor, much greater care and caution will undoubtedly be exercised in compiling the data. The statement is likely to be signed, the data more complete and accurate, and the information fresh and up to the minute. Moreover, it is apt to contain essential profit and loss data when submitted on a form provided by the creditor.

In spite of the disadvantages incident to the indirect mode of obtaining statements, relatively few creditors resort to the direct method, except when in doubt as to the debtor's standing and when the statements

"Large assets are not always necessary to the creation of credit, what is most desirable is, that credit be in relative proportion to the actual assets."

PROPERTY STATEMENT

TO

"The giver of credit is a contributor of capital, and becomes, in a certain sense, a partner of the debtor, and, as such, has a natural right to complete information of the debtor's condition at all times."

Form Adopted and Recommended by the National Association of Credit Men

For the purpose of obtaining merchandise from you on credit, we (I) make the following statement in writing, intending that you should rely thereon respecting our (my) financial condition as of (Date)_____ 19____

(All questions should be answered. When no figures are inserted, write word "None.")

ASSETS			LIABILITIES		
Cash in hand			For MERCHANDISE:		
Cash in bank			Accounts owing not due		
Accounts owing by customers, good and collectible, not pledged or sold			Accounts owing past due		
Notes owing by customers, good and collectible, not pledged or sold			Trade Acceptances payable		
Trade Acceptances receivable, not pledged or sold			Notes payable for Mdse.		
Merchandise (not on consignment or conditional sale.) (How valued; Cost____ Market____)			For BORROWED MONEY:		
			Notes payable to banks		
			Notes or debts payable to others (including relatives and friends)		
Other quick assets:			Deposits of money with us. (Describe)		
(Describe)					
			Owing for Wages and Salaries		
			Owing for Taxes (city, state and federal)		
			Owing for Rental		
			Owing for Insurance Premiums		
TOTAL QUICK ASSETS			TOTAL QUICK LIABILITIES		
Machinery: (How valued; Cost____ Depreciated____)			Debt secured by mortgage on land or buildings		
Fixtures and other Equipment. (How valued; Cost____ Depreciated____)			Debt secured by chattel mortgage or other liens		
Land and Buildings as described below			Debt secured by judgment		
			Other liabilities:		
Notes and Accounts owing from officers, employees, or others not customers			(Describe)		
Other assets.					
(Describe)					
			TOTAL LIABILITIES		
			NET WORTH		
TOTAL ASSETS			TOTAL		

What books of account do you keep?_____

Was this statement made from those books?_____ Do you keep cost records?_____

Do you sell or pledge your accounts to creditors, banks, finance companies or others?_____. If so, what amount is so sold or pledged? $_____ What amount of your accounts have you sold or pledged during the past twelve months? $_____

Are any creditors secured by mortgage or lien of any sort?_____ If so, how?_____

Are any claims in attorneys' hands or suits against you?_____

Have you merchandise on consignment or conditional sale?_____ If so, what amount? $_____

If business property is leased, for what term and what rental?_____

Name and locality of your bank or banks_____

Location and kind of business_____

Previous business experience_____ Where_____

It is important that every question on both sides of this sheet be correctly answered and that the blanks be carefully filled in. In answering questions involving amounts write the word "none" where figures do not apply. You will find it advantageous to keep a copy of this statement for comparison with the showing you will be able to make a year hence.

FIG. 35*A*.—Form of financial statement adopted and recommended by the National Association of Credit Men.

secured from indirect sources prove unsatisfactory and inadequate. Some houses, including banks, generally follow the practice of requiring statements from all new credit seekers. Other concerns require state-

ments from all or most of their debtors at regular intervals, usually, every year. This practice serves to impress the debtor with the vigilance of his creditors, thereby inducing him to measure up to their higher credit standards.

INSURANCE

On Merchandise $_____ On Buildings $_____ Machinery $_____ Fixtures $_____

Other Equipment $_____ Employers' liability $_____

Is any insurance assigned?_____ What amount?_____ To whom?_____

Amount of life insurance for benefit of business $_____

With what companies_____

SUMMARY OF PROFIT AND LOSS

Inventory of Mdse. beginning of fiscal year (not including fixtures or equipment)			Sales last fiscal year		
			Income from all other sources		
Cost of Mdse. purchased during the year			Inventory of Mdse. at close of year		
			Total Income for year		
General expenses including salaries, losses, etc.			Less Total Expenses		
TOTAL EXPENSES			NET PROFIT FOR YEAR		

RECORD OF LAND AND BUILDINGS

Title in name of	Description and location	Book value	Assessed value	Amount of Encumbrances	To whom

BUY PRINCIPALLY FROM THE FOLLOWING CONCERNS

Names	Addresses	Amount Owing	
		Open Account	Notes

Names and Addresses of Owners of Business_____

REMARKS:

The foregoing statement has been carefully read (both printed and written matter) and is in all respects complete, accurate and truthful. It discloses to you the true state of our (my) financial condition on the date above stated. Since that time there has been no material unfavorable change in our (my) financial condition; and if any such change takes place we (I) will give you notice. Until such notice is given, you are to regard this as a continuing statement.

Firm Name_____

Signed by_____

Street_____ Town_____ State_____

Date of signing statement_____ 19____

Form B.

FIG. 35*B*.—Reverse side of Fig. 35*A*.

Forms of Statements.—Several forms adapted to different lines of business have been adopted and recommended by the National Association of Credit Men. These are widely used, particularly by the smaller concerns (see Figs. 35*A* and *B*). Practically all the larger houses have,

F. R. NO. 25 5M—6-25

FINANCIAL STATEMENT

INDIVIDUAL
MANUFACTURING OF MERCANTILE LINES

NAME

BUSINESS ADDRESS

TO

FOR THE PURPOSE OF PROCURING CREDIT FROM TIME TO TIME WITH YOU, FOR MY NEGOTIABLE PAPER OR OTHERWISE, I FURNISH THE FOLLOWING AS A TRUE AND CORRECT STATEMENT OF MY FINANCIAL CONDITION ON_____ 19____ AND HEREBY AGREE TO NOTIFY YOU IMMEDIATELY IN WRITING, OF ANY MATERIALLY UNFAVORABLE CHANGE IN MY FINANCIAL CONDITION. IN THE ABSENCE OF SUCH NOTICE OR A NEW AND FULL WRITTEN STATEMENT, THIS IS TO BE CONSIDERED AS A CONTINUING STATEMENT, AND THAT MY PECUNIARY RESPONSIBILITY HAS NOT FALLEN BELOW THE CONDITION HEREIN SET FORTH.

(ALL QUESTIONS SHOULD BE ANSWERED. INSERT CIPHER IN THE ABSENCE OF ANY AMOUNT. WHEN THE WORD "YES," "NO" OR "NONE" WILL CORRECTLY ANSWER THE QUESTIONS, WRITE THEM IN THEIR PROPER PLACES.)

ASSETS	DOLLARS	CENTS	LIABILITIES	DOLLARS	CENTS
CASH ON HAND			NOTES PAYABLE TO OWN BANK		
CASH IN BANK			NOTES PAYABLE TO OTHER BANKS		
NOTES RECEIVABLE OF CUSTOMERS DUE WITHIN 90 DAYS			NOTES PAYABLE OTHERS		
			ACCOUNTS PAYABLE FOR MERCHANDISE--NOT DUE		
ACCOUNTS RECEIVABLE--GOOD			ACCOUNTS PAYABLE FOR MERCHANDISE--PAST DUE		
ACCOUNTS RECEIVABLE--DOUBTFUL			DEPOSITS OF MONEY WITH ME		
MERCHANDISE--			ANY OTHER CURRENT LIABILITIES--ITEMIZE		
TOTAL ACTIVE ASSETS			TOTAL CURRENT LIABILITIES		
STOCKS, BONDS AND INVESTMENTS--ITEMIZE			MORTGAGES OR LIENS ON REAL ESTATE		
			CHATTEL MORTGAGES		
			ANY OTHER LIABILITIES--ITEMIZE		
CASH VALUE LIFE INSURANCE (OVER)					
REAL ESTATE (OVER)			TOTAL LIABILITIES		
MACHINERY, EQUIPMENT AND FIXTURES			NET WORTH		
HORSES, WAGONS AND AUTOMOBILES					
NOTES RECEIVABLE (OTHER THAN MORTGAGE NOTES) DUE BEYOND 90 DAYS					
FIRST MORTGAGE NOTES RECEIVABLE					
SECOND MORTGAGE NOTES RECEIVABLE					
BALANCE ON LAND CONTRACTS RECEIVABLE					
OTHER ASSETS--ITEMIZE					
TOTAL			TOTAL		

SEE OTHER SIDE

FIG. 36*A*.—Statement form approved by a Federal Reserve Bank for use by an individual.

CONTINGENT LIABILITY OF ANY KIND

UPON RECEIVABLES DISCOUNTED OR PLEDGED BY ME					
UPON ACCOMMODATION PAPER ENDORSED BY ME					
UPON NOTES EXCHANGED WITH OTHERS					
AS GUARANTOR FOR OTHERS ON NOTES, CONTRACTS, ETC.					
CUSTOMERS' ACCOUNTS SOLD AND ASSIGNED					
FOR BONDS					
TOTAL					

CONDENSED PROFIT AND LOSS STATEMENT FOR FISCAL YEAR ENDED _____ 19____

EXPENSE						INCOME					
COST OF MATERIAL OR MERCHANDISE CONSUMED						NET SALES					
ACTUAL EXPENSE OF CONDUCTING BUSINESS INCLUDING, RENT, TAXES, INSURANCE, ETC.						FROM INVESTMENTS					
INTEREST ON BORROWED MONEY AND BONDS						FROM DISCOUNTS ON PURCHASES					
BAD DEBTS CHARGED OFF						FROM OTHER SOURCES--ITEMIZE					
DEPRECIATION CHARGED OFF											
WITHDRAWALS											
NET PROFITS											
TOTAL						TOTAL					

REAL ESTATE

LOCATION	OWNERS VALUE	TAX VALUE	FIRST MORTGAGE	OTHER MORTGAGES	BY WHOM HELD

INSURANCE

LIFE	OTHER

(DECLARATION TO BE PLACED ABOVE SIGNATURE)

I HEREBY SOLEMNLY DECLARE AND CERTIFY THIS TO BE A TRUE AND CORRECT STATEMENT OF MY FINANCIAL CONDITION

AT THE CLOSE OF BUSINESS_____ _____19____

NAME_____

DATE_____19____

FIG. 36*B*.—Reverse side of Fig. 36*A*.

as a rule, their own special form of financial statement, drawn up in accordance with their requirements, although many of them follow the standard forms recommended by the National Association of Credit

FINANCIAL STATEMENT — CORPORATION

Corporate Name .....

Business ..... Address .....

Statement for

CONDITION AT CLOSE OF BUSINESS ..... 19 .....

ASSETS		LIABILITIES AND NET WORTH	
Cash—On Hand, $		Notes Payable for Merchandise	
In Bank, $		Trade Acceptances—Payable	
Notes Receivable of Customers—Due within 90 days		Notes Payable to Banks	
Notes Receivable of Customers—Due beyond 90 days		Bankers Acc. (Amt. Secured, $)	
Trade Acceptances of Customers		Notes Payable for Paper Sold	
Accts Receivable of Customers—Not Due		Notes and Accounts Payable to Officers, Directors and Stockholders	
Accts. Receivable of Customers—Past Due		Notes Payable to Others	
*Mdse.—Finished (How Val.)		Accounts Payable—Not Due	
*Mdse.—In Process (How Val.)		Accounts Payable—Past Due	
*Mdse.—Raw (How Val.)		Deposits of Money with us	
*Mdse.—In Transit		Provision for Federal Taxes	
U. S. Government Obligations		Accrued Interest, Other Taxes, Etc.	
Other Cur. Assets—(Itemize on Page 3)		Chattel Mortgages	
TOTAL CURRENT ASSETS		Portion of Funded Debt Maturing	
Due from Controlled or Subsidiary Concerns—for Merchandise		Other Current Liabilities (Itemize Page 4)	
Due from Controlled or Subsidiary Concerns—for Advances		TOTAL CURRENT LIABILITIES	
Stocks, Bonds and Investments—(Itemize On page 3)		Mortgages or Liens on Real Estate	
Land		Bonded Debt	
Buildings (Before Depreciation. See Reserve Contra)		Any Other Liabilities—Itemize	
Machinery, Equipment & Fixtures (Before Depreciation. See Reserve Contra)		(TOTAL DEBT)	
Notes and Accounts Receivable—Due from Officers, Stockholders & Employees		Reserves—Itemize	
Goodwill, Patents and Trade Marks		Capital Stock Outstanding:	
Prepaid Expenses		Preferred	
Other Assets—Itemize		Common (Par $)	
		(No Par Shares)	
		Undivided Surplus:	
		Earned $	
		Unearned	
TOTAL		TOTAL	

*Unless otherwise specifically noted merchandise entered at lower of cost or market.

RECONCILEMENT OF SURPLUS

Undivided Surplus at Close of Previous Fiscal Year ..... $

Items Not Applicable to Current Year ..... $

Net Addition or Deduction

Net Profit or Loss as per Profit and Loss Statement

Less Dividends — Preferred ($ Per Share)

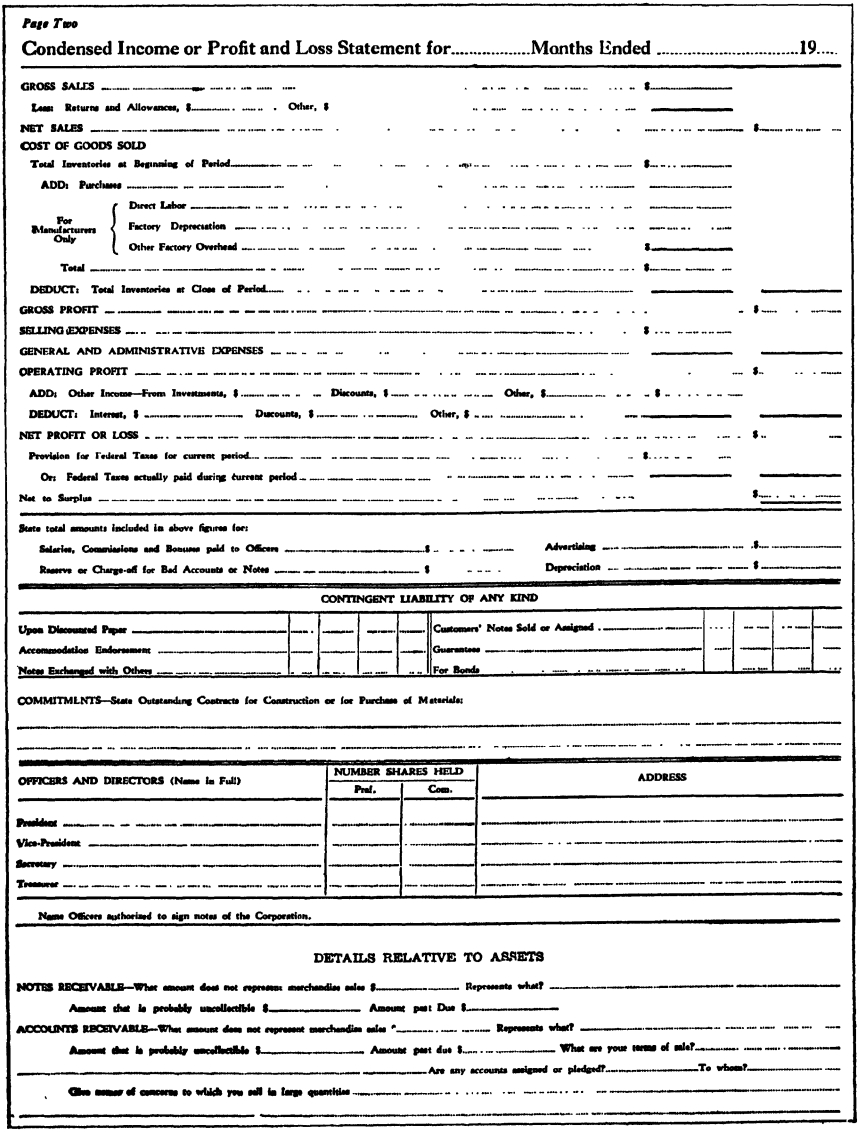
Common ($ Per Share)

Undivided Surplus (See Balance Sheet Above)

FIG. 37*A*.—Financial statement form used by a number of banks in obtaining data from corporations. It calls for more detail than can normally be secured by mercantile creditors.

Men. Other forms in wide usage, especially by banks, are those suggested and furnished by the several Federal Reserve Banks (see Figs. 36*A* and *B*) or by the larger commercial banks (see Figs. 37*A*, *B*, *C*, and *D*).

An examination of a large number of forms used by houses operating on a substantial scale reflects a special effort on their part to simplify the form so as to contain only the most important items. Experience



Page Two

Condensed Income or Profit and Loss Statement for.....Months Ended .....19.....

GROSS SALES ..... $.....

Less: Returns and Allowances, $..... Other, $ .....

NET SALES ..... $.....

COST OF GOODS SOLD

Total Inventories at Beginning of Period..... $.....

ADD: Purchases .....

For Manufacturers Only — Direct Labor ..... / Factory Depreciation ..... / Other Factory Overhead ..... $.....

Total ..... $.....

DEDUCT: Total Inventories at Close of Period.....

GROSS PROFIT ..... $.....

SELLING EXPENSES ..... $.....

GENERAL AND ADMINISTRATIVE EXPENSES .....

OPERATING PROFIT ..... $.....

ADD: Other Income—From Investments, $..... Discounts, $..... Other, $..... $.....

DEDUCT: Interest, $..... Discounts, $..... Other, $.....

NET PROFIT OR LOSS ..... $.....

Provision for Federal Taxes for current period..... $.....

Or: Federal Taxes actually paid during current period .....

Net to Surplus ..... $.....

State total amounts included in above figures for:

Salaries, Commissions and Bonuses paid to Officers ..... $..... Advertising ..... $.....

Reserve or Charge-off for Bad Accounts or Notes ..... $..... Depreciation ..... $.....

CONTINGENT LIABILITY OF ANY KIND

Upon Discounted Paper ..... Customers' Notes Sold or Assigned .....

Accommodation Endorsement ..... Guarantees .....

Notes Exchanged with Others ..... For Bonds .....

COMMITMENTS—State Outstanding Contracts for Construction or for Purchase of Materials:

OFFICERS AND DIRECTORS (Name in Full)	NUMBER SHARES HELD		ADDRESS
	Pref.	Com.	
President			
Vice-President			
Secretary			
Treasurer			

Name Officers authorized to sign notes of the Corporation.

DETAILS RELATIVE TO ASSETS

NOTES RECEIVABLE—What amount does not represent merchandise sales $..... Represents what? .....

Amount that is probably uncollectible $..... Amount past Due $.....

ACCOUNTS RECEIVABLE—What amount does not represent merchandise sales $..... Represents what? .....

Amount that is probably uncollectible $..... Amount past due $..... What are your terms of sale?.....

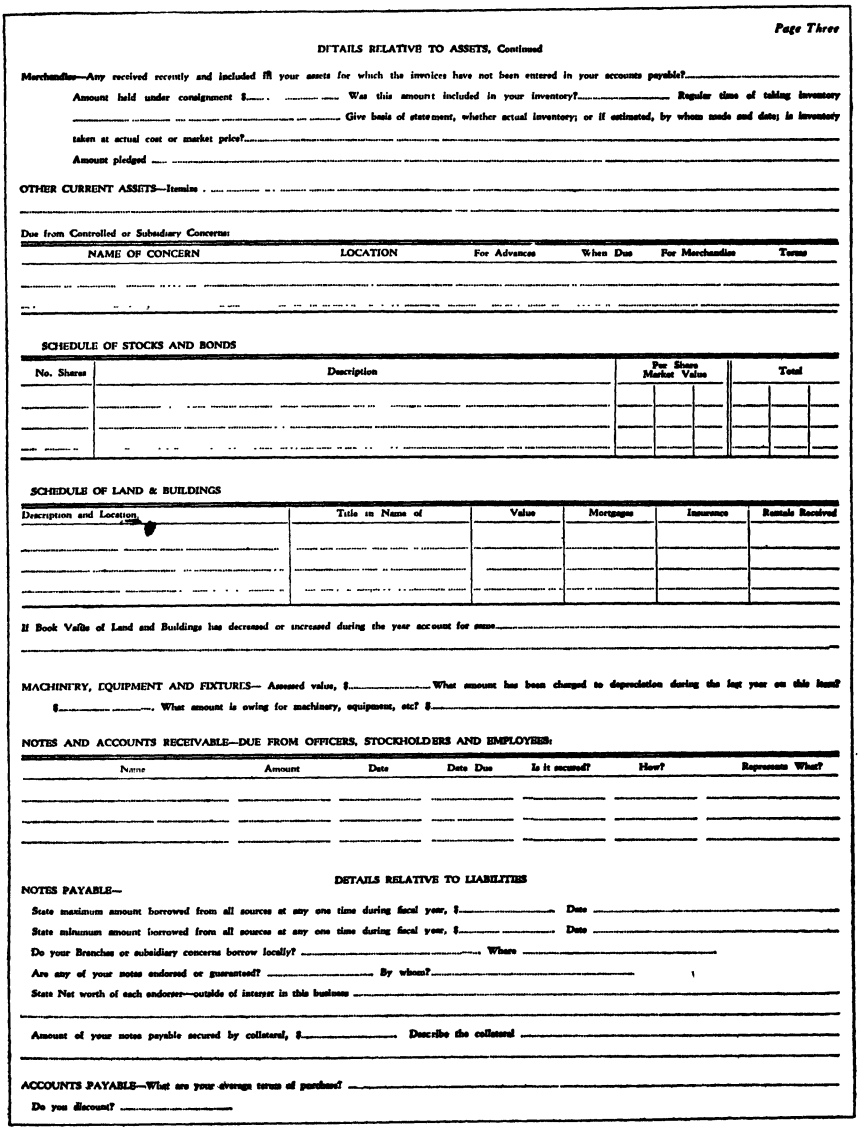
.....Are any accounts assigned or pledged?.....To whom?.....

Give names of concerns to which you sell in large quantities .....

FIG. 37*B*.—Page two of Fig. 37*A*.

has shown that many merchants are discouraged at the outset and either refuse entirely to submit a statement or else omit many points if the form they are required to fill out is too intricate and burdened with all sorts

of details. Many houses have, therefore, concluded that it is possible to ask for too much information and have simplified their forms accord-



Page Three

DETAILS RELATIVE TO ASSETS, Continued

Merchandise—Any received recently and included in your assets for which the invoices have not been entered in your accounts payable?

Amount held under consignment $..... Was this amount included in your inventory? Regular time of taking inventory

Give basis of statement, whether actual inventory; or if estimated, by whom made and date; is inventory taken at actual cost or market price?

Amount pledged

OTHER CURRENT ASSETS—Itemize

Due from Controlled or Subsidiary Concerns:

NAME OF CONCERN	LOCATION	For Advances	When Due	For Merchandise	Terms

SCHEDULE OF STOCKS AND BONDS

No. Shares	Description	Par Value	Per Share Market Value	Total

SCHEDULE OF LAND & BUILDINGS

Description and Location	Title in Name of	Value	Mortgages	Insurance	Rentals Received

If Book Value of Land and Buildings has decreased or increased during the year account for same

MACHINERY, EQUIPMENT AND FIXTURES— Assessed value, $ What amount has been charged to depreciation during the last year on this item? $ What amount is owing for machinery, equipment, etc? $

NOTES AND ACCOUNTS RECEIVABLE—DUE FROM OFFICERS, STOCKHOLDERS AND EMPLOYEES:

Name	Amount	Date	Date Due	Is it secured?	How?	Represents What?

DETAILS RELATIVE TO LIABILITIES

NOTES PAYABLE—

State maximum amount borrowed from all sources at any one time during fiscal year, $ Date

State minimum amount borrowed from all sources at any one time during fiscal year, $ Date

Do your Branches or subsidiary concerns borrow locally? Where

Are any of your notes endorsed or guaranteed? By whom?

State Net worth of each endorser—outside of interest in this business

Amount of your notes payable secured by collateral, $ Describe the collateral

ACCOUNTS PAYABLE—What are your average terms of purchase?

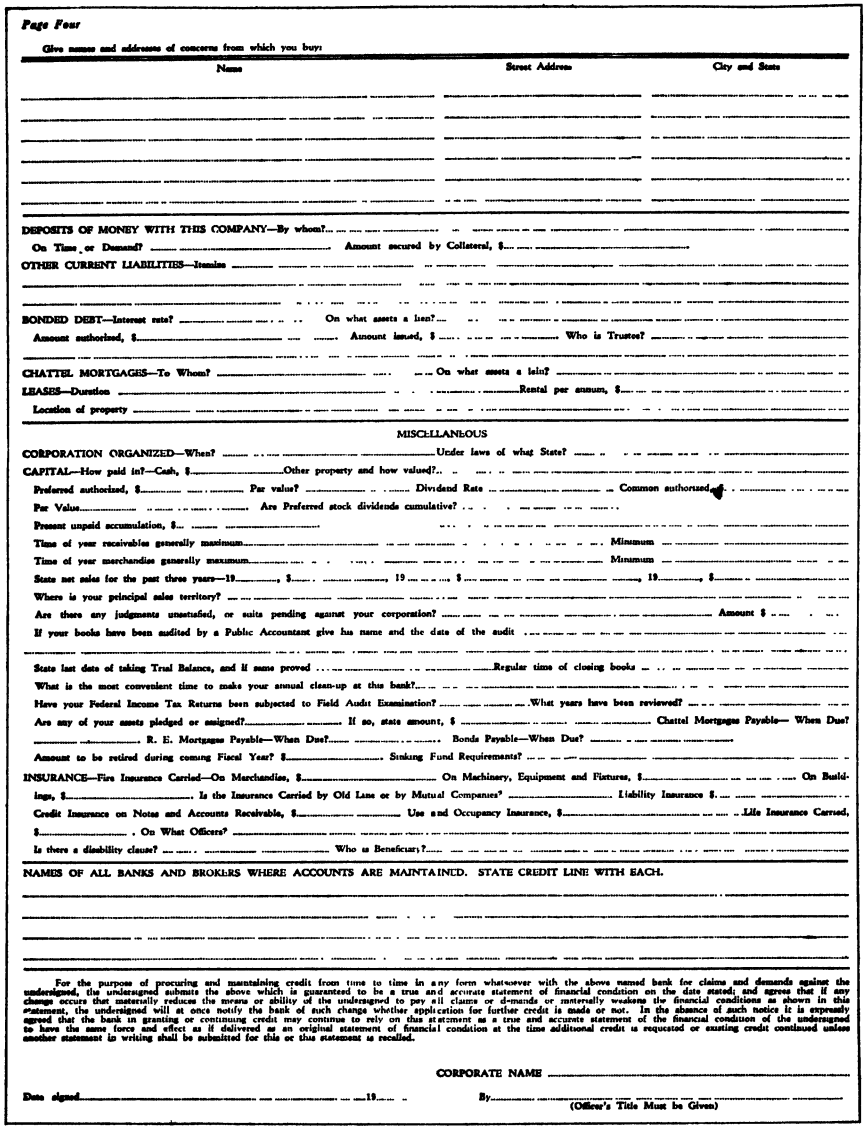
Do you discount?

FIG. 37*C*.—Page three of Fig 37*A*.

ingly so as not to make them too comprehensive but to cover merely the essential and vital points.

False Statement Legislation.—The financial statement as a basis for credit extensions is now thoroughly established in the business world.

With the tremendous development of its use, the next natural step is to safeguard and protect it against unscrupulous persons who would issue a false statement for the purpose of securing credit. A false statement



Page Four

Give names and addresses of concerns from which you buy:

Name	Street Address	City and State

DEPOSITS OF MONEY WITH THIS COMPANY—By whom?

On Time or Demand? Amount secured by Collateral, $

OTHER CURRENT LIABILITIES—Itemize

BONDED DEBT—Interest rate? On what assets a lien?

Amount authorized, $ Amount issued, $ Who is Trustee?

CHATTEL MORTGAGES—To Whom? On what assets a lein?

LEASES—Duration Rental per annum, $

Location of property

MISCELLANEOUS

CORPORATION ORGANIZED—When? Under laws of what State?

CAPITAL—How paid in?—Cash, $ Other property and how valued?

Preferred authorized, $ Par value? Dividend Rate Common authorized, $

Par Value Are Preferred stock dividends cumulative?

Present unpaid accumulation, $

Time of your receivables generally maximum Minimum

Time of your merchandise generally maximum Minimum

State net sales for the past three years—19, $ 19, $ 19, $

Where is your principal sales territory?

Are there any judgments unsatisfied, or suits pending against your corporation? Amount $

If your books have been audited by a Public Accountant give his name and the date of the audit

State last date of taking Trial Balance, and if same proved Regular time of closing books

What is the most convenient time to make your annual clean-up at this bank?

Have your Federal Income Tax Returns been subjected to Field Audit Examination? What years have been reviewed?

Are any of your assets pledged or assigned? If so, state amount, $ Chattel Mortgages Payable— When Due?

R. E. Mortgages Payable—When Due? Bonds Payable—When Due?

Amount to be retired during coming Fiscal Year? $ Sinking Fund Requirements?

INSURANCE—Fire Insurance Carried—On Merchandise, $ On Machinery, Equipment and Fixtures, $ On Buildings, $ Is the Insurance Carried by Old Line or by Mutual Companies? Liability Insurance $

Credit Insurance on Notes and Accounts Receivable, $ Use and Occupancy Insurance, $ Life Insurance Carried, $ On What Officers?

Is there a disability clause? Who is Beneficiary?

NAMES OF ALL BANKS AND BROKERS WHERE ACCOUNTS ARE MAINTAINED. STATE CREDIT LINE WITH EACH.

For the purpose of procuring and maintaining credit from time to time in any form whatsoever with the above named bank for claims and demands against the undersigned, the undersigned submits the above which is guaranteed to be a true and accurate statement of financial condition on the date stated; and agrees that if any change occurs that materially reduces the means or ability of the undersigned to pay all claims or demands or materially weakens the financial conditions as shown in this statement, the undersigned will at once notify the bank of such change whether application for further credit is made or not. In the absence of such notice it is expressly agreed that the bank in granting or continuing credit may continue to rely on this statement as a true and accurate statement of the financial condition of the undersigned to have the same force and effect as if delivered as an original statement of financial condition at the time additional credit is requested or existing credit continued unless another statement in writing shall be submitted for this or this statement is recalled.

CORPORATE NAME

Date signed, 19 By (Officer's Title Must be Given)

FIG. 37*D*.—Page four of Fig. 37*A*.

may be defined as one which conveys the impression that the financial condition of the enterprise is otherwise than it is in reality. This is usually accomplished by overestimating the value of the assets, omitting

liabilities, or improperly classifying them so as to place, for example, a liability among the assets. It may or may not be fraudulent, as will be shown later.

The Federal Law.—Makers of false financial statements may be prosecuted under the Federal law, Section 215 of the U. S. Criminal Code providing punishment for the use of the United States mails to defraud. To secure conviction under this law it is necessary to prove:

1. That the debtor issued a false statement in writing, either directly to the creditor or to a mercantile agency.

2. That the statement is materially false. The false items must have been so misrepresented that, were the true facts given, an ordinarily cautious person would not have extended credit on the strength of the statement. The items most susceptible of definite ascertainment for this purpose are cash on hand and in bank, accounts receivable, notes and acceptances receivable, amount owing for merchandise, amount owing for borrowed money, liens or chattel mortgages on merchandise and equipment, and mortgages on real estate. Others are matters of opinion or represent estimates.

3. That the statement was made for the purpose of procuring credit or an extension of time on an account already carried.

4. That it was made with the intent to defraud and that it should be relied upon. This may be proved by the circumstances under which it was given.

5. That the statement was sent through the mails. This requires that all envelopes in which financial statements are received should be carefully preserved after having been dated and signed by the party receiving the statement and by a responsible witness to the effect that the signed envelope contained the financial statement in question. This precaution proves of great value in offering reliable testimony to the effect that the mail was used to defraud. Houses following the practice of preserving envelopes containing statements will find it to their advantage to utilize one of the combined statements and mailing envelope forms adopted and recommended by the National Association of Credit Men.

The advantage of the Federal law is that it imposes more severe punishment on fraudulent debtors than do the state laws. It is also sometimes easier to prove the use of the mails to defraud than to prosecute under a state statute. Furthermore, the prosecution may be had either in the district in which the statement was mailed or in the district in which it was delivered, regardless of the absence of the accused in the latter district.

On the other hand, the Federal law is inadequate. It covers only cases where the mails have been used as a means of transmitting false statements for the purpose of securing credit and with the intent to defraud, *i.e.*, to deprive creditors of their property, inasmuch as the prosecution takes place under the Federal mail-fraud statute. Nor does

it apply to the numerous instances involving the submission of false statements in person.

State Laws.—The rapid development and increased use of financial statements as a basis for credit necessitated still further protection than that afforded by the Federal law. Although nearly every state has some form of statute providing for the punishment of offenders, who, by means of false pretenses or representations secure credit, such statutes have fallen short in numerous instances where acts have been committed in connection with the issue of false statements of financial condition. In view of this fact, 39 states have already enacted some form of special statute for the punishment of offenders, who would not otherwise come within the provisions of preexisting laws.

The New York statute, passed in 1912 (section 1293(a) of the Penal Law), is considered the model state false statement law and has been copied practically verbatim in many other states. The law is broad enough in scope to cover all cases involving the making of false written statements for the purpose of obtaining credit in any form, including cases where such statements are made direct to the creditor or indirectly through the commercial agencies, brokerage houses, and the like, whose intention it is to communicate them to such persons or firms as may have occasion to consider entering into credit transactions with the maker of the statement. Moreover, the law aims at the person who makes the statement or causes it to be made, irrespective of whether credit is thereby sought for his own benefit or for that of any other person, firm, or corporation.

The law seeks to punish the mere making of a false statement in writing "with intent that it shall be relied upon." Obviously, a statement may be false without being fraudulent. Items may be misrepresented for the purpose of obtaining credit and ultimately paying for the property thus secured, and not with a view of defrauding the creditor. In spite of innocent intent, the statement is nevertheless false and the law makes it a crime and misdemeanor, by applying the same principle which makes the carrying of concealed weapons a crime. It is the prevention of the possession of instruments of crime that presumably deters the commission of the real crime.

The law also seeks to punish any person procuring credit on the basis of a false statement irrespective of whether or not he is the maker of it.

In most of the 34 states which have enacted statutes similar to that of New York, the only elements of proof required against the defendant are:

1. That he made the statement.
2. That the statement is materially false.
3. That it was made for the purpose of procuring credit or an extension of time on an account already carried.

4. That he made it with the intent that it should be relied upon.

5. That the statement was made in the county in which prosecution is sought.

In six of the states[1] it is also necessary to prove that property was obtained upon the strength of the statement. A crime is committed under such circumstances only when property is actually obtained on the basis of the false statement. In all instances the burden of proving the various elements of the crime rests upon the shoulders of the credit manager who seeks to punish the offender.

Special Aspects of Financial Statements.—To make for greater accuracy and to facilitate prosecution, a creditor should require that the statement be completely filled out and signed by the maker. An oral statement is of no value in a criminal action or in barring a discharge in bankruptcy as can be done when a false financial statement was made in writing. It can be used merely for civil action, as additional evidence in support of the creditor's claims. Unfilled spaces should not be permitted. It should contain a statement that it was given for the purpose of obtaining credit and that it completely represents the maker's financial condition. It should also contain the provision that all debts owed to the creditor in question become due immediately upon the debtor's insolvency, transfer of the maker's merchandise in violation of the Bulk Sales Law, and under similar conditions. It is further advisable to have a provision to the effect that not only is the statement true as of the date stated thereon but that it is to be regarded as a continuous statement until the creditor has been notified of any changes of a derogatory character. In the absence of such a provision on the statement, the courts have held that when the statement is given to establish a general line of credit the representations are continuing for a reasonable period of time; in all other instances the apparent intent when the statement was made is a determining factor. If the statement was made for a particular transaction only, it is obviously not continuing in effect. If, however, the statement was given as a continuing one, the debtor is bound to notify his creditors of any unfavorable material changes in his financial condition.

The New York Statutes also provide that a false representation that a financial condition previously shown in a statement continues to be true is regarded as a punishable crime if property has been procured upon the faith thereof. The law of that state goes farther and declares it a crime for anyone knowingly to procure any property upon the faith of a false financial statement made by another, thus punishing the maker of a false financial statement, the one who knowingly uses a false statement, and the one who knowingly defrauds another on a previous statement which is no longer true.

[1] Alabama, Colorado, Georgia, Idaho, Nevada, and Virginia.

Selected References

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FIXEL, A. E.: "False Financial Statements," 2d ed., Mathew Bender, 1934.
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MARKS, M.: "How to Correct Credit Abuses," Chap. 3, Harper & Brothers, 1930.
"Credit Manual of Commercial Laws," National Association of Credit Men, 1937, pp. 199–203.
PRENDERGAST, W. A. and STEINER, W. H.: "Credit and Its Uses," pp. 258–280.
YOUNG, R.: "Industrial Credits," Chap. 4.

Questions and Problems

1. Your company is in receipt of an application for credit from the Fit-Well Shoe Company. In order to have a better basis for a credit decision, you requested a financial statement which the Fit-Well Shoe Company refused to furnish. Show how you would proceed to convince the prospective customer of the desirability of supplying your firm with a financial statement.

2. Assuming that the Fit-Well Shoe Company, despite your sound plea, refuses to submit to you a statement of its financial condition, what other means would be available for securing such a statement?

3. What is the difference, if any, between balance sheets, financial statements, statements of profit and loss, operating statements, and statements of income and expense?

4. Show that the growing practice on the part of debtors in submitting financial statements to their creditors has a beneficial effect upon competition.

5. In what ways is the direct method of obtaining a financial statement superior to the indirect method?

6. Can a financial statement be false and not fraudulent? Explain.

7. Suppose that the Fit-Well Shoe Company was finally persuaded to submit a financial statement to your company. The statement was dated Dec. 31, and showed accounts payable of $56,789. In checking up this item on a Credit Interchange Bureau report cleared at about the same date, you found that the Fit-Well Shoe Company owed creditors approximately $60,135. Assuming willingness on your part to prosecute the maker of the statement, could you secure conviction on the ground that the statement was false and that the accounts payable item was misrepresented?

8. What points must be proved in order to secure conviction under the Federal law for the making and issuing of a false financial statement?

9. In what respects do the state laws governing the making and issuing of false financial statements differ from the Federal law?

10. Which of the two types of law is preferable, from the standpoint of the creditors who rely upon financial statements in the granting of credit?

11. Why does a statement often contain the following words: "We (I) make the following statement in writing intending that you should rely thereon respecting our (my) financial condition as of (date) "? Is there any value in adding that "you are to regard this as a continuing statement"? Explain.

CHAPTER XVIII

VALUATION ANALYSIS OF FINANCIAL STATEMENTS

When carefully prepared and skilfully analyzed, financial statements offer the credit manager an unusually satisfactory source of information. The experienced analyst can obtain from them numerous important facts which are not available from any other source.

Arrangement.—All financial statements may be said to consist of assets and equities. Equities are, in practice, divided into liabilities or claims against the business held by outsiders, and proprietorship, or residual claims against the enterprise on the part of its owners, or stockholders.

All assets naturally fall into three groups, depending upon the manner in which they function within the business enterprise:

1. Current or "quick" assets comprise those properties which are readily converted into cash and made available for the purpose of discharging primarily current liabilities incurred in the operation of a business. This class of assets consists of cash, notes receivable, acceptances, accounts receivable, merchandise inventories, investments easily convertible into cash, and the like. Current assets are sometimes further divided into "quick" and "slow," in which case the latter term is used to denote all those assets which are past due or which cannot be quite so readily converted into cash. Usually, however, the term "current" and "quick" are used interchangeably.

2. Deferred assets, commonly termed "deferred charges," consist of items, such as interest, taxes, insurance premiums, and other payments made in advance. They also include organization expense, alteration charges, and such other items as are amortized or written off in subsequent accounting periods. None of the deferred charges result in an accession of cash, hence they cannot be used for the future payment of debts and, for these reasons, must not be shown as current assets.

3. Fixed assets constitute the third class. These are of a permanent nature, since they are not subject to radical changes within short periods of time. Land, buildings, equipment, machinery, fixtures, good will, patents, and trade-marks exemplify this class of properties.

All liabilities, consisting of debts and obligations to others, are distinguished in analogous fashion between current and fixed.

1. Current liabilities are those which mature within a year from date of the statement and must be paid promptly, usually out of current assets.

They ordinarily include accounts payable, notes payable, dividends declared but unpaid, and accrued expenses. The last represent expenses that have been incurred during the period covered by the statement but the payment of which has been postponed to a later accounting period. Among these accrued items are wages due but unpaid, rent, interest, and taxes.

2. Fixed liabilities consist of obligations which do not mature for a considerable time, usually not less than a year from date of statement. This class includes all real and chattel mortgages, promissory notes maturing at a relatively distant future, and all kinds of bonded obligations.

Types of Financial Statement Analysis.—There seem to be in practice two distinct types of statement analysis for credit purposes. The older and probably the less satisfactory of the two consists of a simple evaluation of the different items appearing in the balance sheet, without reference to proportions or relationships except in the most haphazard manner. It is a means by which the balance sheet is "trimmed" down to figures that are regarded as reasonable and the credit decision is based on the status of the subject thus revealed.

The other method of analysis, which is the more advanced process, may be termed the ratio analysis method. Experience has shown that there are in business certain fundamental relationships. When these relationships are favorable, profitable conditions usually prevail, and vice versa. These relationships are expressed in ratios, a detailed discussion of which will be presented in the following chapter.

Some authorities feel that both analyses should be used at the same time in any given statement. A duplication of effort will invariably result, however, from such a procedure. One of the purposes of the ratio analysis is to test the value of each item in the statement that is being analyzed, just as it is in the case of a valuation analysis.

Procedure.—Regardless of the type of analysis to which a financial statement is subjected, the first consideration is whether or not the statement has been audited and, if so, by whom. By having the statement and records audited by a responsible firm of chartered or certified public accountants, creditors can feel more certain that the figures presented are accurate and that they reflect the true condition of affairs.

An audited report is of little significance unless a certificate by the accountants responsible for the audit is appended, because audits vary in their scope and for that reason certifications vary. Hence, it is essential that a creditor read the certificate carefully so as to ascertain the character of the audit and the conditions underlying it.

Although accountants find it necessary to conform to the wishes of their clients, nevertheless, no responsible firm will deviate from sound and well-recognized accounting principles in behalf of unscrupulous

clients. Consequently, only high-grade and reliable firms whose opinions are impartial should be employed, if the confidence of creditors is to be gained as a result of an audit.

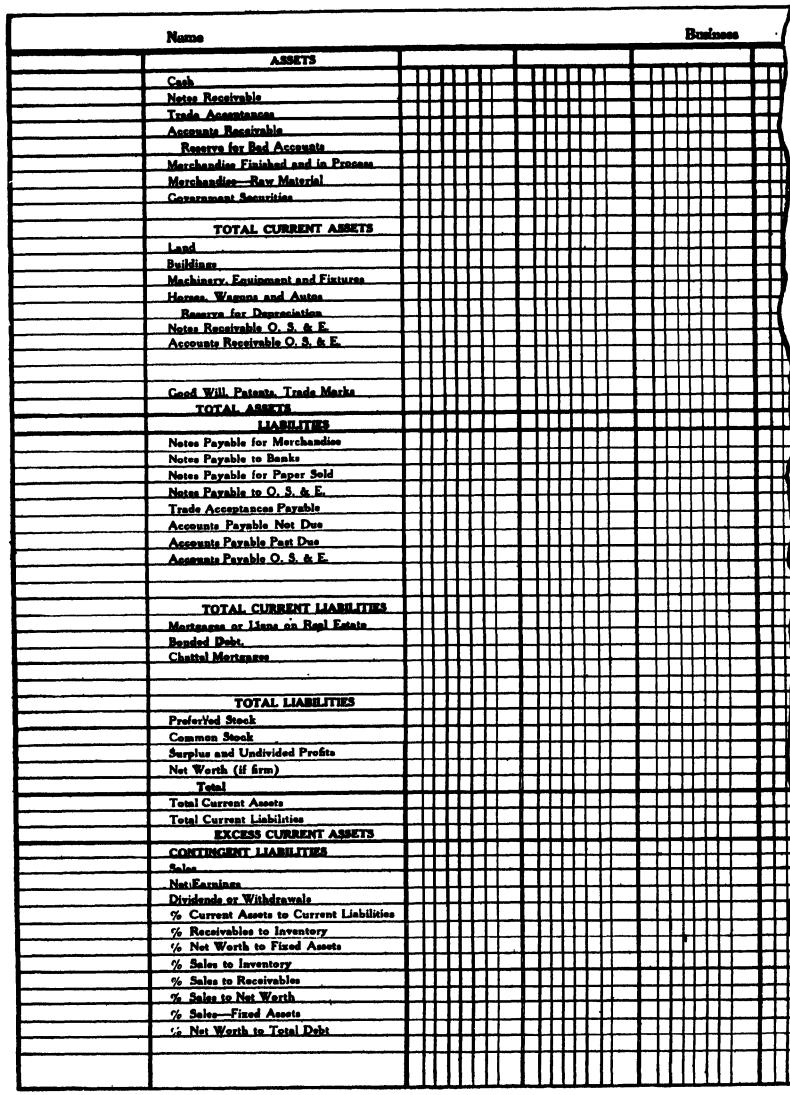


FIG. 38.—Comparison of statements form commonly used in financial statement analysis.

The next step is to reclassify the items in the statement on a "comparison of statements" form, since the data submitted differ widely in arrangement unless presented on a blank furnished by the recipient (see Fig. 38). This form also makes possible the recording of a number of

successive statements so that trends over a period of years may be ascertained. Where only a superficial analysis is to be made, this step may be eliminated, as is often the case in actual practice.

The third step in the procedure is the analysis proper. The data are scrutinized in order to arrive at a conservative valuation of the various items covered, as indicated in the following pages.

VALUATION OF ASSETS

As a precautionary measure, credit grantors deem it necessary not only to ascertain the correctness of the items listed on the assets side of the balance sheet, but also consider prudent a policy which calls for "shading the assets," or writing off a certain percentage. Some intangible items, such as good will, patents, or trade-marks, are usually deemed worthless for debt-paying purposes and are, therefore, entirely disregarded. This policy is based on the assumption that the maker of a statement, for the purpose of procuring credit, by endeavoring to make a favorable showing, will be prone to list his assets at their highest possible value, which may not at all represent the actual sum which will in all probability be realized ultimately. In this connection it is important to bear in mind that a statement prepared for a going business presupposes voluntary selling and continuity of operations. Consequently, balance-sheet items should be valued on a "going concern" basis and not at forced liquidation prices as is being done all too frequently during years of depression. In valuating assets one may even question the wisdom of manipulating prices in accordance with business conditions prevailing at the time the statement was prepared, thus giving little consideration to reappraisals in anticipation of increased profits.

The amount to which assets should be "shaded" or "shaved down" is contingent upon a number of factors. Among these factors are the kind of business represented by the statement, the nature of the constituent items, the relationship a given item bears to certain others, whether the statement has been audited by a reputable public accountant, and whether the amounts are stated in round figures and, hence, are mere estimates. Above all, there is the individual judgment of the credit manager as determined by the degree of his knowledge and experience, for statement analysis has not yet been reduced to an exact science.

Cash.—This item should comprise the total of cash on hand and in bank, provided the latter is subject to immediate withdrawal. It should not include I O U's, since their collectibility is frequently doubtful; postdated or past-due checks; unexpended balances in the hands of salesmen, which are not to be returned as cash to the business; nor should cash include funds subject to liens, or those which are otherwise tied up so as not to be available immediately for payment of debts. If the maker is

indebted to the bank in which his funds are deposited, the bank has a lien against the deposit to the extent of the sum loaned. For this reason it is advisable to have the cash on hand and that on deposit in the bank listed separately.

Another purpose served in separating the two items is the facility which it offers in arriving at conclusions concerning the probable contents of the cash item. Thus, if the cash on hand seems unusually large in amount, it may be reasonably inferred that it contains I O U's and other items the inclusion of which is forbidden by sound theory and practice or it may be indicative of poor business judgment. No set rule can be laid down regarding the amount of cash a statement should show, since it is an item which materially varies in size with different types of business and at different seasons. If correctly stated and free from encumbrances, and if the relationship between cash on hand and cash in banks appears reasonable, this item should be accepted at its face value in determining its debt-paying power.

Accounts Receivable.—Next to cash, the accounts receivable item represents the most liquid asset. They are merely book accounts, or "open" accounts, with customers. This item should include all unpaid claims against solvent debtors arising from the sale of goods or services. Obviously, only those accounts should be covered by the item under consideration which can be reasonably relied upon for the payment of creditors' claims, as determined by past experience and from information on hand concerning the debtors.

This account should not include: items reasonably known not to be collectible; advances to salesmen and other employees; loans to officers; overdrafts of partners, which really partake of the nature of withdrawals from the capital investment; balances covering merchandise shipped on consignment; amounts in dispute or placed for collection; claims against carriers and others; and loans to subsidiaries, which are not to be collected in the normal course of business activity but constitute a rather permanent investment.

In order to bolster up the accounts receivable item, makers of statements not infrequently include mere bookkeeping balances, which are not to be collected in the normal course of business activity and which cannot, therefore, be relied upon for the payment of debts. To provide for such contingencies, allowances should be made in arriving at the net worth of this item. In any event, a normal allowance must be made for bad debts, for even though only solvent debtors be included, it still remains uncertain whether all of them will be willing and able to meet their obligations at maturity. The percentage of such normal allowance or deduction varies with different houses and different lines of trade from less than 0.5 per cent to as high as 10 per cent. Should no distinction

be made between the good and collectible accounts and those which are distinctly inferior, a much larger percentage than normal will necessarily have to be written off.

The Assignment of Accounts Receivable.—Credit grantors are vitally interested in this point and a question to that effect is invariably included in the form of statement the maker is required to fill out. If this asset is in any way encumbered, its net worth, as well as the current ratio, is considerably affected.

The credit or finance company to which accounts receivable are assigned usually advances approximately 77 per cent cash to the assignor. From the remaining 23 per cent of the accounts, it sets aside a reserve sufficient in size to cover its charges. The reserve ordinarily amounts to about 3 per cent, although it varies considerably with the degree of the collectibility of the accounts assigned. The remaining 20 per cent constitute a margin of protection against some of the accounts which cannot be collected. Credit companies or finance companies that make it a practice to purchase accounts receivable generally require that the 80 per cent of the accounts receivable assigned as collateral for the loan have a first or second credit rating with Dun & Bradstreet. As to the marginal 20 per cent, no specific provisions are made, as a rule.

Credit companies usually charge for their services 0.04 per cent per day on the face amount of the accounts assigned from date of assignment to date of payment to the credit company. In addition a flat charge, usually amounting to $5 per $1,000 on the first $100,000 of accounts purchased from the assignor during any one year, is made.

Book accounts may be assigned for several purposes. If the discount rate on purchases greatly exceeds the borrowing rate on accounts receivable, merchants may borrow money on the latter in order to take advantage of the cash discount offered. Whether or not money can be saved in this manner and to what extent are determined by taking into account the size of the purchase involved, the rate of discount offered for cash payment, and the rate at which money is borrowed on the pledged accounts.

More often, however, open accounts are assigned for the purpose of obtaining the necessary relief when the concern is temporarily embarrassed and no other palliative appears available. Occasionally, the method may be resorted to in order to secure funds with which to take advantage of apparently profitable purchases or otherwise to expand the business.

Arguments for Assigning Accounts.—Many arguments are advanced in justification of the practice of hypothecating accounts receivable. This method is compared with that of discounting trade acceptances and bills or notes receivable, which are but open accounts closed. Credit companies further claim that the funds secured through hypothecating

accounts receivable have seldom been used to commit frauds against unsecured creditors, although it is admitted that these funds have often been used to the detriment of the credit companies themselves, inasmuch as sums thus secured are practically in all cases used to pay off debts to insistent unsecured creditors.

Again, credit companies claim that the sale of accounts receivable does not affect the liquidity of the assignor's assets nor does it change its net worth. On the contrary, it greatly improves the showing made by its financial statement, inasmuch as it substitutes cash for about 77 to 80 per cent of the accounts receivable, leaving the remaining 20 to 23 per cent as they were, except for the prior claim of the credit company to which they are subject if the 80 per cent cannot be collected.

Following this line of reasoning, credit companies refute the statement made by opponents of the practice that it leads to overtrading and speculation. They argue that a concern cannot overtrade, by selling 80 per cent of the merchandise for cash, which credit companies enable it to do indirectly, since the only difference between selling on terms, say, of 80 per cent cash against shipping documents and that of receiving 80 per cent cash for its accounts receivable, with the balance as soon as collected, is the contingent liability incurred by the assignor on the hypothecated accounts, which amounts to a loss of approximately 1 per cent of sales, according to the experience of credit companies.. Yet the former practice is considered legitimate, while the latter is found objectionable. This attitude, say credit companies, is unreasonable and unjustifiable, and is based primarily on prejudice against a new method of financing which deviates from the customs of the past.

With respect to charges, credit companies claim that they are no more excessive than the cash discounts found in practically every line of trade. Since the charges of credit companies seldom exceed the cash discounts offered, it is argued that it makes no difference to a concern whether its customers or credit companies discount the bills. In this connection it is to be noted, however, that when customers discount the bills, all risk of loss from bad debts is at once obviated, whereas the assignor is contingently liable to the credit company for any amount which is uncollected, in addition to paying the high charges.

Arguments against Assignment of Accounts.—The general feeling among merchants and, particularly, among bank creditors is against the selling of accounts receivable. It is unfair, they claim, to expect credit accommodations on single-name paper or merchandise on a mere verbal promise to pay at the same time that the credit company is secured by the borrower's accounts receivable, one of the most liquid assets. As a result of such security, the credit company is a preferred creditor in case of bankruptcy, while the others are simply general creditors.

Another reason why the practice is generally condemned by bankers and merchandise creditors is that there is the feeling that strong concerns do not have to resort to this method of financing, while weak companies cannot afford it. A third objection is that the ease with which additional funds can be procured in this manner tempts the small and unsophisticated merchant to overtrade and expand his business on an unsound basis.

Probably one of the principal objections against borrowing funds on the assignment of open book accounts is the opportunity it affords unscrupulous and dishonest merchants to mislead their creditors as to the real status of their financial responsibility until it is too late for the general creditors to take protective measures. If such transfers or assignments were required by law to be recorded, creditors would be protected. As it is, too often the first notice which creditors receive concerning an assignment comes when failure is precipitated and the discovery is made that the debtor's accounts cannot be relied upon.

In the fifth place, raising capital by assigning accounts under the notification plan is unfavorable to the assignor, inasmuch as his business reputation is apt to suffer considerably when his customers learn of the assignment, which usually reflects financial weakness. Sixth, the cost of borrowing funds in this manner has its objectionable features. Such accounts not being considered a high-class collateral, the rate of interest charged on these loans is generally much higher than the current rate on other kinds of loans. Obviously, the average merchant cannot afford to pay exorbitant rates of interest without feeling its bad effects, unless resorted to at rare intervals for the purpose of taking advantage of unusually profitable transactions. As a matter of fact, a debtor resorts to this plan of financing only when hard pressed for ready funds with which to meet obligations to insistent creditors.

Seventh, credit companies to the contrary notwithstanding; it is believed that although the sale of accounts receivable immediately places the assignor in a stronger financial position, by substituting cash for open book accounts, ultimately he is worse off. Any increase in cash, as a rule, proportionally increases the owner's immediate ability to meet his obligations. But, for example, in order to secure $9,800 in cash temporarily, the assignor must definitely pledge $12,727 of his accounts receivable. In this manner, the credit company secures a preference against the amount, thereby appropriating a portion of the subject's most liquid asset as security for its loan, whereas other creditors are expected to extend accommodations on an unsecured basis. Furthermore, the company's current assets have been reduced from $12,727 in accounts receivable to $9,800 in cash. In addition, the assignor is contingently liable for the $9,800 which must be paid in case the accounts prove uncollectible. Besides, it is not likely that the cash will remain long in

the hands of the borrower, and if used to speculate in merchandise or for investment in fixed assets, which may be an unwarranted assumption although not in its entirety, the borrowing concern is placed in a position of having as a result a smaller portion of a slower asset in place of accounts receivable. Such a situation is less likely to obtain when banking and merchandise creditors are the only ones who, through their cooperation, regulate and control a debtor's ability to overtrade.

As a final argument against the practice, "regular" creditors point to the large percentage of concerns who abandon the credit companies and turn to the usual institutions for financing as soon as they are extricated from their financial difficulties.

Notes and Bills Receivable.—This item should include only negotiable promissory notes received from solvent purchasers in temporary settlement for goods sold and delivered. If trade acceptances are customarily taken by the firm in payment for goods sold, as in the raw-silk trade, they should be listed separately to facilitate distinction between the two items for purposes of analysis. The notes receivable account should not include notes given in settlement of loans to individuals, nor should it contain notes covering overdrafts and similar obligations of partners, officers, directors, employees, subsidiary companies, or any other similar obligations. From this account should also be excluded all notes which have been discounted, assigned, or transferred. In a word, only those notes should be listed under this heading which are the outgrowth of commercial transactions, incident to the normal course of business activity.

To determine the approximate value of notes receivable, the analyst should know the kind of business and terms of sale granted by the firm under consideration. In most lines of trade, debts for goods sold are usually evidenced by open book accounts. Under these conditions, notes are not taken in the regular course of business. Where this system prevails, notes receivable may represent extensions on accounts already past due, put into note settlements. Hence, a substantial amount of notes receivable, unless it is customary in the trade to operate on that basis, frequently indicates a large past-due indebtedness and reflects laxity in the performance of the credit granting and collection functions. Irrespective of the terms of sale, a certain percentage should be deducted in estimating the value of notes receivable, to provide for bad debts. This percentage is to be based on the average percentage of losses in the given trade and upon the debtor's credit policy and methods.

Merchandise Inventories.—Merchandise constitutes one of the most important parts of the current assets, but is appraised with difficulty. This item covers all sorts of goods which are to be sold in the normal course of business. It includes raw materials, goods in process, and

finished products to which ownership is claimed by the firm submitting the statement. All merchandise stocks which have been pledged as security or which are subject to liens as well as supplies must necessarily be omitted from this item.

Another item which calls for some consideration in this connection is that of merchandise consigned for sale. This should be excluded from the merchandise item of the consignee but included instead in the inventory of the consignor. It constitutes the property of the one who has consigned it and does not, therefore, belong to the consignee. The latter merely acts as agent charged with the duties specified in the contract governing the relationship between the two parties. He has no direct financial liability to the consignor, for he is only required to exercise "ordinary care and diligence" in seeing that the merchandise is disposed of in accordance with the provisions of the contract.

In connection with an appraisal of the value of merchandise inventories, several important questions arise, relating to the kind and condition of the stock of goods, mode of ascertaining the quantitative measure of the merchandise on hand, and method employed in pricing the inventory in order to secure a money value of the merchandise in stock.

If the statement is submitted by a manufacturing concern, it is essential to know the proportion of the stock of goods that is in the state of raw materials, goods in process, or finished goods, for merchandise in the shape of raw materials is of much greater value proportionally in case of a forced sale than are goods in process. Raw materials are not subject to radical style changes and are, therefore, more marketable, *i.e.*, readily convertible into cash, while goods in process require additional material, labor, and time before they are rendered salable. For the same reason, finished goods can be more readily disposed of than merchandise in process.

In all cases, adequate allowance must be made for old stock and depreciation. Although merchandise is normally sold at a profit, nevertheless circumstances may arise which greatly diminish its value, since all goods are subject, in varying degrees, to changes in style, declines in value which accompany the downward movement of the business cycle, errors in demand anticipation, and physical deterioration. Obviously, no uniform basis or scale for writing off the merchandise account, which would apply to all lines of trade, can be profitably established. Whereas a 10 per cent deduction from the merchandise item may suffice for the grocery trade, 20 to 25 per cent will probably be required in the dry goods line, 25 to 30 per cent for clothing, and as high an allowance as 35 to 50 per cent for the millinery business. The percentage thus varies in the proportion to which the goods under consideration are subject to the changes hereinbefore enumerated.

A consideration of somewhat less importance is the method employed in arriving at a quantitative measure of the stock of merchandise on hand. It is of some importance to know, in order to gage the accuracy of the figure, whether the item represents an actual or physical inventory or has been arrived at by means of a perpetual inventory system. In some instances, it may represent simply a guess. As a rule, when the figures given in the statement are in round numbers, omitting cents and the last digit in the dollars column, the conclusion may reasonably be drawn that the inventory has in all probability been a mere guess and represents no actual values. In this connection, it is also well to note the date of the inventory. If taken at the close of the season, the quantity of goods should be at the low-water mark, and vice versa.

With the adoption of different practices in regard to pricing inventories, it is essential to know what method has been employed. Some houses inventory their merchandise at cost; others at selling price; whereas a third group value their merchandise stocks at cost or prevailing market prices, whichever is the lower. Conservative practice requires that the last of the three methods be employed on the assumption that the debt-paying power of a commodity is determined not so much by its cost as by the amount at which it can sell, which is, in turn, reflected in the prevailing market price at which it could be purchased for resale. When inventories are valued at selling prices, appropriations are made of anticipated profits the realization of which is highly problematical. Even though profits are made as a result of a sale, they properly belong to the subsequent accounting period. Moreover, in following this practice, it is easy to overlook the expenses chargeable against a sale of the goods under consideration.

Investments.—This includes short-term notes, stocks, bonds, and other securities of subsidiaries or other companies, held by the maker of the statement. These securities may be readily marketable and invested in only temporarily, or may be held for relatively long periods for purposes of control. The value of securities of the first type only should be included among the current assets. Their value for debt-paying purposes is readily ascertainable, if listed on an important stock exchange. Otherwise, they are greatly discounted or entirely disregarded by the credit grantor.

Deferred Assets.—Having no direct debt-paying power, the significance of these items lies in that they reflect the system of accounting which is employed by the maker of the statement, which is no unimportant criterion of management ability.

Plant, Machinery, and Tools.—These constitute an important part of the fixed assets and, not unlike the other items of the same class, are not to be sold in the normal course of business activity. They, therefore,

do not contribute directly to the ability of the owner to meet obligations currently maturing. Nevertheless, they add to the stability of the business and in event of a forced liquidation the proceeds from their sale will be applied in payment of creditors' claims, according to priority. To be sure, under such circumstances, the sum realized would probably amount to a small percentage of the listed or book value. However, these as well as some of the other fixed assets, are extremely important in analyzing financial statements, as their ratios to other items disclose methods and policies employed the effect of which is either to increase or diminish the firm's earning capacity and credit responsibility.

In estimating the worth of these properties, an adequate allowance must be made to cover depreciation in value due to wear and tear and obsolescence, if they are listed at cost and no sufficient reserve has been provided.

Most forms of financial statements provide a space for the listing of real estate. The maker is required to list each parcel separately at cost price. By comparing these figures with the assessed valuation, some check is afforded against any overstatement of assets. Such comparison, assuming correct cost price to have been given, also affords an opportunity to study fluctuations in real estate values, in the neighborhood in which the debtor is located.

Furniture and Fixtures.—Adequate allowance should be made for depreciation, and since the worth of this item in case of a forced sale is very low, a substantial percentage is sometimes written off by credit grantors. In this connection it should be ascertained, if possible, whether the size of the investment in this item is consistent with the requirements of the business.

Intangible Assets.—In this group are included good will, trade-marks, patents, copyrights, certain contracts, franchises, and other assets of like nature. Most of these are practically disregarded by credit managers in analyzing financial statements, for, it is argued, they can only be realized on when the business is sold and only when they yield satisfactory returns. Although they are not available for debt-paying purposes, if representing real value they should always be included among the fixed assets, inasmuch as intangibles may sometimes constitute the chief and most valuable asset of a concern, as in the case of the patents of the United Shoe Machinery Company.

VALUATION OF LIABILITIES

Accounts Payable.—This item should represent the total sum owing to creditors on open account, and it is advisable, from the standpoint of creditors, to have it segregated into amounts not due and amounts past

due. The amount owing for merchandise, if listed as a separate item, should be excluded from accounts payable. The reason for showing the amount owing for merchandise separately is because it prevents understatements, for this figure is readily verified. Such a requirement acts as a deterrent from falsification and aids in detecting tendencies to overstocking, which usually precedes bankruptcy. This item should normally be small, for open accounts must be settled promptly in order to take advantage of cash discounts.

Notes Payable.—Under this heading three divisions are to be found:

1. Notes payable to banks, which represents money borrowed by discounting debtor's own notes. If the amount is large, it may represent loans obtained for the purpose of discounting bills of purchase. Good banking accommodations, as represented by this item, are, as a rule, a semblance of strength.

2. Notes payable to merchandise creditors for goods purchased. If the amount is large, it generally represents trade acceptances given and outstanding. Should this be the case, a correspondingly low figure should appear opposite the "owing for merchandise" item. Again, if notes are not regularly employed in the trade in settlement for purchases, these notes probably represent settlements of past-due purchase accounts and are drawing interest, which ordinarily indicates that the debtor's credit is strained.

3. Notes payable to others include notes given when obligations are incurred from sources other than those mentioned, such as officers, directors, relatives, and friends. Their presence in large amounts calls for caution on the part of the credit manager, because these means of securing the necessary funds are resorted to when all banking credit has probably been exhausted. Moreover, in case of insolvency, it is natural for the debtor to protect his friends and relatives to the detriment of his other creditors.

Mortgages.—Liabilities secured in this form may have been assumed as part payment for the property during the acquisition of title or may have been executed at a later date. Ordinary mortgages represent indebtedness secured by a pledge of real estate, whereas chattel mortgages represent indebtedness secured by personal and other movable property, such as a stock of goods, automobiles, refrigerator boxes, cash registers, and the like. In determining the residual value of the various assets, a knowledge of these encumbrances is absolutely indispensable.

Bonds.—In the event of forced liquidation, bondholders' claims, if the bonds are secured by specific property, take precedence of those of bank and merchandise creditors. Hence, if the bonded indebtedness is large, little or nothing may be expected by others than bondholders upon involuntary dissolution. This is a consideration requiring particular

attention when bank or merchandise creditors are contemplating throwing the debtor into bankruptcy.

Contingent Liabilities.[1]—These liabilities are potential and do not become real until and unless certain contingencies occur. Because they do not constitute real liabilities for the present, they are not chargeable, and should not be included among the regular liabilities. Their existence should be disclosed in supplementary remarks, however.

Contingent liabilities arise through the following transactions:

1. When the debtor guarantees payment of another's account. In case of default on the part of the person whose account is guaranteed the guarantor becomes liable for the sum involved. Thus, his liability is contingent upon the default of the real debtor to pay his obligations. The liability as guarantor also arises out of agreements, leases, and the like.

2. When a merchant indorses his notes receivable or trade acceptances for the purpose of discounting them at the bank. Should the maker or drawer refuse payment when the notes are presented for payment at maturity, the indorser becomes directly liable to the bank.

3. By indorsing a note for the accommodation or benefit of another. The evils of this practice have already been discussed in an earlier part of the book and will, therefore, be omitted at this point.

4. When commitments for future delivery of merchandise purchases are made. In this case the buyer becomes contingently liable.

Capital represents the net worth or book value of a business operated as a single proprietorship or a partnership. The amount shown in the statement as the excess of assets over liabilities seldom represents the true net worth as viewed by the credit analyst. A new figure must be developed after the "shading" process has been completed.

Capital Stock.—If it has a par value, capital stock is stated at that figure at all times. If it possesses no par value, the amount of this item should represent the sum actually received from the sale of the security. Only that stock which is actually issued and outstanding should thus appear in the balance sheet.

Surplus is the difference between the net worth of the business and the value of the capital stock issued and outstanding. It is the excess of book or economic values over the amount which the liabilities and value of the capital stock issued and outstanding represent. A surplus may arise through the following types of transactions:

1. Payments made directly by stockholders, forming the so-called "paid-in" surplus.

[1] For a brief discussion of how to value certain contingent liabilities, see E. S. Benjamin, "Negotiated Receivables," *The Certified Public Accountant*, August, 1936. pp. 480–482.

2. Capital stock premiums and purchase by the company of its own securities below par.

3. Stock assessments and conversion payments.

4. Stock donations, gifts and contributions from outsiders.

5. Sale of capital assets for an amount in excess of their book value.

6. Reappraising and writing up the book value of certain assets.

7. Normal accumulations of profits as determined by the profit and loss account balances.[1]

Under normal conditions only the earned surplus, or that arising from the normal accumulations of profits resulting from the ordinary operations of the business, is available for the payment of dividends. The surplus item, if any, plus the capital stock constitutes the owners' equity in the enterprise. If a deficit is incurred, to determine the owner's equity, it should be deducted from capital stock instead of placing it on the assets side of the balance sheet, as is sometimes done.

A reasonably substantial surplus is usually looked upon with favor, for it indicates a safe equity. When compared over a period of years, earned surpluses will indicate whether the business is fundamentally sound and is operated on a paying basis, or whether it is retrograding or standing still. However, when the earned surplus becomes so large as to be entirely out of proportion to the capital invested, there is danger of the business being suddenly handicapped by the payment of large dividends out of working capital. It is, therefore, advisable, from the standpoint of credit policy, to capitalize the surplus as soon as it becomes so large as to be out of proportion to the amount of capital invested, except where no-par-value stock is issued and carried on the books at no definitely permanent figure.

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Questions and Problems

1. Arrange the following asset items in the order of their liquidity, placing the most liquid item first, and so on: land, marketable securities, buildings, investments

[1] BECKMAN, T. N., "Sources and Treatment of Surplus," *The Journal of Accountancy*, May, 1923.

in subsidiaries, cash in the bank, cash value of life insurance, prepaid and deferred charges, cash on hand, sales tax stamps, inventories of merchandise, accounts receivable, leaseholds, notes receivable, trade acceptances, miscellaneous assets.

2. In analyzing a financial statement by the valuation method, what specific points would you desire to know about each of the following items appearing thereon?

a. Cash.
b. Accounts receivable.
c. Merchandise inventory.
d. Fixed assets.

3. Define accrued liabilities and deferred assets. Of what significance are they to the credit man? Classify the following into one of the two categories:

a. Interest due on notes from the preceding accounting period.
b. Rent received 2 months in advance.
c. Insurance on buildings paid in advance for 1 year.
d. Wages due but unpaid.
e. Dividends declared but not paid.

4. The Blank Manufacturing Company has on its books approximately $90,000 in the form of outstandings owed by customers. The company is in immediate need for ready cash and wishes to convert some $25,000 of its accounts receivable into cash. How can this be accomplished?

5. How much may the Blank Manufacturing Company expect to receive in cash immediately upon deposit of $25,000 in accounts receivable? Explain.

6. What would be the approximate cost of the loan if the accounts receivable matured in 60 days from the date on which the transaction took place? What would be the rate per annum?

7. Is it good practice to assign accounts receivable? Give reasons for your answer.

8. If you found it necessary to assign some of your accounts receivable, would you notify your customers of the action? Your creditors? Give reasons.

9. It is often stated that the assignment of accounts receivable is analogous to the discounting of notes receivable. Do you agree?

10. Explain the difference between paying 15 per cent, or so, per annum charged for the accommodation by credit companies when they lend money on accounts receivable and the granting by the seller of a cash discount that may run as high as 36 per cent per annum for the payment of cash in advance of due date.

11. Why is it desirable that accounts payable for merchandise be separated from other amounts owed by the maker of the statement?

12. Under what circumstances may intangible assets be regarded as valuable from the standpoint of debt-paying power?

13. What is meant by the term "surplus"? What facts concerning it should be of value to the analyst of financial statements? What would be the effect of declaring a dividend out of paid-in surplus?

14. Comparative statements over a period of several years showed that the X company followed a policy of "ploughing in" most of their earnings. Would you as a creditor regard such a policy favorably? Discuss. What effect would an undivided surplus tax have upon such a policy and the credit of such a company?

CHAPTER XIX

RATIO ANALYSIS OF FINANCIAL STATEMENTS

Defects of Valuation Analysis.—An analysis of financial statements by a mere valuation of the different items involved has proved altogether too inadequate. In fact, a mere comparison of amounts may even lead the analyst astray. An analysis of bulk figures fails to stress sufficiently the quality and relationship of assets and equities and, consequently, leaves much to be desired in scientific statement analysis. Moreover, such an analysis affords little opportunity for comparison with other companies operating in similar lines and under substantially similar conditions. It even makes difficult a comparison with the accomplishments of the same enterprise over a period of time.

The Ratio Theory.—For these reasons, attempts have been made within recent years to develop and establish a set of proportions or ratios which would serve as a guide in a systematic and orderly procedure in analytical statement studies. Probably the most active among students of the subject under consideration is Alexander Wall, Secretary-Treasurer of the Robert Morris Associates, who has devoted considerable of his time to formulating a system of internal and type analysis.

The theory underlying the ratio analysis of financial statements is that certain relationships between various items in the balance sheet should obtain in a given line of business at a given time in order to be considered safe from the creditor's point of view. When these relationships are unfavorable, unprofitable conditions are bound to result, and when they are favorable profits will be forthcoming, and, hence, the risk may be at least financially desirable.

Need for a Barometer.—Obviously, a study of ratios necessitates the adoption of a barometer by means of which the various proportions derived in any one case may be measured in order to determine their exact value. A ratio is meaningless unless it can be compared with the mode in that line of business or with some other yardstick that is generally recognized as serving the purpose satisfactorily.

One such yardstick is the experience of the creditor with similar firms. From an analysis of a large number of statements issued by a given type of customer it should not be difficult for a credit manager to determine just how far short or how far ahead a given ratio is of the general run of customers of the same type. In other words, one way in which ratios can

be measured, as they actually are in many cases, is by comparing them with what the credit manager remembers to be the normal for such concerns, or with the ratios of the more successful customers of the same type as the one whose statement is being analyzed.

A superior and more scientific method consists in the development of a barometer based on a careful and extensive study of ratios for a representative number of concerns in each line of business. Attempts have been made to evolve a normal set of ratios representing averages derived from an examination of a number of statements. The usual method has been to combine the individual statements of a given industry into one industry statement, by the simple process of addition. From this giant statement ratios for the industry are evolved.

That such a method for determining basic ratios for a given industry is subject to question is quite obvious. A suit of clothes made from average measurements of Mutt and Jeff will fit neither one nor the other. Averages consisting of some of the poorest and the most successful concerns in a given line of business are more than meaningless, for they may even be misleading. A better method by far seems to be that of determining, through an analysis of a large number of statements individually handled, the "common" ratios, or those which are characteristic of most of the concerns represented in the study. Once such a normal is established, it can be used as a yardstick which, when properly applied, will indicate the percentage any given ratio should show to approach a normal condition.

In this study, all the ratios have been so arranged that an increase in the percentage of any individual ratio reflects improvement, and a decrease denotes retrogression. The various ratios to be used as standards in comparing those of any one firm in a particular line of business can be secured in one of two ways. First, they can be developed by each credit manager for his own use. A number of statements representing a given line of trade are taken at random from the creditor's files and the desired ratios are computed. The other method is to obtain them from some organization that has made the computations. The Robert Morris Associates, an organization of bank credit managers, makes them available for its membership. Dun & Bradstreet, Inc., has been preparing a number of financial ratios for different kinds of business each year. The Bureau of Foreign and Domestic Commerce supplies a limited amount of such information. A few of the ratios may be secured from the data published by the Census of Business and by a number of educational research organizations as well as by some trade associations.

Modifying Factors.—In the application of a barometric plan of statement analysis, at least three factors should be taken into consideration. These are: line of trade, location of the business represented by the

statement under analysis, and the date the statement was prepared. The assets of the different lines of trade vary considerably in their stability. The greater the style element involved in the merchandise handled, the less certain and stable is the value of the inventory, and vice versa. Whereas high ratios would be required for women's ready-to-wear establishments, much lower ones will prove adequate for grocers dealing in staple goods. Hence, it is essential to recognize the difference between lines of trade and to establish a set of normal ratios for each line of business.

Similarly, concerns in the same line of trade will produce different normals in different sections of the country, although the variations by geographic sections are not very pronounced. Different parts of the country may be affected unequally, however, by the condition of prosperity, transportation, labor, and other economic factors. For these reasons, it is advisable to establish normal ratios not only on a national scale but on a sectional basis as well.

The time of the year in which the statement is prepared will make a substantial difference in its proportional relationships. Because of seasonal variations in the demand, the stock of goods may be abnormally large during certain parts of the year and exceedingly low during others. A comparison of statements taken at either of these dates with the normal established for the industry will, therefore, prove misleading, unless such differentiation is recognized by the analyst and allowance for deviations made correspondingly. Among the other factors affecting ratios are the size of the enterprise and its method of operation. A large concern with a substantial net worth, for example, may have more of its working capital tied up in merchandise than a small enterprise with less net worth. Similarly, a concern selling principally for cash need not have so high a current ratio as one which operates altogether on a credit basis or one whose credit terms are unusually liberal.

The Financial Statement in a Changing Business World.—Finally, financial statement ratios vary considerably with the business cycle. What may be regarded as a satisfactory ratio in a period of prosperity may be entirely inadequate in time of economic stress, and vice versa. For example, in a study made by the author of 35 lines of trade it was found that in 24 lines of trade and manufacturing the current ratio was higher during the last depression than in so-called "normal times," in nine lines of business the current position was weaker, and in two it remained the same. Similarly, the sales to receivables ratio in time of depression was higher in but eight lines of trade and manufacturing, 12 lines recorded no change, but in 15 out of the 35 lines of business the ratio was below normal. Thus the tendency during a depression is for the receivables ratio to become weaker, despite a stricter collection policy

practiced during such times. This in itself makes necessary a higher current ratio, since the receivables are not in so liquid and so sound a condition. Similar variations are to be found in other ratios during periods of depression. Operating expenses, for instance, increase in time of stress despite all attempts to pare expenditures and to economize, because much of the overhead cannot be eliminated. The volume of sales in dollars is greatly diminished, but the quantity of goods handled may still be very large. Thus the operating ratio is less favorable. It is erroneous therefore to compare the ratios of a statement made during a year of business stress with standard ratios developed during a year of good business conditions.

What Ratios Reveal.—Contrary to a common conception, financial statements show more than the financial or capital strength of the business which they depict. When properly interpreted and skilfully analyzed, financial statements are equally helpful in measuring capacity to manage the different departments or functions of the business and may even reflect the character of the makers by the extent to which they have been "dressed up" for the purpose of making a favorable showing. It is important, therefore, that credit managers thoroughly understand the theory underlying statement analysis by means of ratios and possess the training and experience requisite to its effective application.

Practically every ratio aims to test the value of a given item and at the same time serves to indicate the efficiency with which that item has been managed or the judgment used in bringing about the condition of affairs as discovered in the analysis. For this reason the distinction that is sometimes made between static and dynamic ratios may be subject to serious question.[1] All ratios are static in that they indicate a condition at a given moment of time. Similarly, all ratios are dynamic because they reflect the efficiency of operation responsible for the condition shown by them at any given time. In the sense that all ratios have been evolved as a result of some activity they are dynamic. In the sense that they all denote conditions as they existed at the time the statement was prepared they are static. The distinction is indeed a flimsy one and hence will be disregarded in this study.

In general, it may be said that in an analysis of financial statements for credit purposes an attempt is made:

[1] Wherever the distinction is made, static ratios refer to the relationships existing between assets or liabilities, while dynamic ratios involve relationships between various items in the balance sheet with sales. The latter are sometimes called "velocity relationships." Static ratios are supposed to represent the business when at a standstill. Dynamic ratios, on the other hand, presumably suggest a moving picture of the business in the process of actual operation.

1. To ascertain the true current ratio, by determining the actual liquidating value of the various current assets to a going concern and discovering possible understatements in current liabilities, instead of accepting these items as stated in the balance sheet.

2. To discover the extent of reliance of the subject upon borrowed capital.

3. To uncover false and misleading financial statements.

4. To find out the capacity risk of the subject through ratios that show the relative efficiency of the enterprise and sagacity of the management.

5. To determine the direction of the subject's business, whether it is moving forward, standing still, or retrograding.

Valuable Ratios.—It is the opinion of some authorities on the subject that the whole matter of ratio analysis has been much overdone. While in some instances, exhaustive and detailed analyses of statements may prove helpful and even essential, in the vast majority of instances, especially in the mercantile field, a few ratios will suffice to indicate the desirability of the credit risk. It would, indeed, be foolhardy for any credit manager in the wholesale grocery field to attempt to analyze each statement submitted by his customers so as to obtain 12 or more ratios, in accordance with recommendations sometimes made by academically inclined statement-analysis zealots. Probably three or four ratios would prove adequate. In other instances, five or six ratios may be all that is necessary for a decision. The more important relationships or ratios presented herewith are not intended to be used in connection with every statement analysis. They are presented rather as a means of conveying a clear and comprehensive picture of the whole subject and to indicate their relative importance, depending on the judgment of the credit manager in determining which of them are essential for his purposes. These ratios are as follows:

1. Current ratio.
2. Ratio of Cash to Current Liabilities.
3. Ratio of Sales to Receivables.
4. Ratio of Sales to Merchandise.
5. Ratio of Net Worth to Total Debt.
6. Ratio of Net Worth to Fixed Assets.
7. Ratio of Sales to Fixed Assets.
8. Ratio of Sales to Net Worth.
9. Ratio of Insurance to Merchandise.
10. Ratio of Net Profits to Sales.
11. Ratio of Earnings to Investment.

As indicated, these ratios comprise as related variables the current assets, current liabilities, cash, merchandise, receivables, fixed assets,

net worth, total indebtedness, net sales, insurance, and net profits. These elements are thus combined into eleven relationships, so as to produce a similar number of ratios of varying degrees of importance, some of which indicating the debt-paying power of the subject at date of maturity, and others merely serving as a secondary line of defense and pointing toward conditions as they are likely to exist for a considerable period into the future.

Current Ratio.—This ratio is derived by dividing the current assets by the current liabilities. It indicates the margin between the amount currently due and that currently owing. Notwithstanding sporadic opinions to the contrary, common practice has proved that it is possible to develop certain more or less fixed ratios which are helpful in measuring the financial responsibility of a credit risk. The first step towards the development of a study in proportions has been the adoption of a 2 to 1 ratio of current assets to current liabilities, which means that, in order to establish a favorable credit proportion, the statement must show two dollars of current assets for every dollar of current liabilities. This 2-to-1 rule was based on the theory that a shrinkage might easily occur in assets but seldom in liabilities. Some accounts receivable may become slow and bad, and merchandise go out of style, become antiquated or otherwise unsalable, whereas the indebtedness is rarely subject to shrinkage. Hence the necessity of a margin. The 2 to 1, or 200 per cent, ratio allows a 100 per cent margin of safety, which was generally acknowledged as ample and this has been accepted as a standard ratio after considerable experimentation, although it has in recent years been invalidated.

In the days immediately following the adoption of the 2 to 1 ratio it was the policy of many banking institutions, it is said, to refuse credit to a merchant who could not produce such a proportion between current assets and current liabilities. In present-day practice, however, the rule is seldom adhered to, because of the recognition of differences in types of business, location, date of issue of the statement, and other similar factors, the effect of which is to vary somewhat the proportions involved. Whereas some lines of trade require a 2 to 1 ratio, others may necessitate a proportion of as high as 10 to 1, and still others will prove satisfactory risks even though their ratio is only a little more than 1 to 1. To extend credit accommodations, however, to a merchant whose current liabilities exceed the current assets, representing a "floating debt," is equivalent to purchasing a lawsuit, since there is no likelihood that the current obligations will be met at maturity.

Need for Other Ratios.—The adoption of the current ratio theory is in itself merely a quantitative affair, measuring current assets in bulk against quick liabilities in their entirety. While this is of great importance, it is nevertheless quite as important, or possibly of greater signifi-

cance, that a qualitative analysis of the current assets be made to ascertain their character and liquidity, for a smaller than standard current ratio may be more than offset by fresh and rapidly collectible accounts and by merchandise which is readily disposed of. Again, too much stress on the current ratio leads inevitably to "window dressing," for several methods may be employed by prospective borrowers whereby the ratio could be improved temporarily. One of them, for instance, is to sell merchandise or other property to interested parties, retire part of the debt with the proceeds, and, after they have thus served the purpose of improving the current ratio, repurchase the assets. For these reasons, other ratios have been developed which qualify and add to the value of the current ratio as a measure of credit capacity.

Cash to Current Liabilities.—Credit grantors usually prefer to see 10 to 20 cents in cash for every dollar of current indebtedness. To obtain this ratio, divide cash by current liabilities. If the amount is particularly small, namely, below the former figure, it might indicate lack of working capital and failure to maintain the 20 per cent balance in proportion to loans, on which commercial banks usually insist and thus impair the credit at the bank. On the other hand, if the cash item is larger than 20 per cent of total current debt, it might indicate ultraconservatism and failure to put the funds to work for the profit of the enterprise. Just what the proportion shall be, as in all other ratios, it is necessary to know the common ratio for the business under consideration, either from special studies made along this line or from experience. Unfortunately, so far few attempts have been made to develop a standard ratio of this type, although it is of value in testing both the value of the cash item and the efficiency of the treasurer who manages it.

Sales to Receivables.—This ratio is found by dividing the total net sales for the year by the total of accounts and notes or bills receivable. To secure a true measure of both the value of the receivables item and the efficiency of the credit department which manages it, credit sales and not total sales should be divided by the outstandings. This ratio indicates the proportion of the annual credit sales which are carried on the books as receivables, and denotes the economy and efficiency observed in handling capital tied up in receivables. The older an account becomes, the heavier the carrying expenses are, the greater the possibility of losses from bad debts, and the poorer the return on the investment. Unfortunately, the yardsticks that are now available are based on total sales, rather than credit sales, divided by the receivables.

A high ratio of Sales to Receivables, within certain limits, more than offsets the disadvantage from a current ratio somewhat below the normal. On the other hand, a low character of collectibility and stale receivables, as reflected by a low ratio of Sales to Receivables, necessitates a much

higher current ratio than would have been otherwise required, in order to secure a wider margin of safety against shrinkage caused by bad debts.

To determine the normal ratio of Sales to Receivables, a knowledge of the concern's terms of sale is essential. To illustrate, let us assume that the credit sales for the year amounted to $2,222,063, and that the receivables were $206,896. By dividing the sales by the receivables we obtain a figure showing the number of times these receivables are turned over during the year, which is 10.74 in this case (2,222,063 ÷ 206,896). To determine the number of days of sales carried on the books, divide 10.74 into 365, the days of the year, the result being approximately 34 (365 ÷ 10.74). If the firm sells on 30-day terms, the ratio approaches a normal condition. As a matter of fact, under ordinary circumstances, a comfortable condition of affairs is indicated as long as no more than 25 per cent of the previous month's receivables are outstanding at the end of the current month. Thus, 35 to 40 days' receivables outstanding on a statement of a concern selling on 30-day terms would undoubtedly make a favorable showing.

To measure the liquidity of the receivables over a period of time, it is, of course, necessary to make a study of comparative statements. Should such successive statements disclose an increase in the bulk of the receivables, there is no cause for anxiety, provided the sales have increased either in the same proportion or at a greater rate of speed, which fact will be shown by a constant or increasing ratio, respectively. If, however, an increasing volume of sales is accompanied by a decreasing ratio between sales and receivables, it may be presumed that the liquidity of the receivables is diminishing and that a greater proportion of past-due accounts is carried on the books.

It is conceivable that, by adopting too strict a credit policy, this ratio may be raised considerably. But since this is done at the expense of sales volume, it is seldom, if ever, justifiable, hence the statement that the higher the ratio, *within certain bounds*, the greater the liquidity of the receivables, and consequently, the higher the credit capacity of the risk.

Sales to Merchandise.—To secure this ratio, divide the net sales by the total merchandise inventory. It shows the number of times a merchant is able to convert his stock of goods into cash or receivables. Thus, if the merchandise on hand amounts to $15,000, and the sales for the year are $60,000 the approximate number of times a merchant is turning his stock is determined by dividing the inventory into the annual sales, which in this instance is four times (60,000 ÷ 15,000). Although this is the method commonly employed by credit managers in ascertaining the approximate rate of stock turnover, it is nevertheless inaccurate and not in keeping with sound practice, because sales under such circumstances are figured at selling price, which necessarily includes gross

profits, whereas the inventory is usually priced at cost, or at cost or market whichever is lower.

Much confusion is current everywhere in the methods of determining stock turnover. The true turnover can be found only (1) by dividing total sales by the average selling value of the merchandise on hand, or (2) by dividing the approximate cost of all goods sold by the cost of the average stock kept on hand. Should the inventory not represent the average stock of goods on hand, that fact must be taken into consideration. In order to indicate clearly the two respective correct methods of determining stock turnover, two illustrations are submitted. It is assumed that the merchant under consideration has realized a gross profit of 30 per cent.

1. Sales Price Basis

$$\frac{\text{Total sales at selling price (\$60,000)}}{\text{Inventory at sales price (\$21,428.40)}} = \text{turnover (2.8 times).}$$

2. Cost Basis

$$\frac{\text{Total sales at cost (\$42,000)}}{\text{Inventory priced at cost (\$15,000)}} = \text{turnover (2.8 times).}$$

Another common method of determining the stock turnover on a cost basis is to take the merchandise inventory on hand at the beginning of the fiscal period and add to it the purchases during the year, or the cost of manufactured goods in the case of a manufacturing concern. From this total deduct the merchandise on hand at the end of the year. The resulting figure is the amount of merchandise at cost price that has been sold during the year, which, when divided by the average inventory at cost, gives the stock turnover for the year. For example:

Merchandise on hand at beginning of year	$14,500
Purchases during year	43,000
Total	$57,500
Less merchandise on hand at end of year	15,500
Cost of goods sold during year	$42,000

Stock turnover: \$42,000 ÷ 15,000 = 2.8 times.

Knowing either from normals established in the trade or from experience what the rate of turnover should be, it is not difficult for the credit analyst to discover the degree of business ability possessed by the risk and the freshness and salability of the stock of merchandise. Rapid stock turns indicate good merchandise management, fresh stock, and liquid assets. A slow turnover, on the other hand, reflects possible overvaluation of inventory, too large an investment in merchandise, careless buying, and possibly dead and unmovable stocks.

Worth to Debt.—To find this ratio, divide the net worth by the total debt to outsiders, both current and funded. The net worth constitutes the owners' equity in the business enterprise, consisting in the case of a corporation of the difference between the sum of all assets and the liabilities. In partnerships and single proprietorships it is designated as capital and proprietorship, respectively. This ratio indicates the proportional relationship which exists between money or goods secured on credit from outsiders and the sum invested by the owners of the business.

As the proportion between funds invested by the owners increases over sums borrowed, the concern becomes less dependent upon the decisions and good will of its creditors for working capital. Another way of putting it is the higher the ratio, the less extended becomes the reliance of creditors upon intangible factors involving character and moral risk. On the other hand, an abnormally low ratio of Worth to Debt calls for considerable care and investigation on the part of the conservative credit grantor. Because of the effective significance of a proper balance between creditors' claims and owners' equities, a low ratio should cause the management immediately to revamp its affairs so as to enable it to maintain the integrity of its credit standing.

In case a considerable portion of the debt is funded, it is recommended that a Net Worth to Current Debt ratio be established in order to determine whether or not this ratio is sufficiently high, for, as the proportion of funded debt increases, the necessity for current obligations should be reduced correspondingly.

Net Worth to Fixed Assets.—This ratio is derived by dividing the net worth by the total fixed or noncurrent assets. It indicates the proportion of net worth or owners' equity tied up in plant, machinery, equipment, and other fixed properties. The margin over and above 100 per cent indicates the proportion of the net worth provided for working capital.

Unless permanent working capital has been provided through the issue of bonds or long-time notes, it is essential that owner-controlled funds be secured for the purpose. Good business judgment argues against relying upon mercantile or bank creditors to supply funds needed for that part of the working capital which is permanently required in the business.

If an increase in net worth is accompanied by a decrease in the ratio of Net Worth to Fixed Assets, the inference that may reasonably be drawn is that the owners have expanded the plant more rapidly than warranted by the normal growth of the business. Such a development, where liquid assets are converted into fixed assets, is likely to occur in a period of rising prices, when optimism prevails and the hope of future large profits stimulates expansion to a point of embarrassment. A

declining ratio under such circumstances should be a danger signal to creditors, calling for extreme precautions in their dealings with the subject thus affected.

Sales to Fixed Assets.—This ratio is secured by dividing the net sales by the total fixed assets and serves to indicate the dollars of sales for every dollar invested in plant, machinery, equipment, and other non-current assets.

When a low ratio of Sales to Fixed Assets is shown, it means that the degree of plant utilization is relatively low, which amounts to the same thing as saying that the concern is too large for the volume of business transacted. It is to be noted that the amount invested in fixed assets varies considerably with different types of business. Wholesale grocers, for example, show sales of anywhere from $8 to $14 to every dollar of fixed assets, whereas steel companies, where the investment in plant and equipment is exceedingly heavy, may show a ratio of less than 1 to 1. Hence the necessity for a normal for every line of trade.

This ratio can be used to advantage in conjunction with that of Worth to Fixed Assets. If both of these ratios are below normal or falling, a condition obtains where plant is enlarging proportionally at a greater rate than worth, and where sales are not keeping pace with the increase in size, which is indicative of a dangerous and pernicious policy of overexpansion. When such a situation is discovered, it behooves both the credit grantor and the credit risk to revamp conditions whereby the plant is either decreased gradually or else production and selling efficiency enhanced so as economically to justify the size of the enterprise.

Sales to Net Worth.—To produce this ratio, divide the net sales by the net worth. By this means the dollars of sales for every dollar of owner's equity is determined.

The theory underlying the development of this ratio is based on the assumption that there is an optimum point in the activity of invested capital. Assuming a given margin of profit, the greater the volume of sales, the greater the profits on fixed capital and net worth. Hence, a rising ratio indicates greater activity of the funds invested, and, consequently, larger earnings. If such ratio be too high, however, it may reveal a condition where the concern is overextending its operations and transacting too much business for its capital investment. Such a concern needs either to retrench its activities or else increase its capital investment. It is, therefore, advisable to analyze and appraise this ratio in connection with the proportion of Worth to Debt, for a high Sales to Worth ratio is apt to be accompanied by a low ratio of Worth to Debt, an extreme approaching the danger point of credit.

More frequently, businesses lacking progressive managements do not keep the funds actively employed. If this rate of activity is below

normal or falling, it indicates a condition of "dry rot," where the investment is moving too slowly and sluggishly and the funds are not sufficiently productive. It is a symptom either of overcapitalization or of the approach of a natural death of stagnation.

Insurance to Merchandise.—That the question of fire insurance is very important in considering a credit risk is evidenced by the untiring activity of the Insurance and Fire Prevention Committee of the National Association of Credit Men. Among other functions this committee has as its important duty to devise methods whereby debtors may be induced to carry adequate insurance against fire losses. A concern selling goods on credit to a merchant who is not protected against fire is assuming a double risk; the ordinary risk incident to credit granting and the risk of loss from fire. Furthermore, neglect to protect himself against fire losses frequently indicates to the creditor that the merchant's business methods, in general, are more or less loose. If the stock is properly insured in case of fire, the merchant will not only have enough for the payment of his obligation, but will also be able to start anew.

To produce this ratio, divide the value of the policy by the average merchandise kept on hand, or by the inventory shown in the statement. In event the proportion of insurance to merchandise is low, the inference is that the merchant is too careless and is not sufficiently protected or that the merchandise inventory has been overstated. The nearer this ratio is to 100 per cent, or 1 to 1, the more favorable it is, and vice versa.

In this connection, creditors should bear in mind the 80 per cent coinsurance clause. The purpose of this clause is to induce policyholders to carry insurance to nearly full value of the property insured.

A relatively recent development along this line is to insure the lives of officers of a corporation, members of a partnership, or even the life of a single proprietor. Business insurance is generally recognized today as a secondary factor to be taken into consideration in the extension of credit. Its importance for credit purposes, to be sure, varies greatly with the particular situation and the nature of the business. Where the success or failure depends largely upon the brains and guiding genius of one individual, it becomes almost essential that an insurance policy on his life, in favor of the company, be obtained, if the concern's commercial paper as well as general credit condition is to be strengthened. This dominating individual of a so-called "one-man organization" is not necessarily the president of the corporation, but it may be another important official of high executive talent, selling or engineering ability, or one whose personality is responsible for the good will that the company enjoys. He is the key man, whose death means a permanent or at least a temporary setback. Under such circumstances it stands to reason that, although business insurance will probably fail to restore credit

where it is seriously damaged, it is nevertheless of sufficient importance to warrant its being considered as one of the factors to be taken into account in judging the credit risk.

Operating Ratio.—To develop this ratio, divide net sales or gross income by total operating expenses. Thus, if the sales are $100,000 and the operating expense $40,000, the operating ratio may be expressed as 2.5 to 1, or 5 to 2. It means that it costs on an average $1 to sell $2.50 worth of goods, or $2 to sell $5 worth of merchandise. In either case it shows operating expenses or the cost of doing business to be 40 per cent of sales. This ratio serves as an index to relative business efficiency by comparing it with those of other companies engaged in the same line of trade or by comparing it with a normal established for the line in question.

A rise in the operating ratio normally indicates improvement in the management of the business. However, such an increase may have been caused, not by an increased rate of turnover, but by some temporary and doubtful economies that may be practiced, such as failure to provide adequate reserves for depreciation, bad debts, and the like. These economies, although immediately resulting in an improved operating ratio, are obviously detrimental in the long run of events.

This ratio may also be expressed as a percentage of net sales, by dividing operating expenses by net sales. For standards along this line, the results of the various censuses on business, of the studies made by the Harvard Bureau of Business Research, and of the surveys conducted by trade associations are very helpful.

Earnings to Investment.—This ratio is found by dividing the annual net profit by the owners' equity. It indicates the general profitableness of the enterprise. A high ratio may mean one of two things, namely, that profits are high, or that the business is financed primarily through the issue of bonds and so-called "short-time" notes. When the ratio is falling, the company is obviously retrograding.

Probably a better measure of the earning power of a business enterprise is the ratio of net earnings to *total capital* investment. This ratio shows the net results realized from the various operations of the concern and the full amount of capital employed. To establish this ratio, the total capital as represented by the sum of the firm's assets should be divided into the net profits for the year under consideration.

Standardizing "Standard" Ratios.—Even a brief examination of the subject of ratio analysis will disclose lack of uniformity in treatment and especially in the kind and number of ratios deemed essential or worthwhile. The Robert Morris Associates, for example, develops four so-called "static" ratios involving relationships between current assets and current liabilities, merchandise and receivables, net worth and fixed assets, and net worth and debt, respectively; four dynamic ratios con-

sisting of sales to receivables, sales to merchandise, sales to fixed assets, and sales to net worth, respectively; and two other ratios showing the relationship of profit to sales and of profit to net worth. On the other hand, another authority on the subject[1] has developed no less than 14 ratios which are regarded by him as important. In addition to the current ratio and the relationship between debt and net worth, he has what he considers three important ratios on each of the four items embracing capital, inventory, sales, and net profit.[2] In this analysis, much and perhaps undue emphasis is being placed on the net working capital. It is believed that much the same information can be obtained from the current ratio and the more conventional relationships which aim to test the value of the asset items that enter into the computation of the current ratio.

Still another authority distinguishes between so-called "credit analysis" and statement analysis, implying that most of the financial statement ratios developed to date are of no real value to the credit analyst, since the latter is interested only in the current position of the risk.[3] Accordingly, he claims that there are only two ratios in statement analysis, *viz.*, sales to receivables and sales to merchandise, that are of primary significance in the study of credit analysis, and that these are an inadequate basis for credit decisions. He goes on to suggest that at least four other ratios are needed for credit analysis comprising liabilities to sales, liabilities to working or liquid capital, turnover of liquid capital (sales divided by working capital), and turnover of merchandise in relation to turnover of liquid capital. That this point of view is somewhat erroneous becomes evident after a little study of the subject, for it is based on doubtful assumptions. Although a mercantile and bank credit man deals in current credit, he expects the credit relationship with customers to continue over a long time. Consequently, he is interested in the long-time position of the risk as well as in his current status. It is equally wrong to assume that the current position of a risk can be obtained from only two of the conventional statement-analysis ratios. Finally, it seems that the distinction drawn between statement analysis and credit analysis is a distinction without a difference, provided that the statement

[1] FOULKE, R. A., "Behind the Scenes of Business."

[2] The three capital ratios are: fixed assets to tangible net worth, current debt to tangible net worth, and net working capital represented by funded debt. The three inventory ratios comprise: sales to inventory, net working capital represented by inventory, and inventory covered by current debt. The three sales ratios are: average collection period (in days), turnover of tangible net worth, and turnover of net working capital. The three net profit ratios are: net profit on net sales, net profit on tangible net worth, and net profit on net working capital.

[3] BENJAMIN, E. S., "Credit Analysis v. Statement Analysis," *Bankers Magazine*, Vol. 131, July, 1935, pp. 29–31.

analysis is made for credit purposes in line with the commonly recognized procedure as presented in this chapter.

As may be expected in any new field, all sorts of experiments may be attempted, none of which should be discouraged even though some of them may seem freakish. Thus we have so-called "acid-test" ratios of one kind or another, where quick current assets (usually consisting of cash and receivables) are divided by current liabilities, ratios of plant to net worth, and so on. There is no doubt that from this experimentation some ratios will become definitely recognized and established while others will fall by the wayside. From the standpoint of the credit analyst, it appears that the current ratio is of utmost importance in that it gives a bird's-eye view of the current position of the subject. Next in importance is the ratio of net worth to total debt which shows at a glance the long-time financial position of the risk. Aside from these two overall or "mountain-view" ratios, the ratios of greatest significance are those showing sales to receivables, sales to merchandise, sales to fixed assets, net worth to fixed assets, and sales to operating expenses. All other ratios are of secondary consideration and need be developed only when an exhaustive analysis is desired.

Weighting the Ratios.—To reduce statement analysis, for credit purposes, to mathematical precision, it would be desirable to assign a weight to each of the ratios used, provided, of course, one could agree first on what ratios are the most useful. One such system of weighting was developed by Mr. Wall, of the Robert Morris Associates, using but seven ratios. Applying the same technique to the seven ratios which the author of this book regards as most important and assigning to them the approximate weights indicated below, an index can be developed that will show mathematically how the concern, whose statement is being analyzed, compares with the standard ratios for the same kind of business. For the sake of the following illustration, an actual statement for a department

Ratio	Weight, per cent	Standard ratios	Subject firm's ratios	Relation, per cent	Value, per cent
Current	25	3.0 to 1	4.8 to 1	160	40.0
Net worth to debt	25	2.4 to 1	1.5 to 1	62	15.5
Sales to receivables	10	6.9 to 1	5.3 to 1	77	7.7
Sales to merchandise	10	6.0 to 1	7.6 to 1	127	12.7
Sales to fixed	10	3.8 to 1	3.1 to 1	82	8.2
Worth to fixed	10	1.5 to 1	1.3 to 1	87	8.7
Operating ratio	10	3.1 to 1	2.8 to 1	90	9.0
Index	..	.....	.....	...	101.8

store was used for the same year for which the standard ratios were available. Obviously, the ratios can be expressed either as so many to one or in percentages. Likewise, the operating ratio may be expressed either as so many dollars of sales per dollar of expense or as a percentage that the expenses are of net sales. It is doubtful whether we have as yet reached the point where ratios can be properly weighted and the results mathematically computed. Much experimentation remains to be done by credit men before this can be accomplished.

Value of Comparative Statement Analysis.—The analysis of a concern's financial responsibility from one statement gives the credit manager an insight into the condition of the business at a given moment—at the time the statement was prepared. The business is inspected and scrutinized, as it were, when at a standstill. To keep the finger on the pulse of progress when the concern is in a dynamic state, these analyses should be compared over an extended period of time. Much valuable information can thus be disclosed by comparing the essential items at different dates and by noting changes in ratios at these intervals. From such comparisons the credit manager can thus accurately determine whether the subject's business is improving, standing still, or going down. This, however, need not detract from the value that can be derived from an analysis of a single statement, which is often all that a credit manager can secure.

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Questions and Problems

1. How do you account for the rapid development of the ratio method of financial statement analysis?

2. What is the ratio theory of financial statement analysis?

3. What points of special importance do ratios reveal?

4. Show that the financial statement not only gives the analyst a conception of the maker's financial condition but also throws light on his character and capacity.

5. What is the "2 to 1" ratio? Show that it is a myth.

6. In analyzing a given statement, how do you know whether the ratios obtained show a healthy condition of affairs or are indicative of unfavorable circumstances?

7. Would a ratio of sales to merchandise for a manufacturing concern bear any different significance than for a trading establishment? Explain. What further information would be needed in the former instance?

8. In the autumn of 1929, before the financial "crash," in an industry where the model ratio of sales to merchandise was 4.8, company A had a ratio of 3.5 while company B had a ratio of 6.2. Other things being equal, which of these two companies was the better credit risk at the time and why? Under normal conditions, which of them would be preferred?

9. In what way, if any, would an improper collection policy or undue liberality in credit granting be reflected in a ratio analysis of a financial statement?

10. The Sunnyside Corporation, manufacturers of paints, had property valued at $320,000, consisting of a building, equipment, and materials. The building alone which was insured for $150,000 was valued at approximately $230,000. What would be the liability of the insurer if the loss on the building as a result of a fire were $200,000? Only $160,000?

11. Company A submitted a financial statement as a basis for securing credit from company B. The statement showed sales to the extent of $2,500,000 and receivables of $200,000, of which $40,000 were assigned to a credit or finance company. Company A sold about 80 per cent of its goods on credit, the terms being 1/10, net 30 days.

a. Compute the receivables ratio for company A.

b. What does this ratio show?

12. The *XYZ* company, engaged in the wholesale grocery business in a Middle-Western city of approximately 250,000 population, was organized over 40 years ago. On Aug. 21, 1937, the company expressed its desire to commence business relationships with a manufacturer of cereals and flour by placing a first order with the manufacturer amounting to $6,400. On request of the manufacturer, the *XYZ* company submitted the following statement of financial condition as of June 30, 1937:

Cash	$ 32,130.32	Bills Payable—Banks	$ 235,000.00
Notes Receivable	22,176.22	Bills Payable—Other	20,350.00
Accounts Receivable	221,049.83	Accounts Payable	24,365.98
Merchandise	550,109.32	Accruals	9,642.88
Total Current Assets	$ 825,465.69	Total Current Liabilities	$ 289,358.86
Fixed Assets	267,020.93	Reserves	1,000.00
Deferred	24,538.85		
Investments	30,850.00	Capital	800,000.00
Miscellaneous	30,373.69	Surplus	87,890.30
Total Assets	$1,178,249.16	Total Liabilities	$1,178,249.16

Sales	$4,775,838.42
Profits	111,226.82
Dividends	77,583.33
Insurance on Merchandise	500,000.00
Insurance on Buildings over 90 per cent.	

The statement was audited by the A. B. C. Audit Company and was submitted direct. Inventory was valued at cost or market, whichever was lower. Miscel-

laneous assets consist chiefly of first-mortgage notes receivable and cash value of life insurance carried for the benefit of the company. The company operates three cash-and-carry branches, doing approximately $1,500,000 of business a year. About 90 per cent of the remainder of the business is done on credit terms.

Analyze the above statement according to the latest approved method of financial statement analysis, listing the various ratios discovered. Interpret the results of the analysis and indicate whether or not the order should be accepted.

13. The following statement was presented by a dealer in furniture for the purpose of obtaining credit from your firm. Analyze the statement by the means of ratios and determine the financial strength of the dealer and the general worth-whileness of establishing business relations with him.

CURRENT ASSETS			
Cash		$ 3,000	
Liberty Bonds		5,000	
Accounts Receivable	$20,000		
Res. for Bad Debts	1,000	19,000	
Merchandise Inventory (cost)		21,500	
Total			$48,500
REAL ESTATE AND EQUIPMENT			
Delivery Equipment	2,000		
Depreciation	500	1,500	
Office Equipment	1,800		
Depreciation	360	1,440	
Store Equipment	10,000		
Depreciation	3,000	7,000	
Building	30,000		
Depreciation	2,500	27,500	
Land		10,000	
Total Fixed Assets			$47,440
Total Assets			$95,940

CURRENT LIABILITIES			
Notes Payable		$ 5,000	
Accounts Payable		10,000	
Accrued Expenses	500		
Accrued Taxes	875	1,375	$ 16,375
Mortgage Payable in 3 years, interest at 6 % on 15,000			15,000
Total Liabilities			$ 31,375
Net Worth			64,565
Total			$ 95,940
Sales			$198,389
Expenses			$ 65,430

CHAPTER XX

SOURCES OF CONSUMER CREDIT INFORMATION

Interest in credit information concerning individuals as consumers of goods and services or as borrowers of money is unusually wide. Retailers of all kinds of goods, including a number of manufacturers who sell to ultimate consumers at retail, are naturally interested in this sort of intelligence. In addition, facts concerning individual consumers are sought by service establishments such as garages, beauty parlors, and undertakers; by professional people including doctors, dentists, and lawyers; and by insurance companies whether in connection with the issuance of an insurance policy or a bond for an individual occupying a position of trust or in adjusting claims. Similarly concerned with such information are building and loan associations, finance companies in making personal loans or in financing the sales of dealers, and commercial banks which are either making personal loans or desire to check on the antecedents and character of business borrowers. In recent years, a number of governmental agencies, such as the Home Owners' Loan Corporation, the Federal Housing Administration, and the Farm Credit Administration, have become directly or indirectly concerned with individual borrowers and, hence, have been seeking information about them. Then there is a wide variety of lending organizations, brokerage houses, real estate firms, individual mortgagees, and institutions such as hospitals and hotels that are interested in securing character credit reports concerning individuals. The need for such information and the number and variety of uses to which it is being put are constantly growing.

Credit information concerning consumers, using the term in the broadest sense, may be obtained from a variety of sources. In general, the major sources are five in number and include the personal interview, references, credit reporting agencies, cooperative credit bureaus, and banks. This does not mean that retailers, for example, confine themselves to the information secured from these sources. As indicated elsewhere, a retailer may subscribe for the services of such agencies as Dun & Bradstreet in order to check on sources of supply and occasionally to obtain light on a customer who is in business and, hence, rated by the agency in question.

PERSONAL INTERVIEWS

In the consumer credit field the personal interview is a vital source of information. The retailer, unlike the mercantile creditor, is indeed

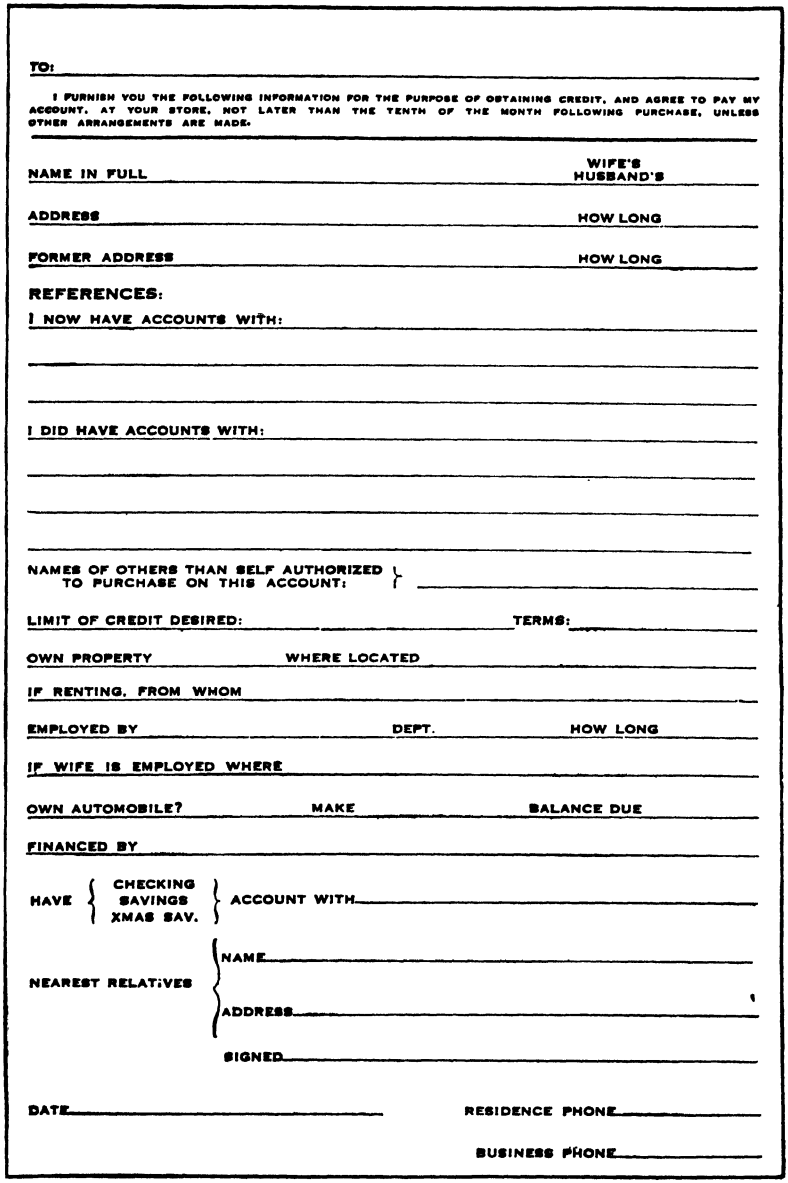
fortunate in being able to interview the prospective credit customer, usually at the former's place of business. With finance companies, the interview may be held either at the place of business or at the borrower's residence. In small retail establishments, where the credit manager can interview personally all prospective patrons, it is a comparatively simple matter in many instances to reach a decision solely on the basis of such an interview. In larger stores, however, it becomes necessary to delegate this power to one or more "application clerks." Under such circumstances, it is quite important that the clerk receiving the application note in an appropriate place on the form his judgment as to the apparent credit responsibility of the applicant.

There appears to be considerable difference of opinion as to whether the position of application clerks, or even credit managers, should be filled by men or women. Some merchants believe that a woman is more capable than a man of meeting a woman customer on common ground and of securing essential data. On the other hand, many stores feel that women customers normally prefer to deal with a man, because, it is argued, a man is usually more courteous and attentive to customers than a woman. Irrespective of whether a man or a woman is charged with the duty of securing applications and interviewing prospective patrons, it is essential that the person be competent and give every appearance of being familiar with human nature and the policies of the house regarding matters of handling applicants.

Application for Credit.—Because of the impression of a third degree conveyed by the method of questioning the applicant in detail, many retail establishments have adopted a special application form which is filled out by the interviewer. In cities where a credit bureau is in operation, the member stores are supplied a uniform application blank sometimes taking the form of a card, to be used when requests for credit accommodations are made from them. In many cities these blanks are filled out in duplicate, in order to supply a copy to the credit bureaus. These forms usually contain spaces for the following information: name in full; residence; former address; bank; property claimed, in whose name, and value, whether encumbered or free; references; remarks or personal impression; and signature (see Fig. 39).

1. *Name in Full.*—The first name as well as the last must be given in full. Otherwise confusion between names having similar initials is likely to result, particularly in large establishments handling many thousands of accounts. It not only causes embarrassment when names are confused, but sometimes losses are quite likely to be incurred as a result. Furthermore, the full name will indicate whether the account is opened in the name of the husband, wife, etc. If in the name of the husband, it becomes the duty of the store to ascertain the extent of his responsibility

in the account, for a husband is, in some states, not responsible for debts incurred by his wife individually, irrespective of whether or not she has



TO: _____

I FURNISH YOU THE FOLLOWING INFORMATION FOR THE PURPOSE OF OBTAINING CREDIT, AND AGREE TO PAY MY ACCOUNT, AT YOUR STORE, NOT LATER THAN THE TENTH OF THE MONTH FOLLOWING PURCHASE, UNLESS OTHER ARRANGEMENTS ARE MADE.

NAME IN FULL _____ WIFE'S HUSBAND'S _____

ADDRESS _____ HOW LONG _____

FORMER ADDRESS _____ HOW LONG _____

REFERENCES:

I NOW HAVE ACCOUNTS WITH: _____

I DID HAVE ACCOUNTS WITH: _____

NAMES OF OTHERS THAN SELF AUTHORIZED TO PURCHASE ON THIS ACCOUNT: _____

LIMIT OF CREDIT DESIRED: _____ TERMS: _____

OWN PROPERTY _____ WHERE LOCATED _____

IF RENTING, FROM WHOM _____

EMPLOYED BY _____ DEPT. _____ HOW LONG _____

IF WIFE IS EMPLOYED WHERE _____

OWN AUTOMOBILE? _____ MAKE _____ BALANCE DUE _____

FINANCED BY _____

HAVE { CHECKING / SAVINGS / XMAS SAV. } ACCOUNT WITH _____

NEAREST RELATIVES { NAME _____ / ADDRESS _____ }

SIGNED _____

DATE _____ RESIDENCE PHONE _____

BUSINESS PHONE _____

FIG. 39.—Application for charge account.

used the prefix "Mrs." Under such circumstances, it is advisable that notice be served on the husband to the effect that an account has been

opened in his name. This will give him an opportunity to confirm or decline the arrangement.

2. *Residence and Former Address.*—The part of the city in which the applicant resides gives an idea as to the applicant's means and responsibility and whether excessive rents are paid, in case the property is not owned by the would-be charge customer. The former address, together with the present address, facilitates complete identification by references later consulted and by the credit reporting bureaus. If it is revealed that the applicant is a newcomer, it is essential to determine whether he is a temporary visitor, and, if so, to obtain the full home address in addition to the temporary address.

3. *Business or Occupation.*—The name of the concern with which he is connected or of which he is a member or officer should be obtained; also the length of time engaged in the capacity should be stated. Some stores also require information concerning the salary or wages received by the applicant. To obtain this bit of information much diplomacy must be exercised by the credit manager, since many persons resent disclosing such intimate facts.

4. *Business Address.*—In the event the applicant should later change residences, it will be a simple matter to locate him, if his exact business address is known. Such knowledge is also required for the purpose of making an investigation, verifying the applicant's statements and tracing him, if he later moves to another town or city.

5. *Bank.*—Possession of a deposit account by a customer usually indicates thrift and a desire to establish a credit balance. Knowledge of the bank with which the customer deals helps to verify some of the facts stated in the interview and sometimes affords valuable information. The quality and extent of information which may be gained through that source depend, of course, upon the bank's willingness to cooperate in the exchange of credit experience.

6. *Property Owned and Encumbrances Thereon.*—This information can be readily verified through an attorney or a credit bureau, and if the value of his equity is substantial, greater reliance can be placed on the customer's ability to meet his obligations ultimately.

7. *References.*—Three or more references are usually required, preferably those of other merchants from whom purchases are or have been made on charge accounts. Next in preference are names of individuals already on the books of the store, for from these references a customer's movements may be readily traced in case of his disappearance. Personal references are frequently the only ones offered by an applicant. Because of the inclination to refer only to persons favorably disposed to the credit seeker, their value is limited to that of securing corroborative information and in assisting to locate the risk in the event of a change in residence.

A highly desirable reference is that of the employer or some responsible officer of the house by which employed. Such a reference is sometimes difficult to secure, however, on account of the unwillingness and general resentment on the part of prospective patrons, who are frequently possessed of peculiar business ideas. All references should be consulted by phone, wire, or letter without delay.

8. *Remarks.*—As already indicated elsewhere, the credit manager of large establishments finds it impossible to interview personally all applicants. A clue given by the application clerk based upon his first impression of the intending customer is, therefore, of tremendous importance in some cases in determining what decisions should be rendered. These remarks are usually brief and impressions are often expressed as "OK," "Unreasonable," "Bears watching," and the like.

9. *Signature.*—An applicant's signature is a particularly important factor in stores where it is used for identification purposes when making purchases. As will be shown in Chapter XXIV, some stores employ a coin, card, or charga plate as a means of identifying *bona fide* charge purchasers. Under these circumstances, a customer's signature on the application blank may well be dispensed with; otherwise it is essential that it be secured as a protection of the interest of the store and of the customer as well. A signed application is in reality a contract to which reference can be made, if need be, in collection letters.

10. *Items Bearing on Instalment Credit.*—Inasmuch as purchases on the instalment plan are now very common, additional space is being provided on the application form of many stores for information relative to them. A credit manager is of necessity interested in the extent to which obligations have been incurred by an applicant for credit which will require payment out of current and future income. A person's debt-paying power is diminished in the proportion to which his income is drawn upon for instalment payments.

While the type of information indicated above is more or less standard, there are many stores which require many more details. They may require facts in regard to previous employers and length of employment with each, the exact occupation of the risk, his affiliations with lodges and churches, and the salary earned. Many ask whether an account had previously been maintained at the store in question, and call for the names of all persons authorized to buy on the account when opened. Others also provide spaces on the application for notation of the results of the investigation that may be pursued by the store.

CREDIT REPORTING AGENCIES

In the past, almost every city of any size used to have one or more credit reporting agencies, frequently designated as Bureaus of Credits, Merchants' Credit Rating Companies, and the like. Most of these

organizations have been absorbed since by chambers of commerce, or associations of local merchants. There are still a number of organizations, however, operating as independent enterprises on a profit basis. While such organizations are technically acting in the capacity of agents and should be designated as credit reporting agencies or in some other similar manner, many of them have adopted a firm style which has the word "bureau" in it. For purposes of this treatise, the word "bureau" will be used only in connection with credit organizations operating on a cooperative plan, on a nonprofit basis.

Functions.—The chief function of these organizations, aside from collecting doubtful and bad accounts, is to publish rating books. These books are not sold, but leased to subscribers. They are to be used as confidential information, in accordance with a written agreement entered into between the subscriber and the agency. Rating books are issued by some agencies semiannually, by others annually, and in many instances biennially. They contain the actual experiences of the merchants operating within the territory covered by the respective organizations.

Rating books usually contain the following information: the name, occupation, and residence of the individual rated, and his rating or inclination to meet his obligations with promptness. Ratings are expressed by symbols and intend to indicate whether or not the person under consideration is entitled to credit accommodations. Thus P may indicate prompt pay, S slow pay but good risk, and another type of symbol, say X, may indicate a poor risk or one that cannot be recommended for credit. It is also customary to indicate the number of merchants effectively consulted concerning any given name appearing in the book. For example, X4 would show that the individual cannot be recommended for credit by four merchants. Again, P6 S3 means that the individual is reported as prompt pay by six merchants and three merchants report him as slow pay. The rule ordinarily followed is to extend credit rather freely when prompt pay predominates and to require cash or security when one or both of the other ratings predominate. It may be observed in this connection that, where names have carried several good reports and only one unfavorable, the latter is not published, but placed in the file record at the office and is published only in case an additional unfavorable report is received at a later date.

Another feature of the rating books is to include a list of pay days established by the different industrial and mercantile institutions in the community, so that, in arranging dates of payment, retail credit grantors will so fix them as to coincide as nearly as possible with the dates when income is received.

Rating books usually contain the names of current buyers on credit only. They do not as a rule include names of transients, minors residing

with parents, cash buyers, and persons concerning whom information is limited or conflicting. Neither do rating codes include the names of those individuals whose credit standing is so superior that no one has made any inquiries concerning them.

Another function of these agencies is to issue bulletins periodically, usually monthly or bimonthly, containing changes in ratings; names and addresses of newcomers and newlyweds; suits for debts as taken from court records; trusteeships; bankruptcies, voluntary and involuntary; new incorporations; changes in address; building permits; legal notices to the effect that the notifying persons will not be responsible for any debts contracted by anyone other than themselves; and other similar items of interest to retail credit grantors including brief discussions of credit topics. When rating books are published infrequently, ample space is provided in them for entering new names, changes, and corrections as they appear in the bulletins from time to time.

A third function of credit reporting agencies is to furnish reports either over the telephone or in writing. This is done on application of subscribers and a charge is made for some of them as, for example, in case of reports on out-of-town accounts. With some of the agencies the rendering of character credit reports is a primary function.

Some Examples of Credit Reporting Agencies.—The Ohio Bureau of Credits, Inc., located in Columbus, Ohio, is probably typical of the more progressive agencies operating in the retail field. One of the older organizations of the kind, being founded in 1901 with a membership of but 48 users of its service, it now serves more than 1,000 subscribers and has even branched out into the mercantile field to some extent. Its master credit file contains approximately 600,000 individual credit records on which are recorded more than 5 million items relative to the paying habits of residents in the several counties of Central Ohio. In the consumer credit field the company publishes "The Red Book of Columbus and Central Ohio" giving ratings of consumers in the territory designated, issues bulletins at frequent intervals, operates a clearance department for the preparation of regular credit reports, a special investigating department, and a collection department. Through its affiliation with the National Consumer Credit Reporting Corporation and the hundreds of retail credit bureaus and agencies that are a part of the system, it has access to credit records about consumers throughout the United States.

A leading factor among consumer credit agencies is the Retail Credit Company, of Atlanta, Georgia, which maintains offices in 92 cities in North America and is said to have about 1,100 full-time inspectors and 55,000 correspondents. These inspectors are trained to obtain all essential facts in a credit investigation and to present them properly in accordance with the company's high standards. Unlike most credit

reporting agencies, the mainstay of this organization does not lie in rating books but in credit reports. These reports cover the fields of life-, fire-, and casualty-insurance reporting, character-credit reporting, employment reporting, and claim-investigation service.

Recently Dun & Bradstreet, Inc., entered the field of consumer credit reporting, rendering character-credit reports primarily for the benefit of insurance companies. Since this service constitutes but a minor phase of the company's work, it cannot be regarded as a retail credit agency in the true sense of the term.

RETAIL CREDIT INTERCHANGE BUREAUS

Rise and Growth of Retail Credit Bureaus.—Prior to 1900, retail credit interchange bureaus, variously referred to as "retailers' cooperative credit and collection bureaus," "retail credit exchange offices," "merchants' protective associations," "reference clearance bureaus," etc., were practically unknown in the conduct of a retail credit business. The Denver Retail Credit Men's Association, for example, one of the pioneer organizations of its kind, was established as late as 1898 by an exceedingly small group of merchants who recognized the need for reliable credit information.[1] Previous to the establishment of these organizations, when an application for credit was made, the retail credit grantor was governed in his decisions principally by his own personal knowledge or outward appearance of the applicant. To be sure, some data were made available at the time by privately owned and privately operated companies who collected such information as was within their reach, published rating books containing opinions of consumers' credit standing, and issued special reports upon request. This information, however, was, as a rule, exceedingly meager and in many instances vague and out of date.

Prior to the twentieth century, communities were considerably smaller, consumers were better known, strangers rarely approached a merchant with a request for credit, and the bulk of retail business was conducted on a cash basis. The custom of trading in one place further aided in the effective maintenance of direct and personal contact between merchants and patrons. Under these circumstances, the granting of credit on the basis of the meager information then available might have been satisfactory for the most part. But conditions have changed to such an extent as to necessitate the development of a more scientific method for the basis of extending credit accommodations to consumers. Towns and cities have grown to enormous dimensions, the population is constantly shifting, credit is asked for more freely, even by strangers,

[1] O'BRIEN, JOHN C., "How Denver Retailers Handle Credits," *The National Retail Clothier*, Aug. 3, 1922, p. 60.

customers have formed a habit of trading in more than one store engaged in a given line of business, and the size of retail establishments and their corresponding clienteles have increased many times.

Because of these changed conditions, it was obviously impractical as well as disastrous for a merchant to rely merely upon his personal knowledge as a basis for decisions respecting the numerous prospective customers who applied for credit. Consequently, the merchant was put to much trouble in seeking information about other charge accounts which prospective patrons mentioned to him when opening the account. The difficulties were further accentuated by the fact that applicants failed to list all of the stores in which charge accounts were maintained. Hence, the merchant had no means of knowing where the prospective patron had charge accounts other than those establishments to which reference was made by him and it was, therefore, difficult to ascertain the aggregate indebtedness. Moreover, the applicant generally confined his references to stores where the account was in good standing. Frequently, an account had to be closed by some stores because of slow pay or otherwise unsatisfactory dealings, by collecting it through an attorney or collection agency, or by charging it to the reserve for doubtful accounts and thence to profit and loss. If such data had been readily obtainable, retail merchants would have been saved considerable sums by refusing such risks when applying for credit.

In order to obviate the difficulties encountered in seeking complete and pertinent data concerning applicants for credit as well as accounts already on the books, the establishment of a central bureau becomes essential. For this reason there is hardly a city of any size in the United States without a central bureau for the collection and dissemination of relevant data concerning individuals seeking to open charge accounts. The growing importance of retail credit bureaus may best be judged by the tremendous progress of the Credit Service Exchange Division of the National Retail Credit Association. When this division, which was established in 1921, was definitely consolidated, in 1924, with the National Association of Mercantile Agencies, the number of allied stations or credit bureaus was 267. In 1925, the number reached 471, and in 1927 there were over 800 such bureaus in operation.[1] At present there are more than 1,250 such credit bureaus, serving more than 180,000 business and professional men. These bureaus are said to have records for more than 50 million individuals covering the entire United States and Canada. Through correspondents, reports can also be secured from other countries.[2] All of these bureaus are affiliated with the National Retail Credit Asso-

[1] TRUESDALE, J. R., "Credit Bureau Management," pp. 15–16.

[2] HAGIOS, J. A., "Retail Credit Manual," *The Bulletin of the National Retail Dry Goods Association*, June, 1937, p. 46.

ciation and their work is coordinated through the National Consumer Credit Reporting Corporation which now confines its activities to the promotion of national consumer reporting among the bureaus. They are also affiliated with the Associated Credit Bureaus of America, organized in August, 1937, for use in connection with Inter-Bureau reporting and the supervised collection departments of the individual bureaus.[1]

Organization.—Practically all retail credit bureaus are merchant owned, merchant controlled, and merchant operated. Most of them are strictly cooperative, nonprofit, mutual-benefit associations, operated solely for the convenience and protection of their members. The actual conduct of the business in all of the bureaus is entrusted to a salaried official designated as "manager" or "executive secretary," who is elected annually by the board of directors. The relations of the members one to another and to the organization are governed by by-laws and the contract entered into when a member joins the association. The contract usually outlines the means by which the member is expected to cooperate with the bureau and lists the services the association purports to render the member.

Purpose of Retail Credit Bureaus.—The chief aim of these organizations, not unlike that of the credit interchange system of the National Association of Credit Men, is:

1. To provide an impartial medium between debtors and creditors and among creditors themselves.

2. To establish a system whereby those who are interested in any accounts may freely and unreservedly interchange the facts contained in their ledgers without the necessity of direct reference, each to the other, and without divulging their information under their own name.

3. At all times to receive in exchange for items contributed by them the combined experience of all the others interested in the account.

4. To relieve the individual concerns of the necessity of furnishing the same information over and over again in different forms to different houses requesting it, for one of the requirements of membership in many instances is absolutely to refuse to furnish ledger facts, except through the central bureau.

Method of Operation.—The feature which characterizes retail credit bureaus is that they depend for their success and efficiency upon the closest cooperation of their member stores; laxity and carelessness on the part of any member of the organization in the discharge of obligations lessen to that extent the efficiency of the entire system. Hence, it is insisted that when a retail merchant enrolls in the organization he agree

[1] Information on this point was supplied in a letter of October 22, 1937, by C. M. Reed, President, Associated Credit Bureaus of America, Inc., whose courtesy is gratefully acknowledged.

to furnish the association with information as may be required from time to time.

One of the first requirements of new members is that they register immediately with the bureau all their charge accounts on slips or forms provided for the purpose. The information included in these forms consists of: the name; residence; former residence; occupation; business address; date account was opened; highest amount of credit extended; amount owed; paying habits; whether the account is active or inactive, satisfactory or unsatisfactory; and general remarks.

Thereafter member stores are required to report new accounts to the bureau if not cleared through it, as rapidly as they are opened. Stores in which new accounts are added daily are asked to report them daily. Many bureaus require that members furnish daily duplicates of the application forms of new applicants, together with a statement of whether the account was opened or refused, and, if refused, the reason therefor.

Members further agree to report immediately when an account is closed and the reason for the action. They must also furnish all kinds of derogatory information, such as accounts turned over for collection to an attorney or agency, bad checks received, and the like.

Some bureaus also require their members to report daily all inquiries for credit information which they give to nonmembers. In all instances they are to furnish the organization with any information pertaining to the credit standing of patrons, as may be required from time to time, including changes of addresses, changes in ratings, and so on.

In addition to retail dealers in all sorts of commodities, some of the larger bureaus serve dentists, physicians, automobile companies, banks, hotels, mortgage companies, governmental agencies, insurance companies, etc.

Where many different lines of business are represented by the members of a bureau, each line of trade is represented by a series of consecutive numbers, and each member in a given group is designated by an individual number. Thus, for example, shoe dealers would have numbers 1 to 50, stationers, 50 to 100, wallpaper dealers and decorators, 100 to 150, department stores, 150 to 175, and so on. Any individual shoe dealer would then be given a number somewhere between 1 and 50, depending upon the number of dealers already carried as members in this group at the time of enrolment. Similarly, a department store would be assigned a number somewhere between 150 and 175.

In the office of the bureau there are thousands of cards technically termed "master cards," bearing the names of people who have asked for credit from local and out-of-town merchants. Such a master card is made out for each individual about whom information is available at the office. The contents of these cards vary with different bureaus.

Usually, however, master cards provide space for: the name of the individual; his address; former address; business address; date of the information recorded; the numbers by which reporting subscribers are identified; credit limit or amount of credit extended; and rating assigned or current standing of the account in column headed "Why" (see Fig. 40).

In addition to the files containing master cards, some of the larger bureaus maintain a set of files containing special information concerning names on record which may have considerable bearing in determining whether to accept or refuse an applicant for credit. In any event, a separate record must be maintained of information obtained from the court records and through the clipping service for which there is no room

Name

Address Former Ad.

Business Ad.

Date	No.	Time	Amt.	Why	Date	No.	Time	Amt.	Why	Date	No.	Time	Amt	Why

FIG. 40.—Retail credit bureau master card.

on the master card. Occasionally, the master cards take the form of a folder or an envelope, thus obviating the necessity of maintaining separate files for special information.

The master card files are so divided that any desired card may be found without the least delay. Since much, and in smaller bureaus practically all, of the information is disseminated to members over the telephone, many direct lines connect the office with the larger member stores, and a corps of telephone operators, each of whom has charge of a certain part of the alphabet, are constantly answering inquiries. In addition to the telephone service, many bureaus have a messenger service by means of which reports are sent out several times a day. The large percentage of rush inquiries not only necessitated the use of extensive switchboards, but also brought into use the turret telephone system, the

telautograph, and the telephone-typewriter. By the latter two devices, the member writes the inquiry on the machine which is reproduced exactly on the bureau's machine. After the information is looked up, the process is reversed. When these machines are hooked up in a group, all members thus connected with the bureau can be simultaneously notified of vital derogatory information.

Each day, the clerical force of the bureau adds to the master cards on file any additional information that comes in from members concerning bad or short checks, accounts closed, and accounts reopened and reasons therefor. In this manner each patron's record is kept up to the minute.

To illustrate the method of operation of a typical bureau, we might cite a complete transaction. Suppose customer X applies for credit from one of the members of the association. The credit manager of the store from which credit is sought has him fill out a credit application form. This form is designed to give a statement of the applicant's residence and occupation for several years past. It also reveals his financial responsibility by showing whether he owns property and, if so, its value, encumbrances, and whether it stands in his name. When the application form is filled in and further information is deemed desirable, the credit manager or his assistant telephones the bureau, whereupon the operator, after consulting the master card file close at hand, reads all the information appearing thereon. If no record of the applicant is on file, the credit manager will have to act on the basis of the answers to the questions on the application form, or else delay opening or refusing the account until further data are procured, whereupon the bureau will proceed, at the request of the member affected, to investigate the risk. If the references given reside within the city, it is, of course, possible for the bureau to get in touch with them immediately, particularly when they represent business houses. If the references given represent merchants in other cities where the prospective customer formerly resided, these references are cleared by the bureau, which sends a letter to merchant-owned associations or directly to the out-of-town stores requesting that the proper data be filled in on a convenient form provided for the purpose.

Again, if the information on file appears to be old, usually over 60 days, attempts are made to gather the most recent ledger experience on the subject of inquiry by telephoning to all members whose codes appear on the master card. When the information is thus compiled at the request of a member, the clerk in charge of the branch or alphabetic section of the master card file in which the subject's name appears immediately telephones the results of the investigation to the inquiring store.

In order that members may translate the information contained in the reports and bulletins issued by the bureaus, a confidential code or key is furnished each member. These codes vary considerably with the

different bureaus, as to both the scope and method. The following is a key devised by a number of bureaus, relating to payment schedules, checks, and special information:

CODE KEY

Payment Schedule	
A	30 to 60 days
AA	As agreed
B	60 to 90 days
C	90 to 120 days
D	Slow but good
E	Enquire
F	Collection
G	Profit and Loss

Checks	
P	Protest
NSF	Returned, not sufficient funds
RNA	Returned, no account
RAC	Returned, account closed
RPS	Returned, payment stopped
RAA	Returned, account attached

Special Information	
ACR	Account closed, request
ACTS	Account closed, too slow
ACCC	Account closed, can't collect
CR	Chronic returner of goods
DB	Dead beat
DC	Don't charge
DPR	Declined past record
DSI	Declined special information
EU	Extremely unsatisfactory
ID	In debt
IR	Insufficient reference
L	Loan negotiated
LR	Loan rejected
NBC	No basis for credit
PD	Past due
PNK	Promises not kept
R	Rejected
REP	Repossession
RV	References unsatisfactory
U	Undesirable
UFC	Unfair claims
VS	Very slow
NR	Nonresponsibility
FP	Fraud purchases on this account

Some bureaus have, in addition to what has been given, a code pertaining to the amount of credit, somewhat as follows: 1 represents $10; 2, $20; 3, $30; etc.; x represents $5; lx, $15; 2x, $25, etc. H represents $100 to $200; and HI $200 and over.

Types of Retail Bureaus.—On the basis of ownership, there are at least two distinct types of retail credit bureaus, the merchant-owned and those operated by the chamber of commerce or by a Better Business Bureau. Privately owned bureaus are in reality credit agencies and should be so classified. A more significant basis for classifying credit bureaus is that of service. On this basis, all retail credit bureaus may be divided into two types, namely, the bureaus that render complete ledger information service and those that render an abbreviated service consisting solely of derogatory information.

In a number of the smaller communities may be found bureaus reporting only on persons whose credit is in any way impaired. The members of such bureaus are not required to submit their complete lists of cus-

tomers or to report the opening of new accounts. All they are asked to do is to report unfavorable experiences with customers. It is said that such a system of reporting has been favored partly because of its cheapness, but more largely because in the smaller towns merchants seem to be reluctant to disclose who their customers are.

Bureaus rendering only derogatory news perform a limited service for their clients. Their work is by no means of a constructive type, since a merchant cannot use such a report as a basis for setting a credit limit or for developing a customer into a more profitable account. The report is of necessity negative in nature; it merely serves as a danger signal and in no way acts as a business-builder. Such a report is also incomplete. It does not present a picture of the account as it actually is. Furthermore, there is nothing to compel a member to supply even such limited information as goes into the report, for there is no way of checking up on his customers and their activities.

Kinds of Credit Information Collected.—Practically all credit bureaus that render a complete credit service gather ledger experience of the retailers with their customers. Such data may be gathered in several ways. One method is to require all merchants to submit a list of all of their customers as soon as they join the bureau, giving all the necessary information on their accounts. These lists are supplemented thereafter with information concerning new accounts opened, credit shut-offs, changes in address, and other pertinent items. Emergency matters involving short changers, bad checks, and the like, are usually transmitted over the telephone as soon as such information is obtained.

Another method of gathering ledger experience from merchant-members is to have them submit to the bureau detailed reports on their credit customers once or twice each year, on blanks provided for the purpose. The larger stores would obviously find such a task too burdensome. Periodic meetings held under the auspices of the bureau constitute another means of gathering credit information of the ledger type.

Credit bureaus also aim to gather considerable legal news relating to chattel mortgages, real estate mortgages, conditional sales contracts, foreclosures, transfers of deeds, and garnishments. Records of marriage licenses issued and divorces obtained are also important, for they invariably effect a change in the nature of the credit risk. All of this information can be obtained from city and county courts, from the county clerk, from the office where deeds are registered, from the daily press, and especially from some special daily publication containing legal matters of the nature described.

A third type of information gathered by retail credit bureaus consists of "pick-up" material secured largely from the local papers. In addition to some of the items listed in the preceding paragraph, the local papers

will yield data on births, deaths, new arrivals in the city, and changes in address.

STANDARD INTER-BUREAU REPORT

Adopted by the
NATIONAL RETAIL CREDIT ASSOCIATION
SERVICE DEPARTMENT

INDIVIDUAL

REPORT ON _____
(Surname first) (Mr. Mrs. Miss) (Given names) (Wife's or husband's name) (If single, parent's name)

Residence Address _____
(Number and Street or R. F. D.) (City) (County) (State)

IDENTITY
- Length of time applicant has been known in our files
- Length of time applicant has resided at this address and in city
- Type and condition of residence and neighborhood
- Is applicant considered a permanent resident?
- Age (If 21, verify if possible) · Nationality or race
- State if single, married, separated, widowed or divorced
- Number and identity of dependents

HISTORY
- Former residence addresses and how long there? NOTE: On reverse side give summary of credit reports received from other towns.
- Name and address of present employer or business
- Size and reputation of firm
- Nature of occupation or business and how long?
- Name of previous employer, position and how long?
- Employer's opinion

CHARACTER
- How regarded as to character, habits, morals, etc.
- Reputation of applicant's friends and associates
- Suspicion of liquor or narcotic traffic, if any
- Record of thrift — Steady employment — Moving often — Over-buying

RESOURCES
- INCOME—Approximate monthly income from employment or business, if salary or commission, when and how paid
- Is income steady and prospect of permanency?
- Details of estimated earnings of wife or others in household
- Income from other sources, investments, rentals, stocks, etc
- REAL ESTATE OWNED—Location and assessed value, when such information is available from public records.
- Mortgages or conditional bill of sale on property
- Other property or tangible assets
- If applicant rents, give amount of rent and paying record
- Applicant is generally estimated to be worth
- Bank experience
- If financially involved in any way, give details

CREDIT RECORD AND REMARKS:

Type of Business	How Long Sold	Loans or Open Acct.	Recent High Credit	Owes Now	Amount Past Due and How Long	PAYING HABITS (Specify 30, 60, 90 days, etc)	Remarks

USE REVERSE SIDE for suits, judgments, garnishments, bankruptcies, loans, chattel mortgages, repossessions, domestic troubles, etc. Amplify any incomplete or unfavorable information given above. Give a brief word picture of the subject, stressing any unusual history or condition. State if radical change has been noted in bills paying habit and give reason.

Report for _____ Your File No. _____

Developed by _____ Date _____

The confidential information given in this report is in answer to a request for same. This report is given simply as an aid in determining the propriety of extending credit, or the value or condition of an existing credit and is based upon information obtained from sources deemed reliable, the accuracy of which, however, is in no manner guaranteed. The inquirer, in accepting this report, agrees to hold same in STRICT CONFIDENCE for his own exclusive use, never to be communicated, and to be personally responsible for any damage arising from a violation of any of the above provisions.

FIG. 41.—Form of special report in use by many retail credit bureaus.

Rating Books.—Not unlike the privately owned credit agencies, some of the retail credit bureaus issue rating books annually, biannually, or at other regular intervals, although a bureau may be found here and there

that issues a rating book at indefinite periods. Relatively few credit bureaus publish rating books. Information for such a book would naturally be taken from the master cards. Since at the end of six months such information is usually regarded as of little value the usefulness of a rating book would be too small to justify the expenditure. Wherever rating books are issued they are kept up to date either through the regular bulletin service of the bureau or through special supplements issued weekly or monthly.

Trade Clearance Reports.—As already pointed out, the chief aim of these bureaus is to furnish information concerning applicants for credit and accounts already on the books upon request of members. Although the inquiries are answered by telephone, nevertheless written transcripts of a customer's record may be furnished by messengers who make the trips in accordance with a regular schedule several times a day.

This type of report which is usually conveyed verbally over the telephone is sometimes designated as an "In File Report," or an "Office Report," because it is based on whatever information concerning an individual is already in the files of the bureau, provided that such information is less than 6 months old. If the available data are not sufficiently current, the various stores whose codes appear on the subject's master card as well as others known to have had dealings with the risk are called, the necessary ledger facts are obtained and relayed to the inquiring member. In a few bureaus reciprocal reports are given free of charge to all members contributing ledger information to a new written report.

Special Reports.—A second type of report in common use is the "Special" or "Antecedent" report. In addition to the usual ledger information, it contains data on the identity of the subject, his antecedents, character, and resources. A number of bureaus have adopted for use on local written reports the standard inter-bureau report form shown in Fig. 41. A similar type of report is furnished on "out of town" applicants, but since the information must be secured through the cooperation of another bureau a larger amount is charged for it. Other types of special reports have been designed to suit particular needs.

Indebtedness Reports.—If knowledge is desired concerning a customer's buying activities and his aggregate indebtedness, the bureau is prepared to supply it. Upon receipt of a request for such a report, the bureau makes inquiry of each of the member stores known to sell the customer and a summary of the information thus procured is made in the form of an indebtedness report. Some bureaus make it a practice to furnish a copy of the report to each member interested in the subject.

In case the consumer is found to buy unusually heavy on some accounts and to have overextended his credit, the merchants will take the proper action either through the bureau or through a committee,

usually the former, sometimes calling for a liquidation of his debts before any further credit is to be extended by any merchant. A common method is for the bureau manager to call upon each interested member and, if agreeable to all concerned, the bureau manager or the largest creditor writes the customer a letter requesting an interview. At that time the facts are laid before the customer, and a request is made for a statement of his financial responsibility, or for any other information which would tend to justify such large indebtedness. If the additional information is unsatisfactory, arrangements are then made for the payment of the account, which may be done through the association, in which case payments are distributed pro rata each time a certain sum is collected, or the customer may agree to pay each member proportionately until the account is again reduced to safe limits.

Derogatory Information.—The bureau keeps its members informed of happenings to an account in which they are interested. Thus, information concerning unusual activity in opening new accounts, buying unusually heavy on any one account, or when an impostor is buying on an account is automatically broadcast to all members interested. The bureau serves as a receiving station for all sorts of credit information. The organization usually has a working agreement with the postoffice department and sometimes with the express companies whereby the names of forgers, passers of "bad paper," and other suspicious individuals are reported to the association. Again, reports pour into the office daily, from members, of short and bad checks received. As rapidly as this information is received by the association, it is flashed by telephone to the stores likely to be interested in the names in question.

The bureau also notifies the members daily, usually by telephone, of the names of individuals who were refused credit or whose accounts were closed by other members, and the reasons for such action. This is sometimes called "automatic notification service." Other information which is generally considered detrimental or derogatory, and, consequently, passed on to members whose codes appear on the master card, consists of suits for debts, assignments, collection accounts, mortgages, and the like. Finally, the members of the association are notified of the presence of short- or bad-check artists in the city, as soon as their presence becomes known to the bureau.

Tracer Reports.—Upon request of a member, the bureau traces missing debtors and issues tracer reports, containing a summarized statement of the action taken and the results obtained. The usual charge for such a report is 75 cents or $1.

Real Estate Reports.—A few bureaus furnish reports on real estate, compiled by special agents from real estate records in the county recorder's office. They contain the name of the subject about whom

inquiry has been made, street, original lot, sublot, foot frontage, ownership, tax value, mortgage and mortgage holder, amount, date, second mortgage and holder, amount, date, and additional comments of the reporter. The purpose of such report is to check on the statement made in the application form concerning properties owned by the applicant. When the merchandise is to be affixed to the home such information becomes indispensable. Another way in which this information is made available by the association is by keeping a plat of all the additions and subdivisions of the city, together with the names of the owners of property. This record is kept up to date by rechecking daily with the real estate transfers as reported in the local legal journal. Charges for these reports generally vary from $1 to $2.

Special Bulletins.—Special bulletins are issued to all members, monthly, semimonthly, weekly, or at even more frequent intervals. All items of interest are contained therein, such as accounts of bad-check passers operating in the city and other communities; information furnished by members regarding bad accounts on their books; notices of nonresponsibility for debts given out by husbands; new firms; changes of address; names and accounts of counterfeiters of currency, traveler's checks, etc. Some bureaus do not issue bulletins at stated intervals, but put one out whenever there is something new or of special interest to the members at large. It is argued that, in the absence of regular intervals at which bulletins are to be issued, more interest is displayed by members, for they know that whenever the bulletin does come out there is something of special interest.

Periodic Meetings.—Monthly or weekly meetings of members of the credit bureau are held for the discussion of credit problems and the interchange of credit information. At these meetings demonstrations are given of methods of opening and closing accounts, and discussions are entered into relating to delinquent accounts, credit and collection policies, and similar matters. A common feature of these meetings is for the bureau secretary to read the names of individuals concerning whom information is desired by some one member present. Such names are usually turned in to the bureau some time in advance of the meeting. As the names are read, any member who has pertinent information respecting any of them signifies the fact by calling out his number and proceeding to supply it. All information at these meetings is usually given in code as indicated in the confidential code key described in the earlier part of this chapter.

Cooperation with Detective Agency.—Whenever possible, the association supplies information to the detective agency employed by the retail merchants so as to facilitate in apprehending shoplifters who prey upon the big stores. In return, the detectives are frequently in a position to

supply the association with useful information concerning individuals likely to approach merchant members for credit.

Collection Service.—Only a limited number of bureaus find it profitable and worth while to operate a collection department. Many of them, however, furnish form letters which are sold to members. Each letter has a space at the top for inserting the delinquent's name and address, and space in the body for the name of the firm and amount due. These letters contain the bureau's letter heads and have an undoubted psychological advantage on the debtor's mind over letters sent directly by a single creditor. Because more elaborate treatment of this phase of credit work is reserved to another portion of the book, it will suffice to add here that the development of collection service by credit bureaus is largely an outgrowth of indebtedness reports which they are called upon to render. When the aggregate indebtedness is found to be excessive, merchants find it convenient to entrust the collection of their accounts to the bureau, as already indicated in a previous connection.

Miscellaneous Services.—Retail credit bureaus render a number of other services which vary from bureau to bureau. They often furnish the member stores with special inserts to be used as direct-mail pieces. Rubber stamps are sometimes supplied and other collection aids. Some bureaus are prepared to conduct so-called "private investigations" in order to unearth intimate but essential facts concerning people who are employed in a strictly fiduciary capacity or who may be required to handle large sums of money. Some bureaus make a special effort to assist debtors to re-establish their credit and to build better customer credit relations with member stores. A few bureaus publish monthly the collection percentages, classified by type of store. Others have a so-called "watch service" under which they issue warnings concerning an individual or send out notices that valuable information regarding a risk, in which the member is interested, has been received and suggest that a report on the subject be asked for. Still others conduct newspaper and billboard advertising campaigns designed to stimulate payment of bills on time, and keep members informed of favorable and unfavorable legislation pending and enacted.

Cost of Service.—Obviously, the cost of the service rendered by retail credit bureaus varies with the different organizations, their membership, and the number of reports requested. Practically all bureaus charge a regular annual fee, which entitles the member to all the services of the organization and a minimum number of inquiries for investigations of customers' records. This fee varies from $10 to as high as $200 and over. Normally, however, it is about $30. All or a large part of this fee is credited to the subscriber's account for services rendered at the scheduled rates. In general, the charge for a verbal trade clearance or

in file report is 50 cents, for a standard special report the charge is usually $1, on out of town applicants the normal charge for a report varies from $1 to $1.25. For most other reports the charge is around a dollar per report. Some bureaus base their charges on a sliding scale, the charge per report being reduced as the number of inquiries is increased.

Three bases for charges are generally used by retail credit bureaus. There is the "flat" charge for unlimited service on a monthly or annual basis. Then there is the flat charge for a limited amount of service to be rendered during a given period. Finally, there is the "metered" charge according to which members pay for the service received at established rates for each kind of service. In smaller cities the tendency seems to be to retain the older method of charging flat fees but in the cities the trend is definitely in the direction of metered charges.

Advantages of Retail Credit Bureaus.—The importance of these bureaus and their advantages to the members may be summed up in the following statement made by a writer on the subject:

> The . . . bureau is to the retail credit grantor what the clearing house is to the banks. It is a pivot around which retail credit business may circulate with reasonable safety; it is a clinic for the chronic credit abuser; it is the pulse of the retail charge business. It is a beacon light on an uncharted sea; a nucleus for a credit men's organization and for the promotion of a credit man's welfare. It is an educational center for disseminating among the public such propaganda as will aid a credit man's work.

Further proof of the advantages that accrue to members through the use of retail credit bureaus is afforded by various studies of the subject which show that a larger percentage of the retailers are now using credit bureau service and that stores which use such service suffer fewer bad-debt losses than those operating in the same field which have not taken advantage of it. For these reasons it is considered good policy for a member to ask for a regular report on every applicant for credit and for an old customer when he becomes delinquent, when he suddenly increases his purchases, when information received from the bureau shows that he is opening many accounts at other stores, when unfavorable information is obtained from court records or the bureau, or when he starts buying again after the account has been dormant for some time. Special reports should be called for as the occasion may require.

Medical Credit Bureaus.—For some time the medical profession has suffered from the unbusiness-like conduct of its practitioners which resulted in tremendous losses from bad debts. It is believed that the professional man's book accounts decrease in value faster than other types of accounts, partly because after he is cured the patient loses his desire to pay and partly because there is no material reminder of the

debt in the form of goods that may be repossessed. The physician himself, who is more interested in the professional phase of the work than in the business aspect, is largely to blame for this condition. Because of this, an attempt has been made in recent years to urge physicians and dentists to utilize the services of retail credit bureaus. In some cities, however, they saw fit to establish their own bureaus whose offices are usually connected with the local Academy of Medicine and whose method of reporting and collecting can be dictated by the profession itself. Among the earlier bureaus of the type is the Toledo Physicians and Dentists Credit Association.

While the main purpose of these bureaus is to collect overdue accounts, they also render a credit reporting service which prevents delinquents from abusing the confidence of doctors and dentists, and attempts to educate the public to the necessity of paying for professional services as they do for merchandise.

Late in 1933 managers of a group of such bureaus operating in the Middle West organized the National Association of Medical Credit Bureaus whose main offices are in Akron, Ohio. This association is to act as a clearing house of service and management ideas that would lead to the development and adoption of a uniform plan of operation for medical and dental bureaus.

An Example of a Retail Credit Bureau.—The Cleveland Retail Credit Men's Company[1] was organized in 1898 and incorporated in 1905 and has been in continuous operation since its inception. During these years it has grown in size and service to its members until today it is one of the largest centralized credit bureaus in the United States. The total membership is approximately two thousand with annual dues of $15.00 and a minimum contract of $30.00. The cost is slightly less for professional men such as physicians and dentists. The membership represents over 100 different classes of retail establishments and professions.

While this bureau has grown in size with reference to members, it has also grown in the type and kind of service handled. Its master credit record file contains approximately 1,500,000 separate records with an additional 900,000 records of detailed antecedent information. The master record for the most part shows the pay record and employment while the special file of detailed antecedent information consists very largely of material on identity, history, character, resources, etc.

The principal types of reports rendered to members, and the charges made for each type are:

[1] The information for this section was supplied by W. H. Gray and E. L. Carter of the Cleveland Retail Credit Men's Company, whose cooperation is hereby gratefully acknowledged.

1. Trade rating.—This report tells the pay habit of an individual or firm. Service includes a summary of information appearing in trade files. Price: 30 cents.

2. Special report.—Complete history of individual or firm is given, including partnership or corporation, showing where employed, salary and pay habit of individual or officers, financial status, etc., of a firm, plus any additional information obtainable or necessary for special purposes. Cost of the standard special report is $1.

3. Emergency report.—This includes all information on hand in the Bureau's trade or special report files or enough information secured on short notice to indicate whether member should accept or reject an application. Price: 60 cents.

4. Real estate reports.—The principal types are:

   a. Search of county records to determine ownership of a specific parcel of property, sublot number, foot frontage, tax value, and encumbrances in the way of mortgages back to the time party acquired the deed. Price: 50 cents.

   b. Search of county records to determine ownership only. Price: 25 cents.

   c. Full description of property. Price: 50 cents.

   d. Check of applicant's chattel mortgages. Price: 25–50 cents.

   e. Real estate reports outside of Cuyahoga County at cost. This usually is $1 each.

5. Clearance report.—This is a complete check of members known to have subject's account to determine full extent of subject's credit activity and up-to-the-minute status of every account. Report shows high credit, pay habit, and amount owing each member reporting. Price: $1.

6. Tracing report (giving new address).—If already in file, it is forwarded at once at the cost of 30 cents. If search is necessary, the cost is $2 when located.

7. Employment report.—This is a verification of the applicant's employment record, showing how long employed, employer's opinion of worthiness, and approximate salary. Price: 30 cents.

8. Out-of-town reports.—This service covers the United States and Canada and several foreign countries. Special reports cost $1 to $1.50, and up.

The present personnel of the bureau is approximately 150. The average number of reports issued daily runs anywhere from 1,400 to 2,000. Members are expected to report all their ledger information, such as accounts past due, profit and loss accounts, collection accounts, NSF (not sufficient funds) checks, repossessed merchandise, disputed

accounts, rejections, changes of address, etc. Much of this information is compiled and published in a weekly bulletin and, thus made available to all members.

In addition to this, practically all litigation in the county, taken from common pleas court, municipal court, probate court and courts of the justices of the peace, and including such information as assignments, attested accounts, administration of estates, bankruptcies, change of names, debtors' petitions, divorces, evictions, foreclosures, incompetents, mechanic's liens, nonresponsibility notices, notices of sale, receiverships, suits for money only, is obtained and recorded on the individual's or firm's record.

An extensive clipping service is maintained where financial news and other items are clipped from newspapers and trade journals and placed in the bureau's files. Many times this information is of great help to credit grantors.

In 1926 this credit bureau organized a Collection Department. The department was organized at the request of a large number of business and professional men, very largely because of inadequate collection service elsewhere. In 1936 this department collected $265,000 in slow accounts. The collections were accomplished by the use of letters, telephone, and outside collectors without the aid of attorneys or litigation. In addition to the collection of slow accounts, the bureau provides a number of collection aids which members are privileged to use on their slow accounts prior to turning the account over to an attorney or collection agency. These aids, for the most part, include collection stickers, inserts, letters, and final notices.

In addition to the above direct credit reporting services, a number of trade groups, sponsored by the bureau, meet at frequent intervals to discuss and exchange ideas regarding their credit and collection problems. These groups for the most part meet monthly at a noon luncheon with an hour-and-a-half session immediately following. This enables the credit man to discuss his own problems with other credit men in his own trade, and in this way they learn directly from each other. These groups have an educational value to the member and considerable good will is created through them for the bureau. Each Thursday noon a group of credit managers from the larger stores, for the most part, meet and exchange experiences and learn from each other how best to handle certain problems. At intervals throughout the year meetings are held of a social and educational nature to which all members are invited. Generally a speaker is engaged to bring a message of special interest to credit executives.

Conclusion.—On the whole, there is a high degree of uniformity both in method of operation and in the kind of service rendered, regardless

of size of community, so long as the bureaus are affiliated with the same national organization. Through the National Consumer Credit Reporting Corporation, the National Retail Credit Association has attempted to secure such uniformity and has even gone so far as to assign exclusive territories to member bureaus and stipulate that reports were to be made available to members only. Against these latter practices, the Attorney General of the United States issued a complaint in 1933 which resulted in a consent decree by the Association so that it is no longer possible for credit grantors to refuse to furnish information to any nonmember credit agency by virtue of a contract to that effect with the member bureau, although each store may of its free will refuse to give such information just as any merchant may refuse to sell to a certain customer.

It is possible that as a result of this decree there may be somewhat less progress toward uniformity, which may be in some respects highly desirable. It seems that retail credit bureaus act altogether too much like relay agencies and do too little independent work of a constructive nature. There is no reason, for example, why some of the larger bureaus should not utilize the wealth of information on their master cards for studies that would lead to the establishment of credit limits on a more scientific basis than at present. With the mathematical and statistical methods at their disposal such credit limits could be computed for each income group with gradient percentages for various influences such as size of the family, special expenditures, and the like. Certainly, the national organization, through its members, would do well by means of bulletins or other publications to acquaint the public with the credit granting system that has been developed in this country for effective service, as a basis for a better understanding between retailer and consumer.

BANKS AS A SOURCE OF RETAIL CREDIT INFORMATION

Banks as a Source of Information.—Although the banker's work lies in the province of financial transactions only, he is nevertheless, in a sense, classed as a retail credit grantor. He operates on the basis of the principles laid down for retail credit grantors every time he extends a loan on an unsecured note, with chief reliance on the borrower's financial and moral responsibility. Hence, the interest of the banker in the manner in which his borrowing accounts meet their obligations elsewhere. In order to obtain the required data from retailers, bankers find it necessary to reciprocate.

Methods of Securing Information from Banks.—Information from banks may be obtained by retail merchants by one of three methods in use: by telephone or telegram, by messenger, or by mail.

Telephone inquiries are at best unsatisfactory, as judged by results obtained. This method usually involves a serious waste of time, due to

the necessity for confirming the inquiry, unless the inquirer's voice is recognized by the person answering the telephone at the bank. In order to insure that the proper person obtains the information, both parties hang up the receiver and connections are reversed. Because of this, it is recommended that telephone inquiries be used sparingly and with a view of obtaining data which can be given with little delay. To secure data from out-of-town banks, inquiries are occasionally made by telegram.

It is customary for large stores in many cities to make inquiries through messengers or runners. These investigators make regularly scheduled trips to the banks from which data are sought. All special cases requiring immediate consideration are looked up at once. All other names on which information is desired are listed alphabetically and handed to the bank's reference clerk, whose function it is to furnish the data on names on file and have the replies ready when the messenger makes his next trip. Obviously, the better qualified the investigator, the higher the quality of information which he is likely to secure.

Inquiries by mail should be reserved for emergencies, or cases where more detailed information of a highly confidential nature is desired. The right sort of an inquiry personally directed to an officer of the bank and signed by the credit manager ordinarily brings the right sort of reply, showing the size of average bank balance, whether the prospective customer honors his notes when due, whether he overdraws his account, or makes unjust claims respecting his balances, and the like.

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Questions and Problems

1. List all the possible sources available to credit managers of retail stores in obtaining information about customers and prospects. Which are the most significant? Who is interested in this information?

2. Point out the significance of the personal interview in retail credit granting. What kinds of information can thus be obtained?

3. Should an attempt be made to ascertain the applicant's salary during the personal interview? His instalment obligations? Give reasons for each of the answers.

4. Distinguish between credit reporting agencies and credit bureaus operating in the retail field and indicate the nature of the ratings furnished by the agencies.

5. How do you explain the existence of credit reporting agencies which operate for a profit while retail credit bureaus operate on a nonprofit basis? Why doesn't the latter supersede the former?

6. Prior to 1900, very few credit bureaus operated in the retail field, while today the number of such bureaus is over 1,200. How do you account for this tremendous development of credit bureaus within such a short time?

7. Mrs. Brown has applied for credit at the X Department Store. What is likely to be the first source of information that will be used?

8. Assuming that a bureau report is wanted on Mrs. Brown, how may it be obtained and what kind of information does it usually contain?

9. What other types of reports can be obtained from the bureau on Mrs. Brown?

10. Can you prove that the use of retail credit bureaus or similar sources of information redounds to the benefit of merchants using them? How?

11. Outline all other services, exclusive of furnishing credit information through various types of reports, which bureaus are prepared to render to the membership. What are the shortcomings of such bureaus?

12. Trace the growth and development of the National Retail Credit Association and show how it has affected retail credit management.

13. The merchants of Littletown, Mo., have decided to establish a credit bureau. You were chosen to be the manager of the bureau. Indicate how you would proceed in the organization of such a bureau.

CHAPTER XXI

FOREIGN CREDIT INFORMATION

Nature of Information Sought.—As in domestic credits, a foreign credit manager seeks all the specific and detailed information concerning a customer's antecedents, manner of payment, character, and ability to succeed. Here, as elsewhere, a complete knowledge of all the facts regarding the applicant is essential to a correct credit decision.

One of the ways of judging a foreign merchant's character and ability is by the length of time he has been engaged in business. Past performance is probably the best indicator of the manner in which he will act in the future. If he has been in active operation for a long time and possesses a record of honest and profitable management, no sane credit manager would refuse credit accommodations. Similarly, the longer the business career of the prospective customer, the greater the opportunity for the credit manager to ascertain any unfavorable conduct on his part. On the other hand, concerns with a limited business experience have little to recommend them as desirable credit risks, even though the management is honest. Although they may prove their merits and superiority over older concerns, in both character and ability to operate their businesses, nevertheless, until such proof is presented in an overwhelming quantity, a credit manager will do well to give preference to those concerns which possess a record of continuous operation over an extended period of time.

A foreign merchant's buying activities and manner of payment constitute another important test of his credit responsibility. Merchants who buy within conservative limits and anticipate or pay their bills promptly are always preferred customers, probably on the assumption that these practices will continue. This does not mean that only those customers who have continuously and consistently met their obligations with great promptness are the only superior risks. As a matter of practice, many of those whose records indicate that payments have been occasionally deferred may also properly belong to this class, provided, of course, that they fully intended to discharge their obligation promptly but were prevented by certain extenuating circumstances.

An insurmountable difficulty, at least for the present, is the lack of adequate accurate information obtainable regarding a foreign merchant's buying activities. It is well-nigh impossible, in many instances, to ascer-

tain the extent of the obligations which have been contracted by the applicant. This is because of the lack of international offices or bureaus through which ledger experiences may be cleared effectively. As will be shown in the following pages, the service which is rendered by bureaus and agencies in this country is limited largely to the experiences of our exporters with the particular foreign accounts concerning which ledger information is sought. But these foreign merchants may also have bought substantial bills of goods in other lands, where their dealings may be decidedly unsatisfactory and reflecting seriously upon their credit and financial responsibility. There is no way as yet, however, in which this information can be secured in as reliable a fashion as that obtained in this country.

SOURCES OF INFORMATION

Classes of Information.—All sources of credit information regarding foreign buyers may be divided into two main classes. One class consists of sources available in this country, and the other comprises the various sources located abroad, particularly in the locality of the prospective customer. The former includes mercantile agencies, credit bureaus maintained by associations, credit service organizations, American exporters selling the same trade, banks, publishing companies and the Federal government through its consular services and the Bureau of Foreign and Domestic Commerce. The latter consists of foreign agencies, foreign banks, American representatives, and the prospective buyer himself.

Domestic Sources

Mercantile Agencies.—Dun & Bradstreet, Inc., the only general mercantile agency in the United States, maintains offices in foreign countries in order to serve our exporters as well as the merchants and bankers whose operations are confined within the limits of this country.

The Company maintains a total of 135 offices in countries outside the United States. Of these, 17 are in Canada, 8 in Australia and New Zealand and the remainder in Mexico, Cuba, Porto Rico, Newfoundland, South America, Great Britain, Ireland, Holland, Belgium, France, Spain, Portugal, Switzerland, Italy, and South Africa. In places where no branch offices are located, the field is covered by traveling reporters or correspondents. In some countries, as in Germany and Austria, the agency has an agreement with similar domestic agencies through which all information concerning risks located therein may be secured.

Over the years the company has accumulated a vast mass of foreign credit information which is constantly revised on the basis of investigations among the suppliers in the United States and in the customer's

home market. Reports on customers located in foreign countries are of the same general type as those prepared for credit risks in the domestic trade, with perhaps a little more emphasis on antecedents and less on financial condition, although in recent years the reports have contained a large percentage of financial statements. The information gathered in the customer's home market by nationals with a knowledge of local trading customs is translated in the New York office of the agency by credit men with wide experience in export business. In this manner, the Foreign Department of Dun & Bradstreet, Inc., assists American exporters in their sales promotion work, in the selection of foreign outlets, and by supplying general trade information. A "continuous service" is now rendered automatically on foreign inquiries, thereby making available for the exporter additional reports, without charge, for a period of 1 year following the original request for information on the risk in question. In addition, the department conducts special surveys on foreign markets and compiles trade lists upon request.

While the general mercantile agency is in an excellent position to render valuable services to export credit managers, it is difficult to match its service in the domestic field. The distance from the foreign customer, the sharp competition with some of the local agencies abroad, the difficulty in securing reliable data from foreign suppliers and the expense and delay incident to frequent revisions of reports have been factors in the situation.

The Credit & Audit Co. of America, located in New York City, operates a foreign department which specializes in furnishing confidential reports on firms all over the world. It has particular facilities for countries in Asia and South America. Special investigations are made in the field and emphasis is placed on trade experiences. The rates charged vary according to the type of report, but usually amount to $5 and up to $10 per investigation and report.

For a number of years the National Credit Office, a special mercantile agency, operated a Foreign Department of considerable size, serving especially concerns in the textile, leather, and automotive trades. This work is now conducted at the headquarters of Dun & Bradstreet, Inc., although under certain conditions subscribers of the National Credit Office can be provided with the service without having to subscribe for the service of Dun & Bradstreet.

The Foreign Trade Bureau of the Commercial Museum of Philadelphia furnishes credit reports as part of the service it renders to American manufacturers and exporters. Upon payment of a moderate charge, nonmembers may also obtain such information. Much of the data for the reports is collected through resident correspondents maintained in practically all countries.

Then there is the Retail Credit Company of Atlanta, Ga., with offices in all principal markets in the United States and branches in Cuba, Puerto Rico, Guatemala City, and Honolulu, in addition to correspondents covering practically all points of the civilized world. This company specializes in character reports that are essential in the selection of credit risks and the choice of marketing-agency connections.

Finally, there are special mercantile agencies in certain lines of trade which cover in their rating books and report service, foreign buyers and shippers, especially those located in Central and South America. There are also some special mercantile agencies, like the Produce Reporter Company, which include in their service reports on firms located in Canada and Cuba, as well as those in this country. The usefulness of the services of such organizations is limited, however, by their narrow field of operation territorially and by kind of business.

Foreign Credit Interchange Bureau.[1]—This bureau was organized in 1919 by a group of foreign trade and credit executives, is operated by the National Association of Credit Men, and is supervised by a committee of its members representing leaders in American export trade. It is conducted on the same general principles, though adapted more especially to foreign trade needs, on which all domestic bureaus of the Credit Interchange System of the National Association of Credit Men are based. This bureau is a nonprofit organization whose aim is to serve all its members for a charge sufficient to cover the cost of operation. For some little time the charge has been consisting of $100, covering a year's subscription, plus an initiation membership fee of $25. This entitles the member to 100 interchange reports, $1 being charged for each additional report with a discount for certain quantities. The bureau is a clearing house through which all members may freely and unreservedly interchange the data contained in their ledgers, without the necessity of direct reference each to the other and without divulging the information under their own names.

Every member obligates himself to supply the bureau with a list of all the names and addresses of foreign concerns and domestic export commission houses in whom he is interested and to furnish names of new accounts as they are opened. He further undertakes to supply promptly and completely his experiences with any concern under inquiry and to treat all information furnished by the bureau as confidential. The bureau in turn agrees to supply interchange reports upon request of the member; to furnish, without charge, reciprocal copies of reports upon which the member contributes experiences, provided such copies are requested; to supply special reports where requested; to render a moral-

[1] Much of the information on the Foreign Credit Interchange Bureau was obtained through the courtesy of William S. Swingle, its director.

SUBSCRIBER'S REPLY
FOREIGN CREDIT INTERCHANGE BUREAU
NATIONAL ASSOCIATION OF CREDIT MEN
ONE PARK AVE. NEW YORK

PLEASE REPLY PROMPTLY
PROMPT REPLIES MEAN
PROMPT SERVICE

Date of Last Clearance

Name_____ Inquiry No._____

Address_____

TERMS OF SALE

1. Open account payable.....days from date of
   (a) Invoice
   (b) Factory shipment
   (c) Export shipment
2. Open account payable immediately upon receipt of
   (a) Documents
   (b) Invoices
   (c) Goods
3. Account guaranteed. How?.....
4. Voluntary remittance with order
5. Sell for cash in advance only.
6. C. O. D. or S/D to R. R. B/L
7. Cash against documents under:
   (a) Irrevocable L/C - Confirmed
   (b) Irrevocable L/C - Unconfirmed
   (c) Revocable L/C
8. Authority to Purchase, or Letter of Advice:
   (a) Irrevocable with recourse
   (b) Irrevocable without recourse
   (c) Revocable with recourse
   (d) Revocable without recourse
9. Bank acceptance of bank in this country at. ...days.
10. Bank acceptance of foreign bank at.....days.
11. Draft at.....days sight through bank for collection d/a.
12. Draft at.....days date through bank for collection d/a.
13. Draft at.....days sight through bank for collection d/p.
14. Draft at.....days date through bank for collection d/p.
15. Draft at.....days sight through bank for collection documents to customer.
16. Draft at ... days date through bank for collection documents to customer.
17. Consigned stock.
18. Cash against shipping documents, dock receipt or warehouse receipt.
    (a) At customer's office.
    (b) At paying agency other than bank.
    (c) At bank.
19.....

MANNER OF PAYMENT

OPEN ACCOUNT

A. Discounts.
B. Pays when due.
C. Slow.

DRAFTS

H. Anticipates payment.
I. Accepts and pays promptly.
J. Accepts promptly-delays payment.
K. Delays acceptance-pays promptly.
L. Delays both acceptance and payment.
M. Makes unjust claims.

GENERAL

N. Account settled by attorney.
O. Account settled by arbitration or compromise.
P. Account still in dispute.

WE RATE THE ACCOUNT

Q. High.
R. Good.
S. Satisfactory.
T. Unsatisfactory.
U. Undesirable.

How Long Sold	Terms of Sale: Key No.	Terms of Sale: Details	Highest Recent Account	Date Last Dealings	Amt. now Owing (including outstanding drafts)	Amount Past Due	Number Days Past Due	Manner of Payment (Use	Rating Code)	Credit Limited (If Any)	Credit Declined (Give Reason)	REMARKS (Use space below or reverse side if necessary)

Please list below or on reverse side other houses which you believe to be interested in this account (**give complete address.**)

No._____ Date_____ Subscriber's Name_____

KINDLY FILL IN THIS BLANK AND RETURN PROMPTLY TO THE BUREAU.

FIG. 42.—Form on which information is supplied by members of the Foreign Credit Interchange Bureau in reply to a request from the Bureau.

suasion letter service on past-due accounts; to furnish weekly confidential bulletins; to foster the exchange of general information; and in every way to promote the interests of the membership.

Regular Interchange Reports.—The bureau is issuing over 100,000 regular interchange reports per year to its members. In its files it has information on more than 350,000 firms all over the world who are or have been supplied by American exporters. When a member wishes such a report on an account or an applicant for credit, he merely sends an inquiry to the bureau on a form provided for the purpose. If no recent report on the subject is on file, a similar form is sent to all members known from the data supplied previously to have had trade relations with him (see Fig. 42). All replies are consolidated in tabulated form on a master copy of the report from which an original report is made for the inquiring member and a number of reciprocal copies are prepared for those who have contributed and for the files (see Fig. 43). These reports, as seen from an examination of Fig. 43, which are in part keyed, contain information on the length of time sold, terms of sale, highest recent amount extended, date of last dealings, amount now owing, amount past due, number of days the account has been past due, manner of payment, rating assigned by the member, whether credit is limited, if declined, the reason for the action, and remarks. In addition to this ledger information, the bureau includes in the report, if obtainable and readily available, supplementary information concerning the subject's volume of business, capital, kind of goods handled, character of the business he is conducting—whether wholesaler, retailer, etc.—financial data, and antecedents.

One of the things which strongly recommends this source of information is the recency of the data furnished. Moreover, the actual experience which different exporters have had in dealing with the subject of the inquiry is usually of far greater significance than the general information supplied by some other sources in determining the extent and nature of the credit accommodation that should be extended.

The columns which are particularly significant in the interpretation of the credit interchange reports are those which reveal the amounts owed by the importer at the time of the investigation to all contributing subscribers; manner of payment; and terms under which other exporters are selling the applicant. If it is discovered that the prospective customer is accustomed to purchasing under a letter of credit, the credit manager would naturally feel more at ease in refusing a request for a 60 days' sight draft and in insisting upon terms to which he is accustomed. Again, if the "manner of payment" column indicates promptness on the part of the importer in accepting and paying the drafts or in paying his obligations represented by open accounts, the prospective customer is

entitled to fair treatment and to liberal credit accommodations. The aggregate indebtedness to the reporting exporters finally shows whether or not a further extension of credit is advisable. In view of the fact that

FOREIGN CREDIT INTERCHANGE BUREAU

National Association of Credit Men

One Park Avenue New York, N. Y.

QH

The accuracy of this Report is not guaranteed. Its contents are gathered in good faith and sent to you by this Bureau as your agent without liability for negligence in procuring, collecting, communicating or failing to communicate the information so gathered.

REPORT ON: Victor Doe
Mexico, D. F., Mexico

3-25-37

TERMS OF SALE

1. Open account payable ____ days from date of (a) Invoice (b) Factory shipment (c) Import shipment
2. Open account payable immediately upon receipt of (a) Documents (b) Invoices (c) Goods
3. Account guaranteed. Here? ____
4. Voluntary remittances with order
5. Draft for cash in shipping unit
6. C. O. D. or P. D. or R. D.
7. Cash against documents under (a) Irrevocable L/C-Confirmed (b) Irrevocable L/C-Unconfirmed (c) Revocable L/C
8. Authority to Purchase, or Letter of Advice: (a) Irrevocable with recourse (b) Irrevocable without recourse (c) Revocable with recourse (d) Revocable without recourse
9. Bank acceptance of bank in this country at ____ days.
10. Bank acceptance of foreign bank at ____ days.
11. Draft at ____ days sight through bank for collection d/a.
12. Draft at ____ days date through bank for collection d/a.
13. Draft at ____ days sight through bank for collection d/p
14. Draft at ____ days date through bank for collection d/p
15. Draft at ____ days sight through bank for collection documents to customer.
16. Draft at ____ days date through bank for collection documents to customer.
17. Consigned stock.
18. Cash against shipping documents, dock receipt or warehouse receipt
(a) At customer's office.
(b) At carrier agency other than bank.
(c) At bank.
19. ____

MANNER OF PAYMENT

OPEN ACCOUNT

A. Discounts.
B. Pays when due.
C. Slow.

DRAFTS

H. Anticipates payment.
I. Accepts and pays promptly.
J. Accepts promptly-delays payment.
K. Delays acceptance-pays promptly.
L. Delays both acceptance and payment.
M. Makes unjust claims.

GENERAL

N. Accepts settled by attorney.
O. Accounts settled by arbitration or compromise.
P. Account still in dispute.

WE RATE THE ACCOUNT

Q. High.
R. Good
S. Satisfactory.
T. Unsatisfactory.
U. Undesirable.

How Long Sold	Terms of Sale Key No.	Terms of Sale Details	Highest Recent Account	Date Last Dealings	Amt. now Owing (including outstanding drafts)	Amount Past Due	Number Days Past Due	Manner of Payment (Use)	Rating Code)	Credit Limited (If any)	Credit Declined (Give Reason)	REMARKS
Yrs.		Da.										
Sev.		30/ 2/10	2094	3-'37	2094			I	S			
yrs.	1c	30	1000	3-'37	516			A	R	Mexico	City	
yrs.	1		2828	2-'37	641			I	R	Mexico	City	
8	4%cash on receipt of documents		1000	2-'37				A		Mexico	City	
yrs.	1		600	2-'37				A				
yrs.	2b		177	2-'37				A	S			
11	1		965	1-'37				B	S			
yrs.	1a	60	187	12-'36				A	S			
1936	1a	30	541	10-'36				A	R			

Information dated October 1936 indicates that the above joint stock company was established in 1865 in Mexico. Importer, wholesaler, and retailer handling hardware, paints, toys, cutlery, chinaware, glassware, etc. Imports on own account. The firm is of large size. It is reported that their reputation is very good. The oldest and one of the largest wholesale and retail hardware stores in Mexico City.

—0—

5	1a	60	106	2-'37				A	S			

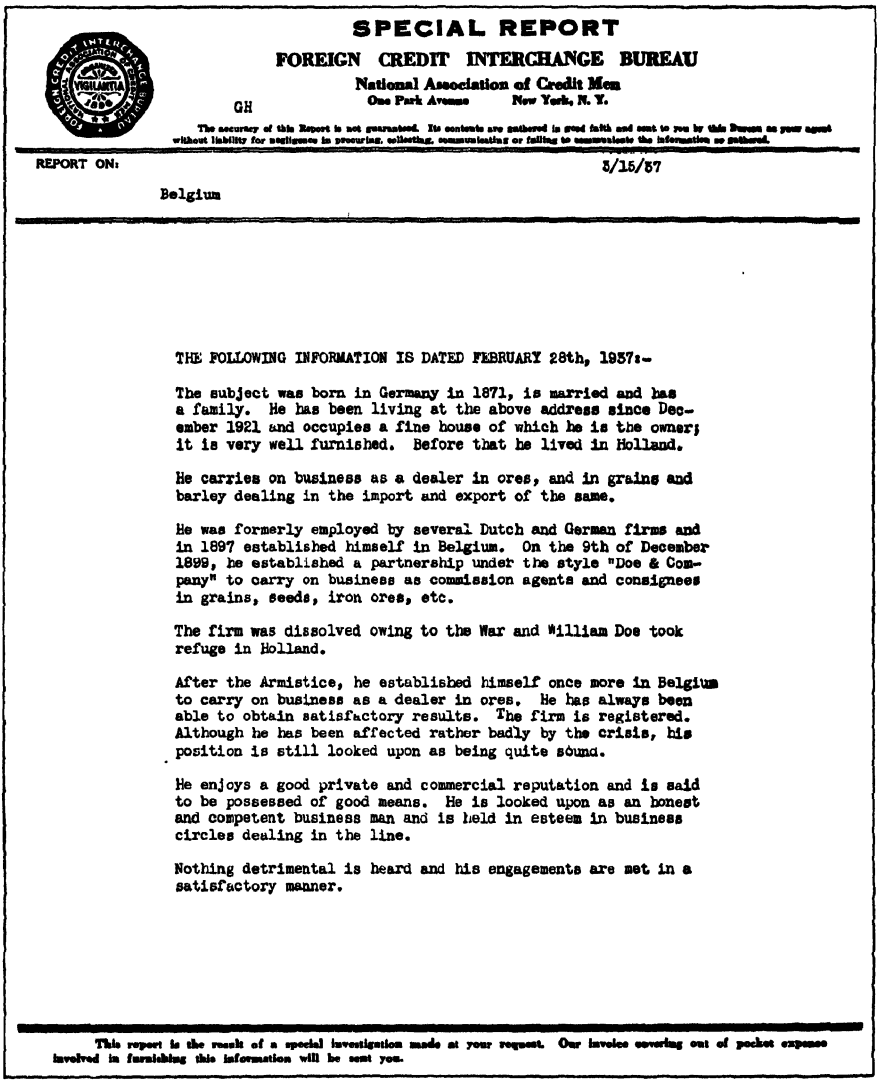
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RECIPROCAL COPY

FIG. 43.—Specimen of a regular interchange report supplied by the Foreign Credit Interchange Bureau of the National Association of Credit Men.

the field of the Interchange Bureau is limited to American exporters who are members, the value of the information relating to a customer's total indebtedness or merchandise purchased becomes somewhat uncertain.

Special Reports.—When the bureau is unable to supply adequate ledger information on a particular subject, the special report service may be substituted for the regular interchange report, if the subject is



SPECIAL REPORT

FOREIGN CREDIT INTERCHANGE BUREAU

National Association of Credit Men

One Park Avenue New York, N. Y.

GH

The accuracy of this Report is not guaranteed. Its contents are gathered in good faith and sent to you by this Bureau as your agent without liability for negligence in procuring, collecting, communicating or failing to communicate the information so gathered.

REPORT ON: 5/15/37

Belgium

THE FOLLOWING INFORMATION IS DATED FEBRUARY 28th, 1937:-

The subject was born in Germany in 1871, is married and has a family. He has been living at the above address since December 1921 and occupies a fine house of which he is the owner; it is very well furnished. Before that he lived in Holland.

He carries on business as a dealer in ores, and in grains and barley dealing in the import and export of the same.

He was formerly employed by several Dutch and German firms and in 1897 established himself in Belgium. On the 9th of December 1899, he established a partnership under the style "Doe & Company" to carry on business as commission agents and consignees in grains, seeds, iron ores, etc.

The firm was dissolved owing to the War and William Doe took refuge in Holland.

After the Armistice, he established himself once more in Belgium to carry on business as a dealer in ores. He has always been able to obtain satisfactory results. The firm is registered. Although he has been affected rather badly by the crisis, his position is still looked upon as being quite sound.

He enjoys a good private and commercial reputation and is said to be possessed of good means. He is looked upon as an honest and competent business man and is held in esteem in business circles dealing in the line.

Nothing detrimental is heard and his engagements are met in a satisfactory manner.

This report is the result of a special investigation made at your request. Our invoice covering out of pocket expense involved in furnishing this information will be sent you.

FIG. 44.—Specimen of a Special Report furnished by the Foreign Credit Interchange Bureau of the National Association of Credit Men.

located in a country where such facilities have been developed. A special charge is made for this type of report sufficient to reimburse the bureau for the out-of-pocket expense actually incurred in securing the information. This type of report may also be requested as a supplement

to the regular report. Such reports are usually obtained by mail unless cable service is specifically designated. On buyers located in the British Isles $1 is charged per report; on those located on the European continent the charge is $1.50 and the charge per report from Cuba, Hawaii, or the Philippine Islands is $2.50 per report in addition to air-mail costs. For reports on customers located elsewhere the charge is in proportion to the work required to gather the information. For a specimen of such a report, see Fig. 44.

Moral-suasion Letter Service.—Members may submit to the bureau names of foreign customers whose accounts are delinquent or in dispute. Letters of moral suasion are written by the bureau to such accounts in their native language, requesting that settlement be made directly with the member. The only charge for this service is for translation expense.

Weekly Bulletin.—The weekly confidential bulletin is intended to keep members informed on credit and collection conditions. It also contains opinions of various members on problems of export credit, collection, and exchange. Thus it affords an interchange of experience and knowledge among the members on the techniques of the profession.

Miscellaneous Activities.—Under the bureau's auspices are conducted trade-group meetings of creditors for the discussion of past-due accounts and other pertinent credit matters. Four such groups are now in operation covering the drug field, foods, hardware and allied trades, and textiles. Through important contacts in Europe, special services can be rendered on customers located therein including adjustments, collections, and the like. Trade surveys may be conducted through the same channels. Finally, the bureau sponsors a monthly round-table conference on foreign credit, collection, and exchange problems. The minutes of these conferences are mimeographed and made available to the members for a nominal charge.

Credit Service Organizations.—In this group may be included a growing number of cooperative bureaus and services maintained by associations. Among the more important of such organizations are the National Association of Manufacturers, the American Manufacturers Export Association, the Motor and Equipment Manufacturers Association, and the American Foreign Credit Underwriters Corporation. The first organization has correspondents in the leading trade centers of practically every country, through whom it secures data about foreign concerns in addition to the financial statements obtained directly from the risk and trade experiences from American manufacturers. Although the service is maintained primarily for members, nonmembers can obtain reports at slightly higher rates. Besides several different types of reports compiled from data obtained in this country and through correspondents abroad, the American Manufacturers Export Association

has special facilities for obtaining credit information by cable. The American Foreign Credit Underwriters' credit-checking reports, used in conjunction with a credit insurance service on foreign accounts, are based on investigations made in foreign markets and trade experiences obtained from members and other sources in this country. It also publishes a market guide for Latin America containing credit ratings on about 50,000 importers and agents located there.

American Exporters.—Frequently, prospective customers give as references the names of other concerns in the United States with which they have had previous dealings. All such references should be investigated directly before shipment is made. It is important, however, to bear in mind the fact that concerns given as references are selected with a view of obtaining the most satisfactory recommendations. It follows, therefore, that only those exporters are referred to with whom the new customer has had favorable and business-like dealings. For this reason it becomes necessary to widen the scope of the investigation beyond the exporters to whom specific reference is made. Other concerns may be then reached through the various organizations through which such information is commonly cleared, as shown in previous paragraphs, or by direct communication. Because of the duplication it involves, the latter method, except when used sparingly, is to be discouraged.

Banks as a Source of Credit Information.—Reliable information about foreign houses sending in orders for the first time may be secured with little delay from the larger American banks. Those banking houses which specialize in foreign trade are constantly revising their credit files and securing data on all buyers abroad. This information is obtained from the numerous branches which some of these banks established in foreign countries, and is supplied free of charge as a part of the regular service to customers. If the exporter's bank lacks the information sought, it is usually secured for him from another bank, since all banks have adopted the practice of freely exchanging credit information among themselves. Of the banking institutions performing this service, probably the National City Bank, Guaranty Trust Company, National Bank of Commerce of New York, and the First National Bank of Boston are the more prominent.

In numerous instances the information supplied by banks includes a complete financial statement of the new customer. Wherever statements of assets and liabilities are not furnished, at least an estimate of his worth is given, in addition, of course, to the experience other creditors have had with the risk. Banks are, as a rule, very conservative and guarded in their reports, which are too often incomplete. Whatever information they do give, however, is considered entirely reliable. It is oftentimes possible to secure superior information verbally when a

close acquaintance has been cultivated by the exporter with his bank's foreign department. In any event, the data secured from banks, even though deficient in many respects, serve to orient the credit manager with regard to the risk, for they indicate roughly whether the risk is good, bad, or indifferent, a knowledge of which is essential before undertaking any exhaustive investigation.

Publishing Companies.—Some foreign-trade publications supply their advertisers with credit information free of charge. Prominent among them are the *La Hacienda*, the *Importers Guide*, the *Business Publishers International Corporation*, and *The American Exporter*. For a moderate fee, others than advertisers may secure similar advantages. The nature of the information furnished is very much like that supplied by banks and general mercantile agencies, although it is not intended as a substitute for regular credit information.

Sources Located Abroad

The most important of the sources located outside the United States are traveling salesmen and the prospective customer himself. Some information may also be secured from various mercantile agencies situated in the locality of the buyer, but the data are for the most part said to be biased and unreliable except in some of the major countries. Inquiries may also be sent to banks in the city in which the applicant is located. Many foreign banks will reply, provided an international money order covering return postage and the small fee which is charged for the service is included. Other banks refuse to reply unless the inquiries are addressed to them through their American correspondents.

Several objections have been raised against the use of sources of information in foreign countries. Cabling is expensive, and too much time is consumed in the process of communicating by mail, so that when the report is finally received it may be useless, since the need for it as a basis for a credit decision might have long since passed. In the second place, it is difficult to determine the reliability of foreign agencies which sell credit information. Although many of them are entirely dependable, many others are unworthy. Then, too, lack of personal contact and close relations with the sources employed result in superficial, biased, and incomplete reports.

Traveling Salesmen and Agents.—Many American exporters have traveling salesmen abroad or employ resident agents. Although their chief interest is in securing orders, it is possible, nevertheless, to educate them by proper cooperation to the necessity of giving an unprejudiced opinion concerning the credit responsibility of their customers. Good salesmen generally appreciate the importance of carrying no bad accounts on their books and can be trusted, therefore, to give an unbiased state-

ment of a customer's standing in the community and his management efficiency. They are on the ground, see the customer in his setting, and can learn many important details regarding his habits and the conduct of the enterprise. It should, therefore, be insisted that they furnish at least one report about each customer at the time when it is of most value, namely, when an application for credit accommodations is made for the first time.

Direct Information.—Relatively little credit information can be obtained from the prospective customer himself. Financial statements are rarely furnished and in many countries they should not be asked for, lest the applicants take offense. This is particularly true of Latin and Oriental countries. Although in some countries the practice of submitting financial statements has already come into vogue, such places are few and far between. There is still a general aversion to divulging details regarding their businesses or personal affairs, probably because of the fear that strictly confidential information may fall into the hands of competitors. Another explanation for the general reluctance to supply financial statements is the method of taxation which prevails in some countries. Taxes are frequently based on the registered capital of the concern. Where this is true, companies usually register a nominal sum and intentionally refrain from keeping books of account. Because of this practice, it is frequently impossible to construct an accurate statement, and even if it were possible to do so, the fear that such statement might find its way into the hands of tax authorities serves as a deterrent. Finally, many foreigners are too sensitive and take offense at any action on the part of sellers which in any way reflects upon their personal qualities of honesty, ability, and integrity.

It should be observed that, even where financial statements are obtainable, they are useful only as a general guide and not as the sole reliance for a credit decision, partly because of inaccuracies, intentional or otherwise, and partly because of the difficulty in interpreting their contents. Methods of accounting that prevail in many foreign countries are loose and unsystematic. Hence many figures presented are often the result of mere guesswork, and since it is the natural desire of every customer to make as favorable a showing as possible, he may give himself all the benefit of the doubt in estimating the worth of his assets. Furthermore, credit managers, because of their unfamiliarity with values of real properties and other items appearing on the balance sheet in the country in which the customer resides, find it next to impossible to determine accurately from the figures submitted the actual net worth of the business, as it is done in an analysis of statements in the domestic trade.

Governmental Agencies.—In the United States valuable facts, in the form of sales information reports, concerning any one of more than 500,000

foreign firms can be obtained from the Commercial Intelligence Division of the Bureau of Foreign and Domestic Commerce. This division also maintains a "World Trade Directory" compiled from data obtained from several different sources. Abroad there are United States consuls,

FOREIGN CREDIT INTERCHANGE BUREAU

National Association of Credit Men

One Park Avenue New York, N. Y.

GH

The accuracy of this Report is not guaranteed. Its contents are gathered in good faith and sent to you by this Bureau as your agent without liability for negligence in procuring, collecting, communicating or failing to communicate the information so gathered.

REPORT ON: Jose Roe
Panama

12-5-36

TERMS OF SALE

1. Open account payable_____days from date of (a) Invoice (b) Factory shipment (c) Export shipment
2. Open account payable immediately upon receipt of (a) Documents (b) Invoices (c) Goods
3. Account guaranteed How?
4. Voluntary remittance with order
5. Bill for cash in advance only
6. C O D or H/D to R. R. B/L
7. Cash against documents under: (a) Irrevocable L/C-Confirmed (b) Irrevocable L/C-Unconfirmed (c) Revocable L/C
8. Authority to Purchase, or Letter of Advice: (a) Irrevocable with recourse (b) Irrevocable without recourse (c) Revocable with recourse (d) Revocable without recourse
9. Bank acceptance of bank in this country at_____days.
10. Bank acceptance of foreign bank at_____days.
11. Draft at_____days sight through bank for collection d/a.
12. Draft at_____days date through bank for collection d/a.
13. Draft at_____days sight through bank for collection d/p
14. Draft at_____days date through bank for collection d/p
15. Draft at_____days sight through bank for collection documents to customer.
16. Draft at_____days date through bank for collection documents to customer.
17. Consigned stock.
18. Cash against shipping documents, dock receipt or ware house receipt (a) At customer's office (b) At buying agency other than bank. (c) At bank.
19. _____

MANNER OF PAYMENT

OPEN ACCOUNT

A. Discounts.
B. Pays when due.
C. Slow

DRAFTS

H. Anticipates payment.
I. Accepts and pays promptly.
J. Accepts promptly-delays payment.
K. Delays acceptance-pays promptly
L. Delays both acceptance and payment.
M. Makes unjust claims.

GENERAL

N. Account settled by attorney.
O. Account settled by arbitration or compromise.
P. Account still in dispute.

WE RATE THE ACCOUNT

G. High.
H. Good.
S. Satisfactory.
T. Unsatisfactory.
U. Undesirable.

How Long Sold	Terms of Sale Key No.	Terms of Sale Details	Highest Recent Account	Date Last Dealings	Amt now Owing (including outstanding drafts)	Amount Past Due	Number Days Past Due	Manner of Payment (Use)	Rating Code)	Credit Limited (if any)	Credit Declined (Give Reason)	REMARKS
Yrs.		Da.										
Yrs.	14	120	1195	Current	1195	295	45	C	S			
yrs.	16	70	3750	10-'36	995			J	T			
yrs.	16	120	867	9-'36	733			I	S			
9	16	60	151	9-'36	151			I	S			
5	S/D		156	8-'36	11	110	50	C	R			
	1	60 days net	67	8-'36	67			C	S			
5	16	90 D/D	1777	7-'36	882			I	R			
yrs.	15	90	1094	7-'36	1094			C-3	to 4 months			
10	11	90	715	7-'36	536			I-L	S			
10	11	60 S/D	247	6-'36	247			J-L	S			
yrs.	12	90 D/D	674	5-'36	674	674	30	I	S			
2	11	60	133	5-'36				I	S			
1	15	60	48	5-'36				K	S			
5	16	90	50	4-'36				I	S			

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ORIGINAL COPY

trade commissioners, and commercial attaches, all of them officers in the service of our government, who are in a position to secure for the American exporter much valuable information. Though not in the nature of credit reports, this information bears directly on the making of credit decisions.

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Questions and Problems

1. Indicate the features that are peculiar to foreign credit as far as sources of information are concerned.

2. X, an American manufacturer, receives an order for $10,000 from Y, in Buenos Aires. Shipment of the goods is to be made in two equal parts 3 months apart. According to information obtained from an American banker, one of the mercantile agencies, and the Foreign Credit Interchange Bureau of the National Association of Credit Men, Y pays his bills promptly, is in good standing, the business is capably managed, and the financial statement shows a net worth of around $300,000. Y desires to buy the goods on terms of 90 days S/D under revocable letter of credit. He refuses to furnish a confirmed letter of credit, partly because of the additional expense and partly on account of other reasons. Should A accept or decline the order? Explain.

3. Show how a regular Foreign Credit Interchange Bureau report differs from one issued by similar bureaus in domestic trade. In what ways is it superior? Inferior?

4. Evaluate the credit interchange report on page 354 and reach a decision on whether you would wish to sell to this customer. Give reasons for your conclusions.

5. How valuable are banks as a source of foreign credit information? Give reasons for your answer.

6. List all sources of information concerning foreign accounts and arrange them:

a. In the order in which they are normally used.
b. According to the frequency with which they are called into use.
c. On the basis of relative value to the creditor.

7. Assuming that additional information is needed concerning foreign accounts and all ordinary sources have failed to supply it, what step should be taken?

8. Are sources of foreign credit information likely to grow in number or importance in this country? Why or why not?

PART III

ORGANIZATION AND MANAGEMENT OF THE CREDIT GRANTING FUNCTION

CHAPTER XXII

THE MERCANTILE CREDIT DEPARTMENT

Place of the Credit Department.—Probably because of the relative newness of credit departments, much confusion is current in the minds of many people as to the proper place of the credit department in the business enterprise. Actual conditions only serve to accentuate this confusion, thereby making a solution more difficult. In very large establishments, one finds the credit department occupying a position similar to that enjoyed by the sales, purchasing, auditing, advertising, or any other major department. In these organizations it is not uncommon to have collection work carried on by a separate unit, usually, however, under the supervision of the credit manager. In medium-sized and small manufacturing and wholesale concerns the position of the credit department and the importance of its activities are colored by historical developments and existing personnel. Thus in many instances the president, vice-president, or head of the firm is possessed of the hobby of handling all financial aspects of his business, including credits and collections.

In the majority of the medium-sized and small mercantile institutions, the credit department is placed in the treasurer's division, in the sales division, or in the accounting division. Whenever the credit department is joined with accounting, not infrequently the credit manager assumes charge of both functions. The same is often true when one person is placed in charge of the office and credits and collections.

Because of the apparently chaotic position in which the credit department finds itself, as far as authority is concerned, many persons question the soundness of almost any position in which it may be placed. Some credit men feel, for example, that their authority should be subject only to the supervision of the general manager instead of being dominated by any head of another department.

Sales managers, auditors, and treasurers, on the other hand, feel that the credit department, by the very nature of its functions, forms an integral part of their respective provinces. Even when a decision has been reached that the credit department occupy a position that is subordinate to some of the other main divisions of the business, the question still remains as to what particular unit of the business has a superior claim

to its supervision. Shall the credit department be linked with the sales division, shall it be merged with the treasurer's division, or shall it become an integral part of the accounting unit?

Arguments for Merging Credits and Sales.—At least two seemingly important arguments are advanced in favor of placing credit work under the supervision of the sales manager. In the first place, it affords an opportunity for securing the greatest degree of cooperation from the sales force in gathering reliable credit information, in following up accounts, and in making collections. Furthermore, both departments aim to accomplish the same end. Both are presumably interested in increasing sales. The credit manager, for example, can increase good will on the part of customers by rendering prompt credit decisions. He can further cooperate with the sales department by persistently following up collections on all due accounts, on the theory that since credit is extended in limited amounts less business can be expected from customers who are delinquent and have therefore used up part or all of their credit with the firm. He may also have other opportunities for cooperation with the sales division. It is imperative, therefore, so it is claimed, that the two act in unison and without friction, and that the only sure way of doing so is to subject these activities to the supervision of one head.

Arguments for Merging Credits with the Treasurer's Division.—Advocates of the plan calling for united effort on the part of the credit manager and treasurer argue that both of these units are directly and vitally concerned with the financial aspects of the business. It is the duty of the credit manager so to dispense credits as to keep his company's funds intact, to venture into the future and prophesy what conditions in collections will obtain several months hence, to provide the financial officer with the data, and to speed up collections when business requirements call for additional cash. Both he and the treasurer are financial officers of their concern. Besides, the credit policy has a profound effect upon the determination of the company's financial plan, and particularly on the amount of current financing that must be provided by the treasurer.

Credits and Accounting.—Both the credit and accounting departments administratively belong together. Both use the same records, so that much duplication and needless expense could be eliminated by merging the two functions.

Reasons for an Independent Credit Department.—Notwithstanding the truth of all of these arguments, it is believed, nevertheless, that all interested parties will be served best through the establishment, wherever possible, of a separate and distinct department for the handling of credits and collections and to make it more or less autonomous, wherever the size of the business enterprise permits, subject only to executive supervision and control. Several important reasons may be advanced in

support of this view. To begin with, credit work is complex and intricate, requiring the full time of an experienced and properly trained executive. A credit manager is a specialist; the technique of credits and collections involves all the intricacies of the business world. It therefore requires a man of broad knowledge and experience. Because of the technical nature of this work, other department heads will frequently fail to appreciate the credit man's position and proceed to issue orders in ignorance of probable consequences.

A second argument in favor of this plan of organization is that it facilitates unbiased opinions and decisions, based upon actual evidence at hand, without fear of displeasing a superior officer under whose direct supervision the credit manager works. Furthermore, the sales and credit departments represent two different viewpoints. Salesmen are by nature optimistic and are likely to overestimate a debtor's ability to meet his obligations, whereas credit managers must of necessity remain conservative and grant credit with great care and caution if losses are to be kept at a minimum. As a result, clashes will often ensue, unless a credit manager's authority is clearly defined.

Finally, the plan of establishing a separate and autonomous credit department would substitute voluntary cooperation for cooperation through compulsion. If anything, it will tend to develop an *esprit de corps*. For no one realizes the benefits of cooperation, the cornerstone of the present-day credit system, to so great an extent as the credit manager. He knows, as all other department heads should know, that the various departments must constantly work in closest harmony with one another. Should there exist the slightest friction between the sales and credit managers, for example, their company would be carrying an expensive load. A willing and competent credit manager cannot properly manage the credits for his concern if he is compelled to work with an incompetent and disgruntled sales manager, and vice versa. The fact remains that the ultimate object of both is to increase profits for their company. As soon as the credit manager assumes an antagonistic attitude toward the sales force or salesmen refuse to cooperate with the credit department, they are defeating the very purpose for which they are employed and developing a condition which militates against the interest of both and which inevitably proves detrimental to the entire organization. Hence, unity between them is essential; each must have full confidence in the other. The absolute necessity for teamwork, perfect harmony, and cooperation in its truest sense needs no argument. But it can be best accomplished not through dictatorship but through a volition born out of a complete and sympathetic understanding of the position of others, and the ultimate aim which all the departments are striving to attain, namely, greater net profit for the concern as a whole.

Credit Department Organization.—Much of the success of any credit manager depends on the organization of his department and upon the system or lack of system with which the work is handled. If he is to occupy a position of a true executive, as he should, and have time for constructive thinking and careful judgment, he must not permit himself to become overburdened with a mass of detailed and routine work. Hence the importance of a system that will permit much of the detailed work to be handled efficiently by an assistant or clerks. Whatever the system employed, it must provide for accuracy of the records, efficiency in handling them, and accessibility so as to enable the credit department force to locate them with promptness and certainty.

Obviously, credit department systems vary in different concerns with the size of the house, number of accounts handled, line of trade, and the degree to which this department is separate and distinct from other departments in the business enterprise. It is not intended, therefore, to submit a description of every conceivable system in existence. Rather an attempt is made to describe briefly a typical plan, which is subject to almost infinite adaptations of handling orders, from both new and old customers and to indicate ways in which credit work may be efficiently controlled.

HANDLING ORDERS FROM NEW CUSTOMERS

When an order is received by the house, it is stamped with the date and hour of receipt, in order to remove any question as to when it was received. Another stamp may be applied bearing spaces for the approval of the sales or order and credit departments, respectively; also a space for the shipping order number. After an order has been received and thus stamped by the mail clerk, it is passed on to the sales or order department for approval and then submitted to the credit department. When it is received in the credit department it is, in most houses, stamped with a receiving stamp and sent to the "credit editor" for checking.

Follow-up Credit File.—Should it be discovered that it is a first order from a new customer, a folder is prepared and an investigation of the applicant's credit and financial responsibility instituted. In the meantime the folder containing the order is placed in what may be termed a "follow-up credit file" several days ahead. This file is a sort of a tickler which makes for accuracy and efficiency. It is almost indispensable where many new accounts are constantly being investigated and old accounts are undergoing revision. This file merely consists of 31 divisions, one for each day of the month, each containing folders of accounts that are being investigated.

Scope of Investigation.—Obviously, the amount of the information needed before making shipment depends upon the line of business in

which seller and buyer are engaged, whether the order is for immediate or future shipment, and whether it is small or large from the standpoint of the seller as well as the buyer, considering the customer's location and general condition of his business as set forth in the salesman's report. When an order is small and ratings are favorable and agree with and substantiate the salesman's report, a first order may, under such circumstances, be shipped on that basis alone, but additional data should be sought for as soon as possible in order to establish a credit limit. On the other hand, if the order is substantial or ratings indifferent or in conflict with the contents of the report submitted by the salesman, additional facts must be obtained before accepting it. Just how much additional data are required would depend on the eagerness of the seller to roll up volume, the amount of apparent reliability of the facts made available by the several sources of information, and the extent to which they agree or differ among themselves.

Another point to be emphasized in this connection is that pertaining to the type of data most desired. In some instances it may be advisable to investigate thoroughly a customer's willingness to pay, or character; on other occasions financial data may be deemed most significant; while in still other cases general local conditions and ability to succeed may be stressed considerably. For this reason it may be advisable for a credit manager to classify the various sources of information according to the type of facts which they are best able to supply.

There follows a list of all possible sources of credit information that may be resorted to by credit managers in the process of securing adequate credit data. These sources are arranged in what is considered the order in which they are chronologically called into service. Thus, for example, salesmen's reports are listed first, because in many concerns salesmen are required to submit a report with every first order. Again, mercantile agency ratings and commercial agency reports appear in the two following places, respectively, since most mercantile establishments subscribe for the services of one or more of these agencies. Reference to previous chapters on "Sources of Information" will at once reveal a substantial duplication in the type of data which some of them ordinarily furnish. A credit manager should, therefore, exercise judgment in the selection of those sources from which the most needed and reliable facts may be obtained at the least outlay. These sources of information are as follows:

1. Salesmen's reports.
2. Commercial agency rating or reference books.
3. Mercantile agency reports.
4. Credit interchange reports.
5. Special agency reports.
6. Trade bureau reports.

7. Financial statements secured directly from applicants.
8. Direct inquiries to trade.
9. Bankers' reports.
10. Attorneys' reports.
11. Direct investigation.
12. Court records.
13. Corporation cards and services.
14. Corporation manuals.
15. Registers and directories.
16. Trade and financial papers.
17. Other customers in same line or location.
18. Other sources of a miscellaneous character.

The Credit Card.—When an adequate amount of information has been collected, the folder and the reports that have accumulated in the meantime are removed from the follow-up credit file and referred to the credit manager for his decision. If the order is refused, the information should be organized in such shape that it may be presented to the sales department, if need be, to convince it of the wisdom of the credit manager's decision. Only by adopting an attitude which expresses willingness and readiness to show reasons for refusing an order will all possible friction between the two departments be eliminated and unquestioned confidence and cooperation gained. Thus, it is the practice of many houses first to pass all information obtained to the assistant credit manager to be written up according to some predetermined plan of procedure. Another reason for transcribing much of the data is that the original information becomes so voluminous in a few years as to require too much space for filing and imposes an extra burden on the clerical force. Accordingly, it becomes necessary to boil it down in a compact and efficient way by summarizing only the important and relevant facts. A method which has found much favor in some concerns is that of classifying the data according to character, capacity, and capital.

If the order is approved, terms and a credit limit are assigned, a credit card is then made out, which is filed in a credit card cabinet in strict alphabetical order or alphabetically under the proper geographic unit, whereby the cards are coordinated with mercantile agency books, thus facilitating revision when new books are issued. This card contains a synopsis or summary of all credit information from the various sources, including the name and address of the customer, type of organization, bank, terms, ratings of the general mercantile agency, summary of credit interchange reports, credit limit assigned, and remarks (see Fig. 45). As soon as the proper data are recorded on this card, the order is sent either to the order department for registration and for pricing or direct to the shipping department for filling. In some cases the credit card is

combined with the ledger card and by a flagging system by means of colored tabs also includes information as to the method of collecting the account and the dates on which collections should be expected. Going through such records weekly or at other frequent intervals, the credit manager notes the purchases, payments, and whether the balances are kept within the limits set.

The Credit Folder.—This folder contains all credit reports on customers which have been collected from agencies, bankers, attorneys, and bureaus; financial statements secured from the customer himself; and clippings from newspapers and trade publications which have a direct

NAME	CARD NO.
POST OFFICE	DUN & BRADSTREET
STORE LOCATED	BANK
SHIP FREIGHT & EXPRESS TO	ATTORNEY
ROUTE VIA	INTERCHANGE
BUSINESS	CREDIT LIMIT
BANKING CONNECTION	SALESMAN

REFERENCE	SOLD	H. C.	OWE	P. O.	RISK

FIG. 45.—Credit card for use by manufacturers and wholesalers.

bearing on the name in question. These folders also contain copies of monthly statements forwarded to the customer as well as copies of all unpaid invoices. They probably constitute the single most important file in the credit department. Folders are usually filed alphabetically. In the smaller concerns no separate files are maintained for credit, collection, or adjustment correspondence. Under such circumstances all current correspondence is kept in the credit folder. If the number of accounts is relatively small, even credit card information may be placed on the outside of the folder and made a part of it so as to obviate the necessity for a separate record (see Fig. 46).

Card Index and Inactive Files.—Two other files are generally found in many credit departments. One is a card index containing the name and address of customers and their file numbers. The card index may be divided into two or more sections. One of these sections merely consists of an alphabetical list of all accounts. Another contains a geographi-

cal list of all customers and serves as a cross index for the alphabetical list and for all credit cards and folders if alphabetically arranged. A third section may contain an alphabetical list of accounts that have been placed in the hands of attorneys or agencies for collection, or those which are in financial difficulties and need watching.

In the inactive file are placed all finished correspondence and other unnecessary and old material in order to prevent an undue accumulation of antiquated data in the credit folder. Similarly, when payment is

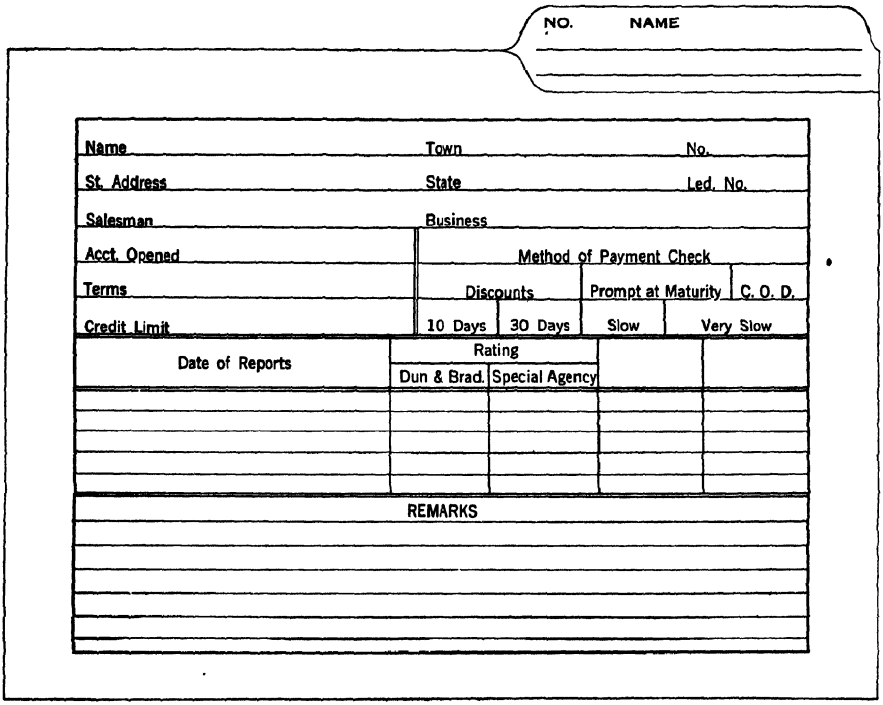


FIG. 46.—Credit folder which is used also as a source of information for checking credits.

received on an account, all paid items are checked on the proper statements which, together with paid invoices, are removed to the inactive file, which may sometimes be kept in the general offices for a stated period of time.

HANDLING ORDERS FROM OLD CUSTOMERS

To handle expeditiously orders from old customers as soon as they are received by the credit department, they should be checked at least twice by the credit manager himself or by his assistant. No matter what kind of a checking system may be in use, it is advisable that the credit

manager himself make it a point to examine all orders which represent fairly substantial amounts. In this way little irregularities which might not attract the attention of assistants may be caught by the trained eye of the credit manager.

In the first checking, all orders should be checked against the credit card as to name, address, credit limit established by the credit manager, and instructions under "remarks." In some houses celluloid cards or tabs of various colors accompany all credit cards, each color bearing a certain significance; thus, yellow may signal caution, red may indicate poor credit standing; clear, good credit standing, and so on. Orders easily cleared are let through quickly in this first checking and dispatched to the shipping department for immediate filling. In some houses, the credit card file or a duplicate thereof is maintained in the Order Register department where the first checking takes place and only orders from delinquents or from customers who have exceeded their limits are submitted to the credit department for action.

In the second checking special attention is given to the information in the credit folders. By means of a "Please Get" rubber stamp, clerks make the necessary folders available within a short space of time for the second checking. As a result of this process many more orders are either refused or accepted and sent on to the shipping department.

The remaining orders are probably retained on account of inadequate information of a recent character. They are, therefore, placed in the follow-up credit file and an investigation instituted as if they were orders from new customers. To be sure, in a majority of cases the revision investigation will be far from exhaustive, consisting, in all probability, of a request for a recent mercantile agency report, or a Credit Interchange Bureau clearance. As the new information is collected, proper notation is made on the credit card and the new reports are filed in the credit folder. From this point on, orders from both new and old accounts are handled in a similar manner. If an order is held pending receipt of payment by the customer, the bookkeeping department is notified so that the credit manager will be informed when payment is received and the order will be released for shipment.

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STEINER, W. H.: "Mercantile Credit," Chap. 2.

Questions and Problems

1. A writer in one of the leading business publications advocated the abolition of the credit department. His contention was that more sales could be made as a result of a lenient policy in credit extension and that the profit obtained from the additional sales would more than offset the added losses from bad debts. It follows, therefore, that the absence of a credit department would result in a maximum of sales and, while the losses from bad debts would naturally increase, they would be far exceeded by the added profits. He further proceeded to state that most people are honest and that the abandonment of the credit department would be a good thing from the creditor's standpoint. Do you agree? Explain.

2. In a wholesale firm with a volume of business of approximately $800,000 a year, what position should the credit department occupy on the organization chart?

3. Would your answer be the same if the volume of business were $4,000,000?

4. The A. B. C. manufacturing company was just organized for the production of a variety of drug items to be sold to wholesalers and to a certain extent also direct to retailers. You were placed in charge of credits and collections. What records and files would you deem absolutely necessary for your operations? What other records and files would you consider advisable to have?

5. How would such records and files come into use:

a. In the checking and handling of first orders?

b. In the checking of orders from old customers?

6. In the event that information must be secured as a basis for judgment whether a first order should be accepted or rejected, what factors would determine just how much and what kind of information should be gathered?

7. Outline the procedure for handling orders:

a. From new customers

b. From old accounts in good standing

c. From old accounts that are delinquent.

CHAPTER XXIII

THE BANK CREDIT DEPARTMENT

The type of organization of a bank credit department must necessarily vary with the size and character of the institution and the nature of the community it serves. There are banks in which two or three officers, together with a discount committee, perform all the necessary functions. On the other extreme, there are some of the largest banking houses with as many as a hundred officers and in which the work is highly departmentized. In such institutions the credit department is in charge of a credit manager, who may rank as vice-president or assistant cashier. Between these two extremes there are a large number of medium-sized banks located in growing communities where the executive officers sooner or later reach a point where they find it impossible to maintain a personal and immediate contact with all customers whose names are carried on the books.

In order to overcome these difficulties and to assist them to keep in touch with borrowing customers, such banks generally conclude that the installation of a credit department, which gathers and files all valuable information and makes it readily available as occasions arise, will solve their problems. The bank credit department came into being toward the end of the last century, was generally established in the large banks in the second decade of this century, and since 1920 gained wide acceptance among medium-sized institutions. The *raison d'être* of every bank credit department is invariably found in the need of the loaning officers for assistance in assembling and interpreting facts and opinions that will help them to determine intelligently whether credit should be extended, and in what amounts.

It is not intended to make the exposition of the organization and operation of a bank credit department so broad as to cover all sorts of banks. An attempt is made rather to explain the operations of credit departments of medium-sized banks, for it is believed that a comprehension of this typical organization will enable every resourceful student of the subject so to modify the mechanical devices and forms to be described as to conform with the needs of the particular bank under advisement.

Control of Bank Loans.—The ultimate source of control is vested in the board of directors. They are required to supervise the work of all

their officers, particularly with respect to loans. In some banks they meet once a month or every week, while in others they meet every day. Only important matters are referred to them at their periodic meetings. If the majority of the directors disapprove of the loan in question, that decision is final, the opinion of the president and of other officers to the contrary notwithstanding. Since in the majority of banks all directors do not meet every day, it is customary to delegate the loan-making power to a loan and discount committee. This committee is usually composed of three or more members, including the president and two or more other members of the board of directors, among whom are generally included the first and second vice-presidents and cashier. To them all applications for loans exceeding certain stipulated amounts must be submitted at their daily meetings. This committee usually makes a complete report of all applications handled each week or month, as the case may be, and the decisions rendered, to the directors under whose supervision it operates.

Next to the loan and discount committee, the president exercises the greatest amount of control over bank credits. All important loans are referred to him by the credit manager for approval or disapproval. Ordinarily, the president does not go into the matter in great detail and acts largely on the recommendations of the junior officers, who analyze the situation with great care. Then follow the vice-presidents, one or more of whom may be placed in charge of certain classes of accounts and who pass upon most credit matters. Where the number of accounts handled is large and the lines of business served are numerous, assistant vice-presidents and assistant cashiers may be engaged in credit work. These officers interview customers and review the financial condition of borrowers with a view to establishing lines of credit, the same as their senior officers, except that they are likely to handle smaller and, consequently, less important accounts. Finally, the credit manager may have authority to make small loans on good security or those which are otherwise reasonably safe.

CREDIT DEPARTMENTS OF MEDIUM-SIZED BANKS

Organization.—In every bank of sufficient magnitude to warrant the required outlay, the personnel of the credit department ordinarily includes an assistant to the credit manager and one or more stenographers. It is advantageous to have, in addition, one trained investigator. In nearly all but the very large banks the credit and collection work is handled by one department. Hence, the work naturally divides itself into the major functions of credit investigation and decision, recording, filing, correspondence, and in following up accounts. For a typical organization

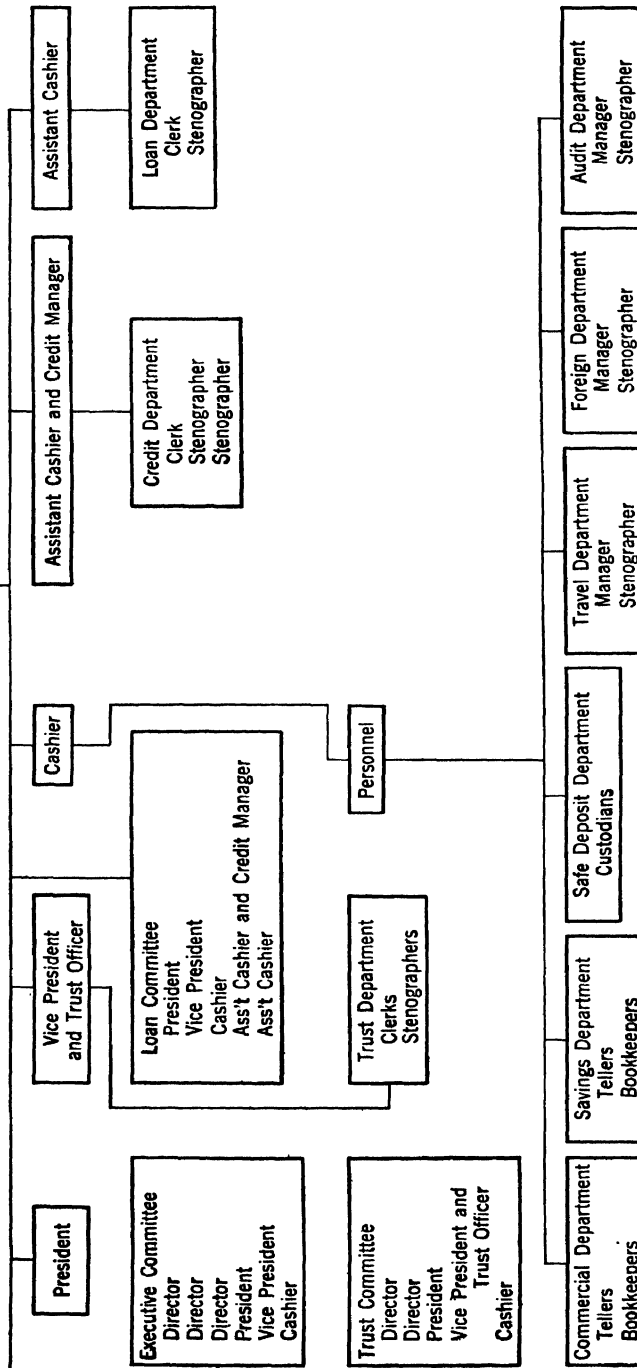


FIG. 47.—Organization chart of a bank, showing the position of the credit department and its relation to the other parts of the institution.

chart showing the relationship of the credit department to other parts of a bank, see Fig. 47.

Functions of the Credit Manager.—The credit manager, of course, exercises general supervision of the entire operation of his department. Each day he looks over the new-account cards, which are made out simultaneously with the signature card. These cards are sent to the credit department by the clerk at the new-account desk. From them, information may be secured concerning accounts opened by new customers, character of accounts, size of deposits, special agreements, if any, and references and affiliations. Upon examining these new account cards he will determine whether or not folders should be made out and investigations instituted concerning those names.

The next function is to interview customers and prospects with a view to securing information sought by the loaning officers as a basis for their decisions. During these interviews he should not only gather information for credit purposes, but must also in every way attempt to cement the friendship between borrowers and the bank, by ascertaining their grievances and complaints, and proceed to smooth them over and remove the causes wherever possible.

Another function is to act as intermediary between the loan and discount committee and his department. From this committee he learns all facts and conditions underlying the granting or refusal of a loan and the position of each individual member when a vote is taken. To obtain these facts, he usually acts in the capacity of secretary, attends all the meetings, and keeps minutes of the proceedings. This enables him to keep in touch with the policies and wishes of his executive officers and adequately to protect the bank against possible losses.

He then proceeds to dictate replies to credit inquiries from correspondent and other banks and all commercial houses.

Still another function of the credit manager is to go over carefully all financial statements received during the day and indicate by means of marks those portions which are to be transcribed to the "comparison of statements" form (see Fig. 38). He then reads all correspondence concerning loans and new accounts, marking those sections which are to be incorporated in the respective credit folders. Finally, it is his duty to review and inspect all new and revised folders prepared during the day by his assistant.

Functions of the Assistant Credit Manager.—The general function of the assistant is to keep the department running smoothly and efficiently and to solve problems of minor importance, involving matters of routine as they arise. It is his duty to distribute the work to the other employees of the department and to assume full responsibility for the successful completion of the work assigned. He checks over the new-account cards and

sets the machinery in operation for assembling adequate information on names that apparently justify the development of a folder. All commercial accounts whose initial deposits are substantial are ordinarily marked for investigation. Requests are thereupon forwarded to mercantile agencies for reports and letters sent to bank and trade references requesting information on the subject under consideration. If the bank is a member of a credit interchange bureau, an inquiry ticket is sent to that organization. In the majority of cases, a form letter is sent simultaneously to the new account expressing appreciation of his business and requesting him to fill out an enclosed financial statement blank and return it in the stamped enclosed envelope. It is usually explained in the letter that it is to the borrower's advantage to furnish the bank with a statement of his financial responsibility, so that the bank's replies to legitimate inquiries regarding his credit standing may be made advisedly and intelligently. In this connection it should be mentioned that where a credit manager's assistant is employed, he not only makes all initial inquiries, but he also handles in a similar manner all inquiries concerning accounts undergoing revision.

As soon as the replies to inquiries are received, the assistant marks all portions which are to be transcribed and passes them on to a stenographer. He then proceeds to copy to the "comparison of statements" form all statements marked by the credit manager. Finally, he consolidates into the credit folder file all data secured from other departments of the institution.

Securing Information from Other Departments.—Outside of the credit department itself, there are several sources within the bank from which information must be secured in order to aid it in its efficient operation. These are as follows:

1. The new-account desk.
2. The loan and discount committee.
3. The correspondence files.
4. The loan and discount department or cage.
5. The analysis or auditing department.
6. General ledgers and savings ledgers.
7. Bond department.

The new-account clerk sends in at the end of each day, to the credit department, a card for each account opened during that day. It gives the name, address, occupation or title of the client, character of the account opened, references and affiliations, and the amount of initial deposit. This is known as the signature card.

Acting in the capacity of secretary for the loan and discount committee in many instances, the credit manager acquires knowledge concern-

ing the reasons for specific action taken by the various members of the committee, individually and collectively.

All finished correspondence dealing with the establishment of an account or with the extension of credit accommodations should be made available daily to the credit department in case such files are kept in the general offices. From these files the credit department ascertains who the borrowers are, negotiations developed, and specific agreements and provisos relative to the establishment of any one account.

The loan and discount department or cage, to cooperate effectively, must furnish the credit department with information regarding loans actually made and advise some time in advance of approaching maturities. Lists of names involved should be furnished daily, containing the amount of the note, whether secured or unsecured, the total indebtedness, the rate of discount, and remarks. It will also show whether an extension was asked, whether such extension was granted or refused, and whether payment was made early, on due date, or after.

The information to be obtained from the analysis or auditing department deals with the average net and ledger balances, the proportion of these balances to credit extensions, and the profitableness of the account since it became active. In some banks the records of this department are sent monthly to the credit department from which are copied the facts stated, on a card provided for the purpose.

From the general ledgers can be obtained information on the checking habits of the borrower. They show whether there is a margin of safety at all times and whether there are frequent overdrafts. Savings ledgers tell something of the financial wisdom of the customer. If a savings account is being maintained it is favorable for it shows that accumulations are made for emergencies. Investment habits of the customer can be learned from the bond department. Bond men usually know who are speculators and who are seasoned investors.

CREDIT DEPARTMENT SYSTEMS

Many systems and mechanical appliances have been devised and new ideas are being evolved constantly by manufacturers of indexes, card systems, and cabinets. In choosing one of these systems, each credit manager should bear in mind the results to be attained rather than the mere means. The files should be so arranged as to permit the greatest accessibility and quickness and accuracy in filing. If the necessary data cannot be secured from the files when needed, much valuable time is lost, and if such delays occur frequently, all operations may soon come to a standstill. Cabinets should be fireproof to safeguard the invaluable mass of information, compiled during a long series of years at the expense of considerable labor and money, against fire contingencies. The filing

system is the backbone of a bank credit department and no real credit department is possible without it.

The Credit Folder.—Although there is considerable lack of uniformity among bank credit departments in regard to their filing systems, because of differences in requirements and comparative age of the institutions, each bank credit department nevertheless uses some sort of a system for filing credit information folders. The folders themselves are of the letter-sized expansion pressboard type or of the lighter manila style. The former are used for the more important and active accounts on which much information is likely to be collected, while the latter are reserved for accounts of a less popular character, concerning which comparatively few data are to be assembled.

In the event credit information concerning a given name becomes bulky and voluminous, it is necessary that it be so classified and arranged in the folder as to make it instantly available. In anticipation of this possibility, many institutions have adopted a folder arranged on the order of a book, containing several divisions separated by index sheets. No less than five divisions or sections are ordinarily made. The first division contains the "comparison of statements" sheet and all financial statements concerning the risk, arranged in chronological order. On the comparison of statements form are transcribed all statements obtained from various sources. In the second division of the folder are placed sheets covering the results of interviews and investigations. These include interviews with banks, brokers, and trade houses, as well as direct interviews with the partners or officers of the borrowing concern. If the name under consideration is that of a commercial paper borrower whose notes have been purchased in the open market through a brokerage house, a memorandum sheet covering the date of purchase, amount involved, due date, rate, and name of the broker is appended to the sheets relating to results of interviews and investigations. In this section is also included a printed form which is usually filled out by the new-account clerk in case the borrower carries an account at the bank. This is known as the "opening sheet" and is sometimes placed in front of the folder. This form covers all details pertaining to the opening of an account, is filled out simultaneously with the signature card, and contains the name, residence, and business address, date the account was opened, character of the account, by whom introduced, references and affiliations, and size of the initial deposit.

The third section contains agency reports as well as reports from credit interchange bureaus. In the fourth section are placed all correspondence with banks, brokers and trade houses concerning the account in question, including carbon copies of letters sent to these sources of information, as well as copies of letters written by the credit department in reply to

inquiries regarding the subject. This item is frequently, however, placed in the next and last section covering miscellaneous items, such as newspaper and magazine clippings and an inquiry sheet showing the names of banks which have made inquiries concerning the account.

Some credit departments prefer to classify all information contained in the credit folder into no more than two divisions, on the basis of whether the information has been secured from direct or indirect sources. All direct data are then clipped on one side of the folder and indirect information on the other side. The various items making up the folder, instead of being arranged in book form, may be fastened at the top and arranged chronologically in each division.

If the name under consideration carries an account at the bank, the direct information division begins with the "opening sheet" referred to in a previous paragraph. Following this is the borrowing sheet, showing the date, amount borrowed, due date, rate, and remarks. If the account is a commercial paper name as well, the borrowing sheet is followed by a memorandum showing date and amounts purchased, as well as the current borrowings of the account and the high and low points. A sheet showing total borrowings through all banks and brokers is inserted next. Following is the comparison of statements sheet and the respective financial statements, received from the several sources. Finally, all interviews with brokers, officers, or partners of the borrowing concern as well as all correspondence of a direct nature are clipped on the direct information side.

The other or indirect information division contains a general information sheet showing the business in which the subject is engaged, the names of other banks which have dealings with the account, and the names of trade references, note brokers, and other interested parties. Then follows a memorandum of inquiries. Following this are newspaper and magazine clippings, sheets covering the results of interviews with banks and trade references, and reports of mercantile agencies and Credit Interchange Bureaus.

In many of the medium-sized banks a certain degree of uniformity has been attained in recent years with regard to the credit folder which is the backbone of the credit department. The form in commonest use among them is the three-sectioned cardboard device made from a long strip of manila pasteboard and folded in three equal parts, the left third folding in upon the middle section and the right third folding in over the left third and middle section. On the outside of the left section of the folder are clamped the carbon copies of letters written by the bank to the particular customer regarding his business affairs with the bank. On the inside of the left section are clamped copies of letters written to others regarding the applicant, including answers to such inquiries, as well as

letters from various credit clearing house associations, and the like. In the middle section are clamped mercantile agency and credit interchange reports, memoranda covering personal interviews and conferences, newspaper clippings concerning the borrower, real estate checks (see Fig. 49), and a record of the borrower's dealings with the bank. On the inside of the right-hand section of the folder are filed the financial statements of the customer together with a comparison of statements form on which are transcribed the latest figures and the necessary ratios are computed.

Filing Credit Information.—There are differences of opinion regarding the best methods of filing. Some credit managers prefer to file all information in strict alphabetical order; others prefer a geographic division of the files, with alphabetical subdivisions by names of accounts under each geographic unit; still others find it advantageous to divide the files in accordance with the types of names handled. While it is difficult to describe all systems of filing in use at the present time, an attempt will be made nevertheless to indicate some possibilities for arrangement of files on the basis of logic and convenience. A filing system must be fitted to the bank and no attempt should, therefore, be made to adapt the bank to the system. For example, in some banks, files and folders covering bank accounts are not regarded as belonging to the credit department; accordingly, they are kept in another department. In other banks, these names are handled together with commercial accounts.

Two separate divisions may be had for deposit and loan accounts and for commercial paper names. In both of these divisions folders are usually arranged alphabetically. Where these two classes of names are filed together, it is advisable to distinguish them by means of colored index tabs placed on the folder. Similarly, one or more files may be had for bank names, one for correspondents, one for bank nonaccounts, etc. These folders are ordinarily filed geographically. Where more than one class of bank names are included in one file, distinction should be made by use of colored celluloid tabs.

Information on commercial nonaccounts and on miscellaneous names arising from inquiries is frequently kept in a separate file division. These folders are filed alphabetically and may also be classified and distinguished by colored index tabs. Bank nonaccounts may be kept separately or filed together with commercial nonaccounts and the miscellaneous file. If kept separately, they are filed on a geographical basis.

The Index Card File.—Every credit department should have an index credit card for every account, giving the name and address of the account and the folder and file numbers or other symbols by which they are designated. Index cards are always filed alphabetically, and are indispensable when files are divided into several separate sections or when folders are filed geographically. Through the index card file one

can immediately learn in what division a given folder is located. Another advantage derived is that the index file acts as a check on the folder files thereby preventing losses through misplacements and inaccurate filing. Folders are sometimes removed by one of the loaning officers without knowledge of the filing clerk. Reference to the index will at once reveal the fact that a folder has been made out for the account in question but that it has either been misfiled or deliberately removed by one of the bank officers or employees. Further to obviate such annoyance arising from inability to locate folders rapidly, some banks require that a person removing a folder from the files place a slip bearing his name in place of the folder. When strictly adhered to, good results may be obtained from this method. An official, when careless or in great haste, however, may take the privilege of not conforming strictly to the rule, thereby giving rise to the difficulty just described. A third advantage closely connected with the one preceding is that the index file furnishes definite knowledge whether or not there is a folder on the name under consideration.

Some banks have, in addition to an alphabetical index, a trade index. Such an index facilitates the work if a revision of all names in a given line of business is necessitated by certain conditions. Index cards filed by lines of business or industry also lend themselves to uses for solicitation purposes, an item of considerable importance to some institutions.

The Pending File.—Many matters come up in the daily routine of the department which cannot be settled for some time. The installation of a pending or tickler file obviates the possibility of delaying or forgetting important matters. Such a file may be divided into 12 monthly divisions with 30 or 31 subdivisions under each. A simpler plan is merely to have 31 divisions, one for each day of the month. Papers filed under each daily division are to be arranged alphabetically. For example, a folder of a new customer would be placed in one of the divisions under the date when the receipt of information is expected and the matter is to come up again. Unless matters are postponed more than 30 days, it is quite evident that one monthly division containing 31 subdivisions would suffice.

THE LOANING PROCESS

Application for Loan.—The amount and nature of the information secured concerning a borrower vary with the nature of the loan (whether it is open or secured), the amount requested, the purpose for which the loan is to be used, and the status of the borrower. Few sources are used for old reliable customers, just to verify their condition, but on a large loan application from a new borrower all available sources of credit information may be checked.

In each case, the "Application for Loan" provides a basis for the analysis of the risk (see Fig. 48). The executive officer who takes the application fills in the necessary information, determines the market

APPLICATION FOR LOAN

OFFICE ..... Date ..... 19 .....

Name .....

Location .....

Business ..... Phone .....

Amount $ ..... When payable ..... Rate .....

For what purpose .....

.....

Collateral .....

.....

Co-Maker .....

.....

Banking Connections .....

Liability This Bank $ ..... Other Banks $ .....

Highest Credit in Past Year .....

Average Balance Last Six Months—Checking $ ..... Int. Paid % ..... Sav. Bal. $ .....

Date of Last Financial Statement ..... 19 .....

Remarks: .....

.....

.....

.....

.....

.....

.....

.....

.....

Approved Not Approved	Approved Not Approved By Executive Committee
..... Manager.	..... Secretary.
Date 19	Date .....19 .....

FIG. 48.—Application for loan at a bank, made by a business borrower.

value of securities offered as collateral, secures a new financial statement if necessary, has the real estate checked from the public records (see Fig. 49) to verify the items listed in the financial statement, and obtains

all available data from the bank's own records. In connection with this, he checks all affiliated accounts which might include a church or club account over which the applicant has control, his wife's account, or any other account in which he has an interest or for which he assumes responsi-

REPORT OF REAL ESTATE HOLDINGS AS SHOWN BY THE PUBLIC RECORDS

In the county of.....

Name..... Date checked.....

Address..... Checked by.....

Title to property in name of.....

Wife's (or Husbands name).....

DESCRIPTION & LOCATION - DETAILS OF MORTGAGES	TAX VALUATION			AMOUNT UNCANCELLED MORTGAGES
	LAND	BUILDINGS	TOTAL	
Street & number..... Addition & lot number..... Prev. Owner.....Date trf..... Mortgaged to.....Date..... ..... Deed recorded vol.....Page..... Mortgage recorded vol.....Page.....				
Street & number..... Addition & lot number..... Prev. owner.....Date trf. ..... Mortgaged to.....Date .... Deed recorded vol. .....Page..... Mortgage recorded vol.....Page.....				
Street & number..... Addition & lot number..... Prev. owner.....Date trf. ..... Mortgaged to.....Date .... Deed recorded vol. .....Page..... Mortgage recorded vol.....Page.....				
Street & number..... Addition & lot number..... Prev. owner.....Date trf. ..... Mortgaged to.....Date .... Deed recorded vol. .....Page..... Mortgage recorded vol.....Page.....				

FIG. 49.—Check of real estate holdings from public records.

bility. The borrower's previous record with the lending institution is filled in under "remarks." Additional facts may be obtained from Dun & Bradstreet, from the Credit Interchange Bureau, or from one or more of the sources already cited.

The Analysis.—If the application is for a small amount, the matter may be passed on immediately by the credit manager or by the loan committee, even without waiting for a new financial statement, especially if the applicant is a regular customer of the bank. In all other instances, a careful and complete analysis must first be made of all the information collected, particularly of those items that bear directly on the risk's financial responsibility. For this purpose, many banks use the ratio service developed by the Robert Morris Associates, showing the normal ratios or relationships that should obtain between certain balance-sheet items for a given kind of business. With these normal ratios are compared those computed for the applicant's business and in the light of the results as well as in consonance with the other information the analysis is completed and a recommendation made to the loan committee.

Making and Watching the Loan.—The loan and discount committee derives its power from the board of directors whose duty it is to pass on every loan which the bank makes. Later, at the regular meeting, the board formally accepts all loans made by the loan committee as a matter of routine procedure. Each loan application is read in full to the loan committee, showing the needs of the applicant, his plans for repayment, and his past record at the bank. The accompanying financial statement is studied. Current assets are carefully examined and current liabilities are noted. To approve a loan some banks require the unanimous consent of all members of the committee. The credit manager's report and recommendations are gone over with care. If the loan is approved, the application for the loan is so marked and signed by the secretary to the committee. Under certain conditions, the applicant may be asked to come in for a conference in order to discuss some of the weaknesses that have been discovered during the investigation, and unless he is willing to take advice and make the necessary changes, the loan may not be granted or else only part of it may be approved, and that under certain stipulations. Generally, it is a bank's policy not to lend more than five times the borrower's average balance for the year.

From the time the loan is made until it is repaid, the credit department must keep a watchful eye on the progress of the customer, all newspaper clippings being filed in the proper folder and other information being properly recorded and appropriate action taken when justified. About 10 days before maturity a date slip appears in the tickler file at which time the borrower is informed of the approaching maturity. In the meantime, a summary containing up-to-date information and the bank's experience with the risk is prepared and presented to the loan committee to determine whether the loan would be renewed if requested. The results of the decision are then sent to the loan cage or department

where they remain until the debtor asks for a renewal or makes full payment.

Making Loans through Branch Banks.—When an application for a loan is made at a branch bank, of which there is a large and growing number, the manager of the branch secures all the necessary information, including the application form properly filled out, the financial statement, and the information which he personally has of the applicant concerning his method of doing business, habits, and general reputation in the vicinity. This information is sent to the credit department of the main office of the bank, where a real estate check may be made and various reports obtained to complete the investigation. The results are then submitted in the usual way to the loan or other committee for action. If the branch manager is fully informed of the prospective borrower's financial condition, he may be authorized to grant the loan at once after obtaining permission by telephone from the credit manager at the main office. The branch manager may be even given power to make loans of, say, not more than $1,000, without referring them to the main office, especially if they are secured by highly marketable collateral. A duplicate application form is retained by the branch office, where the note is filed. The latter is usually a cognovit note which eliminates the necessity for proving the validity of the debt by acknowledging on its face that the signer is duly indebted to the holder and confesses judgment when presented before the proper legal authorities. The branch attempts to collect the loan, but when unable to do so in the usual course, the matter is turned over to the main office.

MISCELLANEOUS TYPES OF BANK LOANS

Personal Loans.—Many commercial banks have in recent years installed personal loan departments and others have been making such loans on a smaller scale. These loans are made to employed persons on a note signed by the borrower and one or two co-signers, all of whom must also be employed. The loan is ordinarily repaid in 50 weekly instalments, drawing interest of 7 per cent plus 2 per cent of the amount of the note for investigation expense. In applying for such a loan, the bank normally requires a considerable amount of information not only concerning the applicant but about each of the co-signers, as shown in Fig. 50. Additional credit information is secured through the local retail credit bureau and from other sources open to retail credit grantors. Should the maker default in his payments the responsibility then rests upon the co-signers.

Automobile Loans.—A number of commercial banks are now making so-called "automobile loans" which differ from personal loans in several respects. The note is signed only by the maker and the wife or husband,

Loan No. _____

APPLICATION BLANK

Approved	Date	Paying Teller
Credit Dept.		
Repayment		

Springfield, Ohio, _____ 193

I hereby apply for a loan of _____ Dollars ($_____)

for the term of _____ months _____ weeks, and offer as security therefore a note signed by me and the co-makers whose names and statements appear herein or are attached to this application.

I authorize your Bank to obtain any information that you require concerning the statements in this application, which application shall remain the property of your Bank whether the loan is granted or not.

I hereby certify that all the statements on this and the reverse side of this page are true and complete and are made for the purpose of obtaining credit.

(State fully for what purpose you will use the money if the loan is made)

_____

_____

GIVE FULL LIST OF PRESENT CREDITORS	ADDRESS	AMOUNT DUE EACH		WHAT FOR

If this loan is granted will you protect your co-makers against loss in case of your death, by insurance through this Bank? _____ (Limited to applicants less than 60 years old.)

Applicant Sign Here _____

If Married, Wife or Husband Sign Here _____

FIG. 50A.—Application to a bank for a personal loan.

Protect your Co-makers and dependents against loss with a Life Insurance Policy through Our Bank. The cost is small, but the benefits are great.

Applicant's Statement

ANSWER ALL QUESTIONS IN THIS COLUMN

Name | Nationality | Age

Residence Address | How Long There?

City | Years in City | Tel. No.

Last Former Address | City

Employed by

Business Address | Tel. No.

Title or Position | Kind of Business

How Long With Present Employer? | Name and Title of Superior Officer

What Is Your Fixed Salary or Wage? $ Per | If Variable Give Average $ Per

If You Have Other Income State Amt. $ Per | From What Source?

Name and Address of Former Employer | How Long There?

Are You Married? | How Many Depend on You for Support? | Rent $ Per Mo. Board $ Per Mo.

To Whom Do You Pay Rent? Name Address

Location of Real Estate You Own or are Buying | In Whose Name Is Title?

Value of Real Estate $ | 2nd Mortgage $

Amt. of 1st. Mtg. $ | Held by

Held by

Do You Own An Automobile? Make Model Year | Do You Have A Mtg. On It? How Much?

Installment Payments on Other Obligations | Per Month $ | Original Amt. $ | Bal. Unpaid $

Amt. of Life Insurance You Carry $ | Who Is Beneficiary?

Were You Ever a Borrower or Co-maker on a Personal Note?

If So, Give Location of Bank

List Trade References | List Bank References

DO NOT WRITE IN THIS COLUMN

No.	Amt.	Bal.	Del.
Appl.			
C. M.			
C. M.			
C. M.			

Add.

Pos.

UNANSWERED QUESTIONS WILL DELAY YOUR LOAN

FIG. 50*B*.—Page two of Fig. 50*A*.

INFORMATION FOR CO-MAKER

Before a loan is made, the applicant must establish his good character and ability to make the required installment payments.

Applicant must furnish at least two Co-makers, who have regular income from employment or other dependable source. Co-makers are not required to own real estate to be eligible.

Answering the questions below is an indication of your willingness to act as Co-maker on the note. It is understood that your statement is given in confidence, and is for the purpose of determining your acceptability.

Co-Maker's Statement

Name	Age
Residence Address	Tel. No.
How Long at Above Address?	Last Former Address
Employed by	
Business Address	Tel. No.
Title or Position	Name and Title of Superior Officer
How Long With Present Employer?	How Long in Present Business?
In case applicant is not more than 60 years of age, do you wish him (or her) to protect you against loss in case of death by insurance through this Bank?	
Fixed or Average Salary, Wages or Income $ Per	Any Other Income $ Per	From What Source?
If You Own Real Estate Give Location	In Whose Name Is Title?
Value of Real Estate $ Amt. of 1st. Mtg. $ Held by	2nd Mortgage $ Held by
How Long Have You Known Applicant?	What Relation Are You to Applicant?
Are You Married?	How Many Depend On You For Support?
Are You Familiar With the Responsibility You Assume in Signing This Note as a Co-maker?	
Have You Ever Been a Borrower or Co-maker on a Personal Note? If So, Give Location of Bank	
List Trade References	List Bank References

DO NOT WRITE IN THIS COLUMN

	No.	Amt.	Bal.	Del.
Appl.				
C. M.				
C. M.				
C. M.				
Add.				
Pos.				

FIG. 50C.—Page three of Fig. 50A. Page four is identical and is intended for a second co-maker.

as the case may be, and is secured by a chattel mortgage on the car properly protected by insurance. These notes may run for more than a year, and the payments are monthly instead of weekly. Nominal rates of interest are as low as 6 per cent, including investigation and servicing costs.

Loans under the National Housing Act.—Under Title I of the National Housing Act (which was passed in August, 1934, and expired in March, 1937), banks were authorized to lend money for the modernization and improvement of homes, stores, office buildings, warehouses, and factories for periods not to exceed 3 to 5 years, payable in monthly instalments and discounted at a rate not to exceed 5 per cent. Under later regulations, loans could also be made for the purchase of certain household and business equipment such as stoves, refrigerators, washing machines, bar fixtures, etc. Qualifying loans were protected by the Federal Housing Administration to the extent of 20 per cent of the total such loans made by the bank. In making application under this title of the act, certain information had to be obtained by the bank on a "Credit Statement." Additional information was then secured, references were checked, and a complete investigation made. If the application was accepted, a regular promissory note was executed, and when the maker became delinquent for a period of 60 days, the Federal Housing Administrator of the district was notified, who reimbursed the bank with the balance due upon receipt of the note duly assigned to him, together with all accompanying papers. Even though such loans are no longer insured by the Federal government, a majority of the banks that were originally attracted to this type of business by the protection feature are now continuing to make such loans on their own responsibility. Thus the National Housing Act has given impetus to the development of personal loan business on the part of commercial banks.

Under Title II of the act, insured real estate loans may be made by banks for a period not to exceed 20 years and in amounts not to exceed $16,000 or more than 80 per cent of the appraised value of the property. Under this plan a detailed application and statement must be filed with the bank by the applicant. Monthly payments on such loans include interest and part of the principal, as well as the proportionate amount of the annual taxes and insurance and the amount due as insurance of the loan itself. Interest rates on such loans vary from 5 to 5½ per cent, servicing costs from 0 to 0.5 per cent, and insurance costs from 0.5 to 1 per cent, depending upon whether the loan is a new one or is being refinanced to pay off a loan to another lending agency.

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Questions and Problems

1. Is it desirable to have uniformity in the organization of all bank credit departments? Why or why not?

2. Indicate the various practices of controlling loan operations by banks.

3. Chart the organization of a credit department for a medium-sized bank.

4. What are the principal functions of the bank credit manager?

5. Wherein is the division of responsibility for accounts among division heads territorially superior to the division on an alphabetical basis?

6. Argue from the standpoint that the best plan is to distribute responsibility for accounts according to lines of business.

7. If you were consulted as to the nature and number of records that should be maintained in a bank credit department of medium or large size, what would be your recommendation?

8. What internal sources of credit information are available to a bank credit department?

9. What advantages accrue from transcribing credit information to special records?

10. Indicate some of the recognized methods of filing credit information in banks, and list the advantages and disadvantages of each.

11. Describe the different types of loans which a modern commercial bank has to make. How do you account for this situation?

CHAPTER XXIV

OPERATION OF A RETAIL CREDIT DEPARTMENT

Types of Organization.—Retail establishments vary considerably in size. This, in turn, affects the organization for credit work. In most of our grocery and drug stores selling on credit, as in many other small retail stores, there are no separate departments for the handling of credits and collections. In fact, departmentization may be totally lacking. Even specialization in personnel may be out of the question; all office work may have to be done by the proprietor himself in addition to managing the buying and selling phases of the business.

Where a separate credit department is maintained, it is often merged with other management functions, especially those dealing with accounting and control. According to one study, 18 per cent of 200 leading stores reporting on the question effected such a merger. Of the stores effecting a merger of functions, 87 per cent had the credit manager also charged with the duty of supervising or managing the accounts receivable, 65 per cent placed under his control credit sales promotion work, 49 per cent gave him control over the Bureau of Adjustments, and 44 per cent put him in charge also of office management. In 14 per cent of the stores the credit manager was also an officer of the company, functioning in the capacity of Treasurer, Assistant Treasurer, Vice-president, Secretary, or Assistant Secretary.[1]

The personnel of the credit department and the distribution of functions obviously vary again with the size of store. For example, a typical specialty store for women's ready-to-wear with approximately 5,000 charge accounts has a personnel composed of seven employees including a credit manager, an assistant, a charge-approve clerk, an authorizer, a bookkeeper, and a stenographer. On the other hand, a fairly large department store in the Middle West employs no less than 17 people in credit work alone comprising a credit manager, three divisional credit managers (one of whom is handling deferred accounts), two interviewers, three authorizers and refer clerks, three agers of past-due accounts, one name and address clerk, one follow-up clerk, and one outside collector.

In general, a modern credit department in the retail field is organized on either a divisional or functional basis. If the divisional plan of organ-

[1] Hagios, J. A., "Retail Credit Manual," p. 13 (article on "Functions of the Credit Manager," contributed by P. W. Schaefer).

ization is used, each division handles the whole gamut of credit and collection routine for approximately 10,000 charge accounts. Deferred payment accounts are usually set up in a separate division as is the work on accounts receivable, credit sales promotion, and authorization. This method of organization enables a person to become familiar with many accounts under his jurisdiction but it does not permit of specialization or uniformity of treatment or emphasis on a specific function. For these reasons, the functional plan appears superior. Under this arrangement, collection functions are separated from those dealing with credit granting and the latter are subdivided into the charge accounts division which handles applications, identifications, and credit limits; an authorization division in charge of a manager who supervises authorizers, refer clerks, tube-room clerks, and others; a credit sales promotion division with its supervisor, clerks, and typists; an instalment accounts division with its manager, interviewers, credit clerks, collection clerks, typists, and analyzers; and an accounts receivable division with its manager, bookkeepers, control clerks, bill adjusters, etc.[1]

No attempt will be made in this chapter to describe and analyze the operation of a credit department in every detail. Treatment of collection work is reserved for subsequent chapters, so that for the most part strictly credit functions are presented at this point. Nor is it feasible to consider the organization and management even of credit work alone for all kinds of stores. Instead we shall dwell primarily on the activities of a fairly sizable credit department such as may be found in many of our department and large specialty stores located in substantial communities. To be sure, such an organization will prove too elaborate and expensive for smaller stores, but it may be adapted to them and several of the more specialized duties may be handled by one person. Several systems or methods of handling a specific credit problem will be described, so that any retail institution may find it possible to employ one of them in some modified form. Furthermore, the discussion is on a functional basis inasmuch as functions are essentially identical in all stores having similar credit problems.

OPENING AN ACCOUNT

Securing New Accounts.—By far the largest proportion of charge business of any established retail store comes from old accounts. Every effort must therefore be made by the progressive credit manager not only to keep such accounts satisfied but to develop customer control records which show just what kind, how much, and how often business has been secured from each of the active accounts. Through an analysis of customer buying habits, proper direct-mail campaigns can be conducted,

[1] *Ibid.*, p. 12 (article contributed by J. M. Malloy).

calling the customer's attention to departments which have not been adequately patronized and to specific items in which the customer's record shows him to be interested. This is a relatively new technique but has proved successful wherever used with intelligence.

If let alone, many of the charge accounts become dormant and inactive. In one large specialty store the author has found 10,000 out of a total of 25,000 in the inactive category. In another instance a department store with a little more than 40,000 accounts places only about 27,000 in the active list. Consequently, one of the most important steps in credit sales promotion is through attempts to revive dormant accounts, especially those that have proved to be satisfactory credit risks. In many stores this work is being done consistently by addressing letters, carefully and tactfully worded, to such customers asking them to take advantage of the store's credit facilities and of its merchandise and telling them how much their visits to the store have been missed. Some of these letters bear the signature of the president of the company.

Additional volume of sales is often obtained from increases in the number of customers buying on time. This calls for attempts to enlist new charge accounts. To this end, internal promotion campaigns may be conducted in which all employees of the store participate. Salespeople are usually instructed to suggest to cash buyers the use of a charge account. Many new accounts are obtained through direct application of the prospective customer. Intensive campaigns may be held periodically in which accounts are solicited by mail or through a personal representative calling on the prospect. Such solicitations may be directed to persons who have previously purchased large amounts on a C.O.D. basis or who have given personal checks of substantial amounts in payment for purchases. Both of these indicate a fair degree of financial responsibility. Newspapers carrying lists of engagements, weddings, and other social items, as well as purchases of homes and the like, furnish a clue. Then there are numerous directories, from which names may be corraled, of responsible persons justifying the use of a charge account. Some of these directories are more discriminating than others. For example, directories of engineers, physicians, bankers, college professors, and the social registerites are more useful for this purpose than are city directories or telephone directories. Lists of newcomers to the community and graduating doctors and lawyers are easily obtainable from local news sources. Finally, selected lists may be purchased from various organizations.

Actually, there is no limit to the possible ways of both enlarging the list of charge customers and of making credit customers more productive and profitable. To perform this cardinal function of a credit manager, *viz.*, that of increasing sales to a maximum, provided it does not result

in undue increases in bad-debt losses, much ingenuity and initiative are called for, which an increasing number are exhibiting. Thus credit sales promotion is rapidly coming to the front to occupy an important place in the list of duties of the modern credit executive.

The Application.—In modern stores the applicant for credit is interviewed by a qualified person in order that a close personal relationship may at once be established between the prospect and the store, the necessary information tactfully elicited, and an application signed by the applicant secured. The general form of application and the conduct of the interview have already been discussed in Chap. XX. Even many of the smaller stores have now adopted the system of securing an application from prospective purchasers on credit. For the benefit of such stores, a special system has been developed by the McCaskey Company. Figure 51 illustrates the application form which also is used as a credit limit card. When the balance due reaches the credit limit, the form is pulled from its position in back of the sales slips and is placed in front of them. This signifies that the credit limit is stopped on the particular account. Whenever possible, no direct questions should be asked but the information should be extracted in running conversation and with little pain and much courtesy.

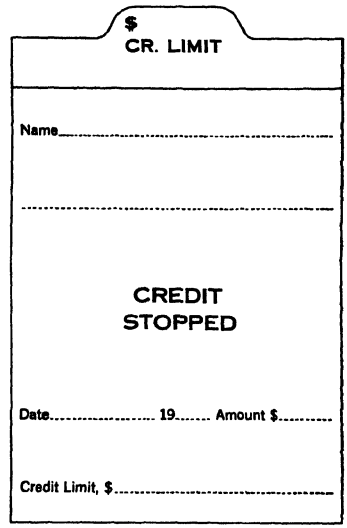


FIG. 51.—Combination of application and credit limit form devised for small stores. On the inside is the information usually obtained on an application for a charge account, signed by the applicant.

Handling the Application.—The methods of handling applications and the time elapsing between receipt of an application and opening of the account vary considerably with the size of the store, type of risk, and facilities at hand. If the store is relatively small and the risk favorable, the account can be rated immediately. The time required in opening such accounts is limited to that of preparing the necessary forms and recording the name in the proper place. Again, where retail credit bureaus are available, it is possible to secure the desired information and arrive at a decision within a comparatively short period of time, particularly when direct telephonic lines connect the member store with the bureau.

When the store is large, facilities of securing information inadequate, or when an exhaustive investigation is necessitated, it is customary to place the various applications in a temporary container or to file them in

pigeonholes arranged alphabetically. Periodically, the new-account clerk collects all the applications thus filed, references are cleared, additional sources of information resorted to, the information is attached to the respective application folders, and the folders are submitted to the credit manager for a decision and rating.

Assigning a Limit.—As soon as adequate data have been collected and interpreted, a limit should be assigned beyond which it is considered unwise to approve purchases on the charge account.[1]

Limits as well as ratings are usually designated by codes, in order to facilitate instructions to authorizers. Codes are also helpful in preventing customers from gaining any information concerning their limits and ratings, should they by chance see their records on the credit manager's desk.

Notification of Accounts Granted.—Some method should be provided in each store of notifying the applicant that the account has been granted or refused. The method of imparting such information differs with different houses. Some stores confine themselves to a formal and dignified letter, while others are very elaborate, praising the customer for his wisdom in opening a charge account, etc. Proper notification should also be sent simultaneously to the bookkeeping, and collection departments, so that they may be informed of the establishment of the account and the credit limit assigned.

Declining Doubtful Accounts.—If an application is turned down because of adverse or insufficient information, an explanation should be made by the store. A letter, to the effect that while the references given speak very well of the applicant they are not sufficient to justify opening an account, and that it is regretted that it is not possible to comply with his request, will answer the purpose in most cases. Additional references may be furnished as a result or the name of a party may be submitted who is willing to guarantee the account. Usually, however, no reply is made, for, if the customer has been slow and unsatisfactory as a credit risk, he probably knows the reason for being turned down and will not, therefore, ask for an explanation.

If an explanation is demanded, it is advisable to state frankly the conditions disclosed by the investigation and that the store does not wish to have on its ledgers accounts running beyond a certain length of time. Should the customer insist on knowing the source of information to the effect that he was slow-pay, etc., the credit manager may, with permission of the firm involved, mention the name of that firm whom the applicant is owing, and, if properly done, the customer might make remittance and thus clear up the past credit record. In many cities where retail credit bureaus are maintained, applicants whose accounts are turned down, are

[1] For further treatment of the subject see Chap. XXXIV.

not infrequently referred to the bureau for an explanation. There he is shown a record of his charge dealings with the different houses, and is caused to appreciate the value of a good credit reputation.

Irrespective of the reason for declining an account, great care should be exercised in conveying the decision to that effect, so as not to lose his patronage and good will. The denial must, therefore, be couched in careful language, the explanation made with earnestness and without abruptness and offense.

IDENTIFYING CHARGE CUSTOMERS

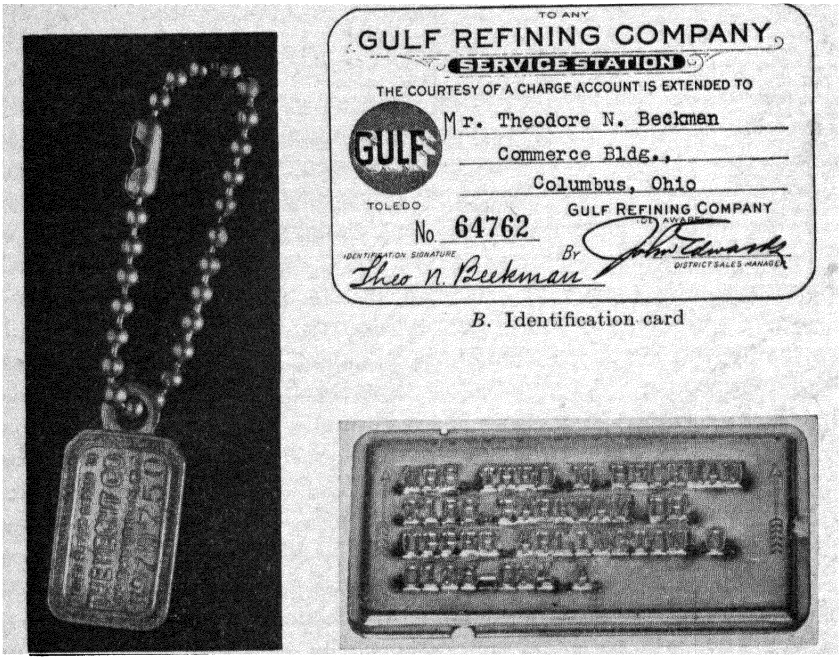
Once an account is established, it becomes the duty of the credit department to devise a system for the handling of charge purchases on such an account that will enable the department to exercise as complete a control over such transactions as is practical. If the system used in authorizing charge purchases is poor or inadequate and errors creep in at frequent intervals, the success of the credit department, together with the reputation of its manager, is seriously jeopardized.

Proper treatment of authorization routine and responsibility calls for a distinction between "charge taken" and "charge sent" purchases. These are frequently designated as "charge take with" and "charge send" transactions, or merely "takes" and "sends." The principal reason for this distinction lies in the problem of identifying customers, inasmuch as such a problem arises chiefly in connection with "take with" purchases when the customer must be properly identified before leaving the store with the merchandise. In case of "sends," however, the address to which the goods is delivered and the signature of the recipient on the delivery slip serve as adequate means of identification.

Importance of Identification.—One of the essentials to authorizing "charge takes" is the proper identification of the purchaser as a patron with a charge account in the store, or one who is entitled to buy for such a customer. It is not at all unusual for servants, children, relatives, or friends to buy on the acount of a credit customer, unless special restrictions are placed on such transactions or other instructions are issued by the customer. To prevent illegitimate and fraudulent purchases, the first important step in handling charge purchases is to be sure that the proper person is making the purchases. This is a task fraught with difficulties, especially in stores in which the number of accounts carried on the books runs into many thousands, as is the case with most of our department stores.

Methods of Identification.—The methods used in identifying charge customers vary considerably with the size of the store, its past experience, and the policy under which it chooses to operate. Methods of identification are sometimes combined with authorization, as will be shown below.

Coins and Cards.—A common method of identification is to provide charge-account customers with numbered metal coins or cards, which not only identify the possessor but serve to indicate authorization to buy within certain limits without the necessity of referring the purchase to the credit department. When larger amounts are involved, authorization must be secured from regular authorizers or from the credit manager himself, as the case may be (see Fig. 52).



B. Identification card

A. Identification coin

C. Charga-plate

FIG. 52.—Principal identification devices used by large stores.

Under such a system, floormen and salespeople are permitted to have the coin, card, or ticket serve as the sole and absolute means of identification and need not use any judgment in the matter, provided, of course, that they are kept informed, through daily memoranda or lists, of the numbers of the coins or cards that have been withdrawn or which are subject to special instructions.

This system of identification and partial authorization has several distinct merits. It prevents delay and ill feeling of customers, since it accelerates the speed of handling ordinary charge purchases. Furthermore, it relieves the congestion in the credit department, which is so serious at times, particularly during periods of peak sales, that some stores have attempted to let all transactions under a certain figure, say $2 or $5, go without referring them to the credit department for authorization.

Finally, the system is flexible, inasmuch as customers may be classified according to the amount which they are ordinarily allowed to purchase without reference to the authorizer. Such limit may be designated by a letter or other symbol following the customer's number, which is registered in the store. Thus, all patrons entitled to $5 credit at any given time on ordinary purchases will be designated by the letter A; those entitled to $10 credit will be designated as class B customers, etc. It may be advisable under this plan that each class, for the sake of simplicity, have its own series of numbers, each beginning with 1.

Notwithstanding these advantages, the system is not without its objectionable features. Many persons do not bring the coins or cards with them. In such cases, it usually devolves upon the floorman to use his judgment—the very thing which it is aimed to eliminate by the system—either in authorizing the purchase or referring the customer to the credit office. Because of this, some people postpone their shopping whenever the coin or card has been forgotten or they may patronize a competitor where they have a charge account and where coins or cards are not required for identification. Other customers dislike the idea of carrying coins with them, although the card has been found less objectionable in this respect. There is also a possibility of such tokens being lost. If found by unscrupulous individuals, purchases will be made on that basis, to the detriment of the store. Then there is the cost in working out the system, which is not inconsiderable. Original installation costs are generally heavy. They include the cost of the coin or card, and the distribution expense which is far greater. Stores must be very careful that the coins are given to the proper persons; hence they are distributed personally or by registered mail, the latter being the more prevalent method although most costly. To this must be added the cost of educating the customers in the use of the coin or card and the cost of registering them, maintaining proper records of changes and losses, and the expense of replacing them. Then there is the possibility that the coin or card will be misused. In case an account is stopped by the credit department, there is no way of recalling the coin or card from the customer; hence there is a possibility that purchases will be made with their aid, at least occasionally, even though clerks are informed of such possible abuse. Finally, these tokens have to be changed annually. It is the policy of most stores using cards to issue new cards, often of a different color, each year. These cards are sent to all customers except suspended accounts and others which the credit department may desire to omit for various reasons.

Identification by Floormen.—Because of the objections to coins and cards, customers are identified in many stores by the floor managers. Where this system is used, the floorman is generally required to identify

customers whose purchases exceed a certain amount, say, $5, before the charge is referred to the authorizer in the credit office. Otherwise, the sales slip or the information thereon is transmitted directly to the authorizer, depending upon the mechanical equipment in use, where the charge is authorized or rejected.

Obviously, it is impossible for a floorman to know all customers possessing accounts at the store. He is therefore required to exercise some judgment in the matter, for he is generally more responsible than the average sales clerk in the store. He may ask the customer to present some means of identification, such as a letter addressed to him or her, a driver's license, a bank pass book, a store's monthly statement addressed to the customer, a Social Security registration card, or something of like nature. At best, the plan is haphazard and represents a weak link in the credit system.

Identification by Signature.—Quite frequently customers are required to sign the sales slip as a means of identification. This method is especially effective when used in conjunction with the pneumatic tube system of authorization, as will be shown in the following paragraphs. Even where some other method of authorization is used, such as the electric telephone, it is customary to require customers to sign the sales check, largely because of the psychological effect it has upon people with fraudulent intentions. It is also easier to trace fraudulent purchasers when the attempt is repeated and to secure conviction once apprehended. The signature method is also helpful in carrying out instructions of patrons. Because of domestic difficulties, for example, a husband may wish to stop all purchases by his wife on his account. He may then instruct the credit department not to approve any purchases unless the sales checks bear a certain signature, which may be his own name signed in a certain way or may consist merely of the telephone number or street address instead of the signature.

Charga-plate Identification.—In recent years the charga-plate token has come into vogue. It is now used by many of the large department stores throughout the country. It consists of a small metal plate which is usually enclosed in a leather case bearing the store's name. Like the identification card, the charga-plate has on it the name and address of the customer, the account number and credit limit, and sometimes also the route number (see Fig. 52). On the back of the metal plate there is a small card which is supposed to be signed by the person using the account most frequently. When a charge purchase is made, the customer hands the charga-plate to the salesperson who inserts it in an addresser that prints the name and address on the salescheck.

The chief virtues of this method of identification, in addition to those of the coin or card system, are: (1) it saves time since it is faster than

handwriting the address; (2) it prints the name and address clearly and accurately thereby minimizing errors in billing and delays in delivery; (3) it obviates the necessity of spelling out one's name and address within the hearing of others. Additional plates for persons authorized to buy on a given account can be secured upon application of the charge customer. This new device is, however, subject to the same disadvantages as the coin and card systems. So far, no foolproof method of identification has been discovered. That may have to await the perfection of television devices or the invention of something which is as yet in the realm of the unknown.

AUTHORIZING CHARGE PURCHASES

The second important step in handling charge sends relates to the authorization of the amount so that the limit established for any particular account may not be exceeded. To accomplish this end, several systems have been called into use, including OK telephones, pneumatic tubes, wire carriers, and the telautograph. For small stores, systems like the McCaskey's to be described presently serve the purpose. Where accounts are authorized in the delivery department, hand stamps are generally used, containing the appropriate symbol, date, and the initials of the authorizer. In authorizing charge takes, however, perforating machines, electrical stamping devices, or other means are resorted to. depending upon the nature of the equipment and system used for authorization purposes. In any event, certain records are essential to the authorizer which must be described first in order to clarify the operations of the authorizer.

Authorizer's Records.—In order to prevent accumulation of packages and clogging in the delivery department, and to permit customers to obtain their purchases with the least delay and embarrassment, it is essential that authorizing work be done quickly and promptly. Hence arises the necessity for such a system of filing customers' names and addresses as will facilitate quick reference. Accordingly, several visible filing systems are to be found in operation in some of the larger successful concerns.

The filing system which is still in use in the majority of the relatively small retail institutions consists of a 3 by 5 index card placed in one or more drawers, and filed vertically in accordance with a decimal system of numbers and split letters. This system is not adapted to large establishments, however. It is too slow and inaccurate. There is always the possibility of cards being misfiled, particularly when handled in large numbers. Furthermore, it does not show at a glance all the information desired. For these reasons visible records have been substituted, which show at a glance all the essential data an authorizer wants

to know, namely, the full name, address, limit, and special instructions. All this information can in most cases be shown in one line.

A number of the larger stores place two credit limits on the visible index, one to be used primarily by the regular authorizer and the other

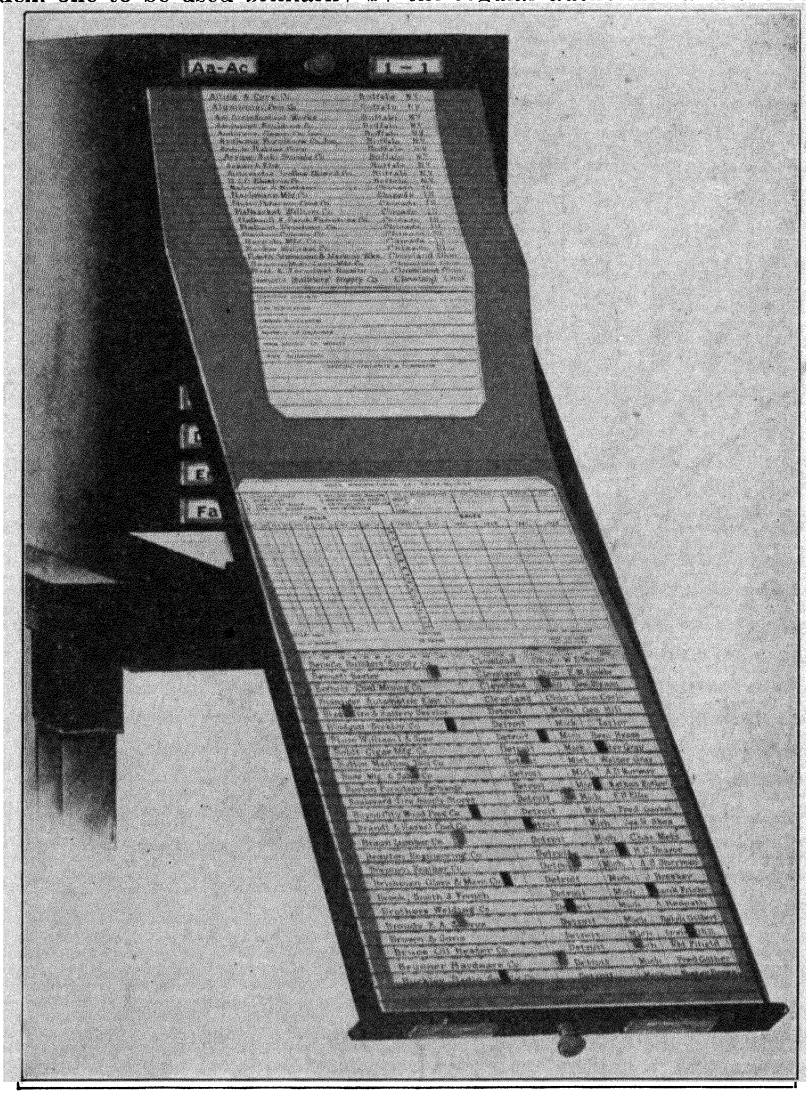


FIG. 53.—Flat-drawer type of visible index.

for main use by the "refer" authorizer. The first symbol for so-called "preliminary" authorization usually consists of a numeral representing a certain money value. For example, numeral 1 may equal $25, 2 may be equal to $50, and so on. The second symbol representing the account

limit ordinarily consists of letters, so that letter A may equal a credit limit of $50, B may represent a limit of $75, etc. Thus a credit limit of 1B would mean that the authorizer could allow a charge up to $25, although the refer authorizer may allow purchases up to $100, including the balance owed. Special symbol designations are used for the unusually poor and for the unlimited accounts, respectively. With many stores the procedure is much simpler, only one credit limit being assigned to each customer which is expressed either in numbers or in letters. One such store, for example, uses the following arrangement: 1 represents a credit limit of $10, 2½ equals a limit of $25, 5 equals $50, etc. A certain department store with around 30,000 accounts uses the following code for credit limits: G equals $25; H, $50; K, $100; L, $150; N, $250; O, $500; and T, unlimited.

Two of the most important visible filing systems used by authorizers are the "flat-drawer" type and the "tube-design" type. Where the former system is employed, cards are arranged in strict alphabetical order and laid out flat in flat drawers, of which there are about 16 to a section, each drawer properly ear-marked, as shown in Fig. 53. The chief merit in this system lies in the fact that it obviates the necessity of thumbing over lists of cards and it shows all the essential data at a glance.

The tube-filing system consists of narrow, transparent celluloid tubes, filed in book form on rotary stands. In each of these tubes a single line of paper containing all the essential information which authorizers are required to know is inserted as shown in Fig. 54. If additional information concerning a customer is desired, two tubes can be used. This system, not unlike that previously described, is extremely elastic and is subject to unlimited expansion by the addition of more panels.

Many concerns also have in the delivery department a cross index of customers' names. This is a duplicate of the original index, but names are classified by towns and streets and the system is, therefore, known as a location or geographical file. Much unnecessary delay is thus avoided in case of faulty or illegible spelling of names when referred to this cross index.

It is generally considered good practice for authorizers to keep records of their work, to make possible intelligent planning for improvements. These records show the number of charges passed daily and the number reserved until the day following. In addition to this information, the "refer" authorizer should have records showing purchase and payment habits of the account; ratings; restrictions, if any; extra or special instructions; reference number of folder file; and the signature of the customer.

Telephone Authorizing.—One of the methods in use throughout the country involves authorizing by means of telephones. The equipment

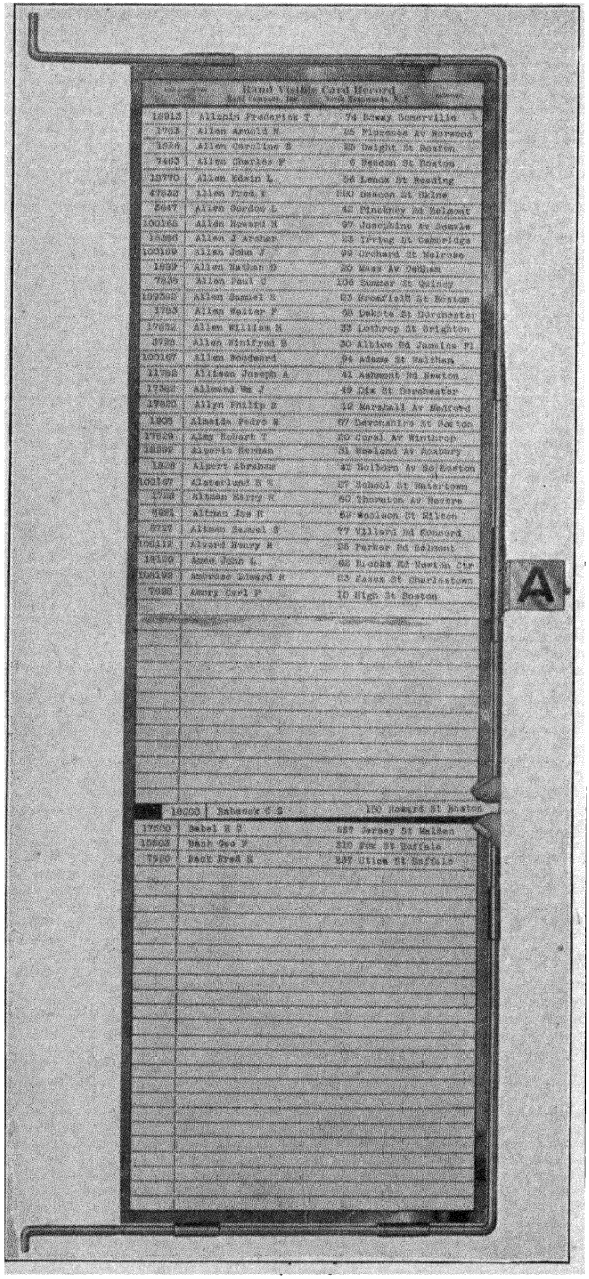


FIG. 54.—Tube-design type of visible index.

of this system consists of (1) stamping perforating telephone units located in different selling departments throughout the store (see Fig. 55); and (2) the authorizers' telephone switchboard which is usually located in the credit department (see Fig. 56). These telephones are also known as "charge phones," "electric telephones," and "OK telephones." Sometimes dial telephone equipment may be used for authorization.

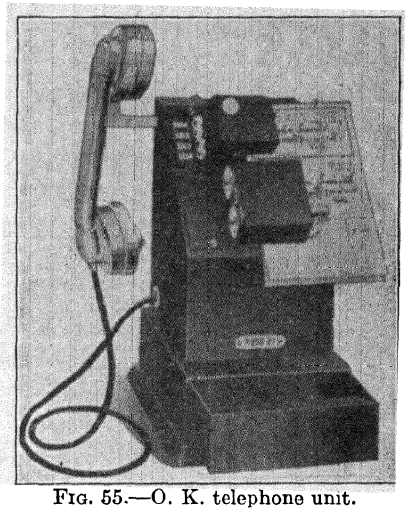


FIG. 55.—O. K. telephone unit.

In using the system which is sponsored by the National Cash Register Company and which appears to be in wide use, the salesperson inserts the charge slip in duplicate in an electrically operated device with telephone connections and presses a button to signal the authorizer. If several authorizers are employed, each taking charge of a division of the accounts falling in a given alphabetical group, say from A to F or G to L, several buttons are provided with each telephone unit so that the proper button may be pressed which will establish direct connections with the authorizer in whose section the name involved may be found. Instantly a light appears on the authorizer's switchboard. The operator then answers the call by inserting a connecting plug in the hole below the

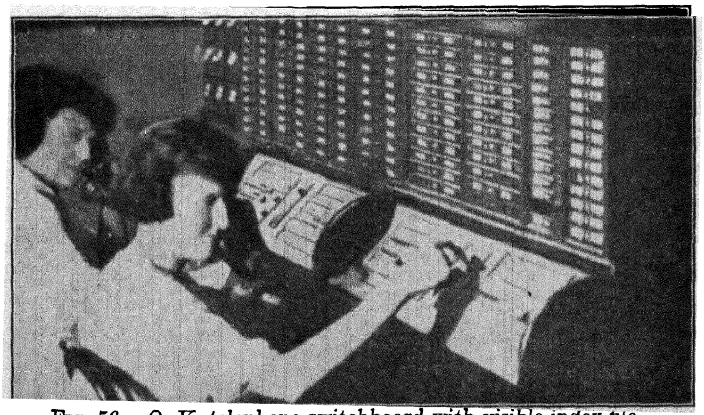


FIG. 56.—O. K. telephone switchboard with visible index file.

light. Next, the authorizer presses the ringing key on the switchboard, which causes a buzzing sound on the calling phone unit, notifying the clerk that the authorizer is ready to answer the call. The salesperson then tells the authorizer the name and address of the customer, the amount of the

purchase, and by whom bought and identified. The authorizer refers to the visible index, such as the tube files or flat-drawer cards which are placed on top of the switchboard so as to make them easily accessible. Frequently an operator, after having been on the same board for some time, may become acquainted with many of the accounts and find it unnecessary to look up all charges.

If the sale is approved, the authorizer presses the "stamping" button on the switchboard, which causes the electrically operated device connected with the calling-telephone unit to perforate the address label or stub of the sales slip, which serves as authority for the shipping room to deliver the package, and to stamp on the original the "charge phone" number, the date, and the OK or CH (the latter meaning charge). The duplicate is then wrapped in the package. There are no marks on this copy to show that the charge was questioned. In case the charge is not approved, the salesperson is so advised over the phone. The customer may then be asked to come to the credit office, or such other instruction may be given as is deemed advisable. If it is difficult for the authorizer to identify the customer because of wrong address, wrong initials, wrong spelling, or, if the authorizer finds that restrictions have been placed on the account, the charge is transferred to the refer authorizer for consideration with the reason therefor stated on the refer charge ticket.

Advantages of Telephone Authorization.—This system makes it possible for every department to be in instant communication with the credit office. It is a speedy means of authorization, stores claiming a speed averaging 45 seconds per transaction. The installation cost of phones ranges from $50 to $115 per unit, depending largely upon the number of units installed.

The electric telephone enables authorizing direct from the credit office, thereby placing the work under the direct observation of the credit manager. The quick service to customers can be maintained at all times by placing refer phones throughout the store in addition to the department stations in case of special sales and other rush periods. It is regarded in some quarters as the most reasonable in installation cost and most economical to operate in the long run. Each stamping phone unit is connected with the credit office by a small inconspicuous wire which does not mar the appearance of the store. If anything goes wrong with one line, others can be used. After the transaction is completed, the original sales check is placed in a drawer at the base of the phone unit. When collected they are in a smooth, uncrumpled condition, ready for posting. The telephone eliminates all handling and rehandling of the sales check, for it does not have to be sent to the central office for authorization and there is no chance for it being returned to the wrong department. It also obviates any possibility of mixing one transaction

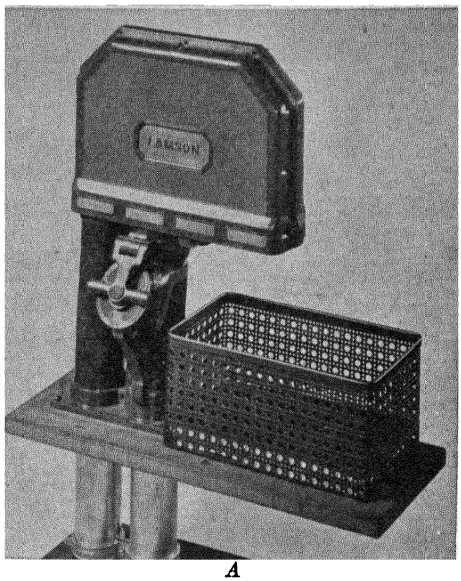
with another and corrections of errors can be made instantly while in communication with the sales clerk.

Disadvantages of Telephone Authorizing.—One of the common objections to this method of authorization of "charge take with" purchases is the possibility for impostors buying on the accounts of *bona fide* patrons. A person with fraudulent intentions may overhear every word of the conversation between the clerk and the authorizer. It is then not difficult to go to another department and purchase on the account which has been found in good standing. This objection may be overcome, however, by the use of powerful motors which make it possible for the clerk to whisper or by placing the stations in sound-proof compartments, as some stores have done. Fraudulent buying may also be detected if the system is properly used. When the reference index is marked, for example, that a fictitious name is being used or that a *bona fide* customer is being imposed upon, quick communication between the authorizer and the store's protection department will result in immediate apprehension.

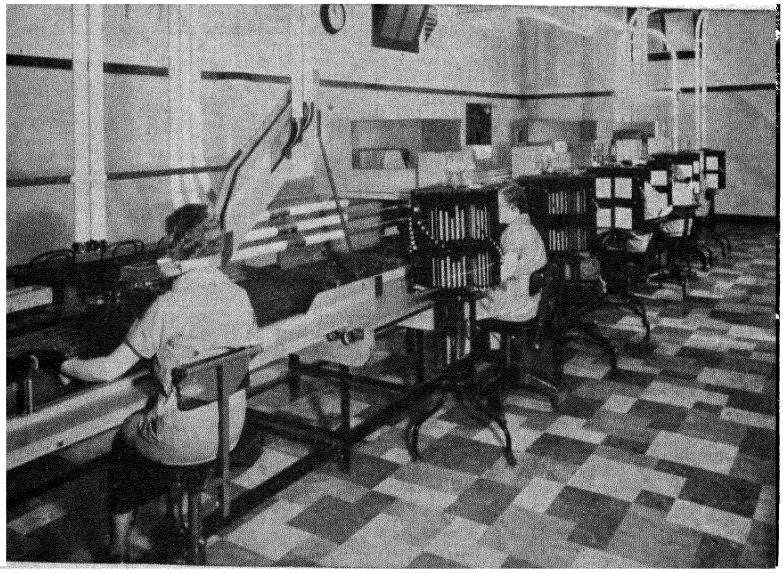
Another objection to the telephone method of authorization is the inability to identify customers by means of their signature, although they may be required to sign all sales checks, but with the pneumatic tube system that is possible and practicable. This objection is not so strong as far as stores located in smaller communities are concerned, for here the problem of identification is almost eliminated.

In case of refer charges, the average credit manager generally wants to see the sales check, which must then be sent by messenger. Furthermore, much congestion may occur at the telephones during large sales and the holiday business season. While this may be met by having a large number of units installed, the process is expensive since many of them will remain idle much of the time. Again, where the number of telephone units is small and one such unit is made to serve two or more departments, the clerk must leave the counter in order to secure approval of each charge. This is often distasteful to prospective customers who might wait longer if the clerk were present but refuse to be left alone even for a short time.

The Pneumatic Tube System.—Under this system a number of tube dispatch stations are placed throughout the store at certain strategic points (see Fig. 57). In case the tube system is used in conjunction with a central cashiering station, the carriers must be distinguished by some color. Thus, in many stores using this system, cash sales checks together with the cash payments are carried in gray-capped purses or carriers. These are opened and handled by the cashier and the change, if any, together with the sales check copy for customers, returned by way of the cash carrier belt conveyer, moving along the desk of the cashier to the carrier return dispatcher and thence back to the department making the sale. Charge sales checks are carried in red-capped or in green-capped



A



B

FIG. 57.—Illustration of pneumatic tube system such as developed by the Lamson Company of Syracuse, N. Y. *A*, pneumatic tube dispatch station. *B*, pneumatic tube authorizing section.

purses, which are relayed in the tube room to the credit office, unless a charge authorization section is located in the tube room, which is very often the case. To distinguish further between "charge taken" and "charge sent" purchases, the entire carrier of one or the other may be painted red or any other color. In this manner, it is possible to give preference to those transactions which require immediate attention.

Just before entering the authorization room, charge and cash transactions may also be separated by a projection on the side of the carrier. Charge slips may then be placed in a carrier having a smooth surface on both sides while cash sales slips are placed in the other type of carrier. When the rough edge comes in contact with a certain point in the tube, the carrier is switched over to another tube which leads to the cashier. The smooth-edge carrier continues on its way to the authorizer. The carriers from the various stations are numbered and are thus returned to their respective points of origin.

When personal checks are offered in payment, they may be approved by floormen or department managers, if within certain limits, and handled as cash transactions. Should these limits be exceeded, the bank checks are forwarded, together with the sales checks, to the charge authorization desk, and, if approved, a rubber band is placed around the carrier. The rubber band signals the cashier located in the tube room to open the carrier and handle the transaction as a cash sale.

The original sales checks are placed in bins as soon as approved. From these they are collected at frequent intervals by messengers from the bookkeeping or auditing department. In this manner practically all the charge sales are posted in the ledger and otherwise handled by the auditing department during the day the sales are made.

Advantages of the Pneumatic Tube System.—The tube system is advantageous in that it makes possible the signature method of identification and can be combined with centralized cashiering, which is easier to supervise. Some stores have achieved a high degree of efficiency in this respect, but the average customer resents waiting for change more than 30 seconds or a minute, especially where purchases involve small amounts. Centralized cashiering may therefore be supplemented with a number of registers in certain departments handling small-unit value goods which are bought largely on impulse.

Seeing the sales check is a decided advantage to the authorizer. It precludes any possibility of misunderstanding, as in the case of telephone authorizing, either of the name of the account, address, or amount, and definitely fixes responsibility for authorization. The quiet method of authorization minimizes fraudulent buying. It provides a means for accumulating sales checks, thereby preventing losses or delays. The modern tube equipment permits the establishment of portable stations

for special sales to take care of unusual business activity. Furthermore, many carriers can go through the tubes simultaneously, and no messengers are required to convey sales checks to refer authorizers, the tubes being used as the mechanical messengers. The cost of upkeep is said to be very small, the tubes causing very little trouble mechanically, much less than the telephones, and the depreciation of the tube equipment is slight. Finally, the salesclerk can proceed to wrap the package, while the carrier is on its way to the authorizer's desk, or to wait on other customers.

Objections to the Tube System.—The tube system is costly to install and with some equipment it is difficult to make extensions of the system, although the modern equipment is not so expensive to install. In addition to this lack of flexibility, which may be overcome when modern equipment is installed, there is the danger that carriers will be returned to the wrong station and slips will come back crumpled and unclean. The tube system is said to be slower than the telephone method, although many stores claim to be able to authorize charges via tubes in less than a minute. Delays are particularly long when the charge must be transmitted to the refer authorizer in the credit department. To keep the customer's good will, floor men sometimes take the liberty of delivering the package before the slip is returned, if the return is unduly delayed.

The Telautograph.—Another system for authorization which is gradually making its way into large establishments is an electrical mechanical writing device known as the "telautograph." Combined receiving and sending stations are placed in the credit department and on the different floors and all communication is carried on by means of writing which is electrically transmitted to the desired station. All sorts of confidential inquiries can be thus made and replies received without the customer overhearing anything. No telephones are tied up while waiting for a reply, and signatures or initials of the persons communicating may appear on the slip as a means of fixing responsibility.

The Carrier System.—The so-called cash carrier system offers another method of authorization, particularly for the smaller stores. The carriers are fastened to a belt which is propelled by an electric motor. This belt transfers the carriers from station to authorization room and return much the same as in the case of the tube system. The belt is constantly moving, and the carriers come in contact with it only when forced, a rough edge of the carrier forming the contact. This system is much slower than any of the systems described in these pages and frequently refuses to work. It permits, however, centralized control of credit transactions which stores of any size could not secure unless they could afford to install one of the other systems of authorization.

The McCaskey System.—For small stores with from 300 to 1,000 accounts a system similar to that developed by the McCaskey Company of Alliance, Ohio, has proved very valuable. This system makes

use of the ordinary sales slip which is carbonized on the back so that a duplicate may be prepared without inserting carbon paper. Each time a charge sale is made, the customer's balance is added to the amount of the purchase. The duplicate is given to the customer which shows the balance due and the original is filed in the "register." All payments are similarly recorded. The file or register may be either vertical or horizontal. A visible index shows the customers' names alphabetically and gives the location of the accounts within the register. The compartments in the register are fitted with spring clips to hold the sales slips in place. The slips are filed in front so that the balance of the account is always apparent. Back of all the slips is the application form that has been filled out (see Fig. 51) with the credit limit jutting out at the top. If the balance after the most recent purchase causes the account to exceed the limit, the card containing the limit is pulled from its position and placed in front of the sales slips, which stops the account automatically. When an account becomes due, a "Due Card" is inserted in front of the appropriate compartment and collection proceeds.

This system is advantageous because it embodies the "one writing" idea, for it obviates the necessity for a day book, a ledger system, and separate statements to customers. It always shows the balance to date. It makes for speed in handling charge accounts, and it eliminates monthly statements. On the other hand, the system is too expensive for stores with, say, less than 300 charge accounts and too cumbersome for stores with more than 1,000 accounts. Furthermore, it is not well suited to stores that are highly departmentized. Too many slips would accumulate in such cases within a very short time and clutter up the register.

Authorizing "Charge Sent" Purchases.—When charge purchases are to be delivered, the problem of handling them is greatly simplified. It not only obviates the necessity of providing means for identification, but it also makes possible authorization at a central point. If the purchases are within certain limits, they are likely to be authorized in the charge authorization section located in the delivery department. If a large amount is involved, or if alterations are to be made, the sales check is sent to the refer authorizer in the credit department or the charge phone may be used for the purpose.

WATCHING THE ACCOUNTS

Once an account is accepted, a credit limit is immediately determined. To guard against running up charge purchases beyond this limit, and in order to obtain and file all relevant facts pertaining to the account, it is essential that a good credit office system be established. Such a system should provide means for securing and filing all credit information in a manner which will make the data available for quick reference. It should

facilitate the handling of changes of condition and address in order always to keep the files corrected. It should provide an automatic check on customers when the limit is approached too closely with a possibility of exceeding it. Finally, a good credit department system should have definite means of keeping the proper department informed concerning changes in residence, deaths, divorces, changes of names by marriage or otherwise, and any other changes which would affect the mailing lists or which offer possibilities for soliciting patronage effectively.

Credit Department Records and Forms.—As the applications are received during the day, they are turned over to a clerk who is charged with the duty of conducting the necessary investigations. When the information concerning applicants is collected, it is placed, together with the application blank already filled out by the applicant, before the credit manager for final consideration as to whether or not the account should be opened. If accepted, a limit or rating is assigned and a card or folder prepared for the credit department files.

Probably one of the best systems is to keep the information in a folder, filed in two-column drawers. All essential information is then typewritten on the outside, while the original application blank, together with replies to inquiries and other data, is enclosed within the folder. These folders differ widely in regard to size and particularly with respect to the information placed on the outside. The simpler forms contain spaces for information similar to that appearing on the application blank. In addition to this, there is usually a space for recording special instructions concerning the account. These instructions deal with restrictions, as when no goods are to be charged without a written order from the customer, or when all charges on an account are to be authorized by a certain designated person or department only; an account may be ordered "stopped" by request of the customer or upon decision of the credit manager, because it is uncollectible, over the limit, or until the amount owed is paid; again, an account may be reopened by request or by order of the credit manager.

Other folder forms are more detailed and provide additional spaces for the classification of accounts, record of purchases by months, a summary of reports of references, list of real estate owned and encumbrances thereon, taxes paid during the preceding year, and so on. Papers which are to be kept as a part of the permanent record may be attached to one end of the folder and other papers of a temporary nature to the other end. The latter are usually destroyed when the folder is revised, generally every six months.

A significant measure which enables a credit manager to keep watch over his accounts is afforded by news clippings. Hence every credit department of a house of some size should have a clipping clerk to record

all relevant data pertaining to accounts carried on the books. An unsuspected flow of information is thus contributed concerning business difficulties involving lawsuits, judgments, foreclosures, and bankruptcies: bad checks; marriages, divorces, separations, and deaths; and records of real estate transactions and registering of deeds. All of these points are at times very illuminating and invariably shed some light on the affairs of a customer. Some of them may indicate substantial changes in a customer's financial responsibility, of a favorable or derogatory nature, which no creditor can afford to overlook. Should a customer be thus found to be involved in some sort of trouble, the practice of credit managers is to place a danger signal or "flag" on his record and perhaps suspend credit accommodations until a thorough investigation has been made, which may lead to the removal of the danger signal or to a closing of the account.

Every credit department should be provided with a form for passing instructions to the authorizers. As has been previously pointed out, accounts may be restricted for various reasons, requiring changes in the indexes of the authorizers' records. Authorizers should be informed of these changes with the least possible delay. This may be accomplished by the use of a form which has sufficient space in which are printed in abbreviated fashion all possible changes and instructions, thereby necessitating merely the insertion of the name and address of the account and several check marks opposite the appropriate spaces in the form.

Relation to Bookkeeping Department.—To exercise effective control over the numerous accounts handled by a large retail store, it is essential that the greatest cooperation exist between the bookkeeping department and the credit department. Where the credit manager is also head of the bookkeeping department, all possibility of lack of harmony is at once eliminated. Under all circumstances, the bookkeeping department must furnish the credit manager with all information pertaining to accounts which are overbuying, have exceeded the limit for the first time, are overdue, or any other information that may be required.

Where the two departments are located on the same floor, it is relatively a simple matter to communicate with each other as occasions demand. However, when they are considerably removed from each other, as when the credit department is located on the first floor for the convenience of patrons, and the bookkeeping department on a higher floor, where space is cheaper and more ample, difficulties may arise unless a proper system is installed. A usual plan, where tubes are used, is to connect the two departments by a tube, by means of which requests for information are sent from the credit department to the bookkeeping department via a tube desk clerk, who is to open the carrier, ascertain the bookkeeper concerned with the name, and dispatch the request along

a wire to the proper place. As soon as the information blank is filled out, it is returned to the tube desk clerk, who dispatches it to the credit department. Where this system is used, urgent requests are made out on colored blanks to receive preference in treatment.

In addition to answering these special requests for information, the bookkeeping department reports daily all cases which are out of the ordinary, particularly when the limits assigned have been exceeded, thereby checking automatically a customer's activities. Immediately after the posting for the day has been completed, sheets are made out, usually one for each letter of the alphabet, on which are entered the name, address, account number, limit, amount owing, and date of last payment on accounts overbuying or past due. Upon receipt of these sheets, the credit manager determines upon the action to be taken, whether the account should be stopped, the limit changed, or the continuation of purchases permitted. All changes are indicated on the visible index by marks or symbols placed opposite the names in question, that fact is also recorded on the credit folder, the sheets are returned to the bookkeeping department, and memoranda of changes sent to the various authorizing sections.

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Questions and Problems

1. If an application for credit must be refused, what is the most diplomatic way of accomplishing it? Why be diplomatic about it?

2. After an account has been opened, what major problems present themselves to the management of the store in connection with the customer's credit purchases? How have they been met?

3. What is the best insurance to the store that the proper person is making the purchases on a given credit account?

4. In what ways is the Charga-Plate superior as a method of identification? Has it solved all the problems incident to identification? Explain.

5. If a store uses the telephone system of authorization, would you recommend that the customers who purchase on credit sign the sales slips? What purpose or purposes would the signature serve under such circumstances?

6. You are about to construct a new building for a department store, the plans for which call for a decision on the fixtures that should be installed for authorization purposes. The choice has finally narrowed down to the OK telephone and the pneumatic tube systems. Which would you select? Why?

7. Would your choice be different if the building were constructed for a downtown specialty store expecting to do approximately $500,000 of business a year? Explain.

8. What other systems of authorization are available and to what types of stores is each of them especially suited?

9. What records and files do you deem essential for the proper operation of a medium-sized retail store in the shopping district of a city? What additional records and files would you consider worth while?

CHAPTER XXV

INSTALMENT CREDIT MANAGEMENT

The discussion of instalment credit in Chap. VII was more or less general in nature. Its origin was pointed out, and an attempt was made to show that instalment credit is new only in the minds of people unfamiliar with it; that it has existed for over a century and a quarter in the United States and very much longer in some of the countries across the Atlantic. It is believed that both advantages and disadvantages were presented in an impartial, impersonal, and unbiased manner. Some of the advantages and objections that have been listed were given primarily for the purpose of presenting a cross section of current thought on the subject and not because the author places stock in their validity.

It is commonly recognized that discussions of instalment credit ordinarily fill the air with big generalizations, big figures, and unusually big words. But when many of these statements and thoughts are placed under the microscope and subjected to some analysis, one is surprised to find that many of these thoughts and statements often spring from narrow and biased motives, rather than from broad, impartial reasoning based on facts and figures. The few facts available on this subject are frequently distorted and so interpreted as to justify preconceived notions and prejudices. It is probable that if we had more real information on the subject, there would be fewer opinions and less argument concerning its good points and bad features.

Need for Efficient Management.—The real problem in the instalment field is not concerned with the question of whether or not instalment credit is justified from an ethical point of view, although many attempts have been made to treat it purely or largely as an ethical issue. Instalment credit can no more be condemned as fundamentally unsound than any other type of credit. Like all such types of credit or buying and selling devices, it is subject to both sound and unsound plans of operation. The real problem, therefore, involves a consideration of the practice from a business standpoint. The important query is: How can we retain the good points inherent in the plan and eliminate its bad features? How can we benefit from the use of instalment credit without suffering from its disadvantages?

Every student of the subject will concede that instalment credit is here to stay, that it is too basic to vanish and suddenly disappear, and

that it has won for itself a permanent place in our credit and business structure. It is apparently filling a real need of the consumer and bridging a gap in business practice. Consequently, instead of being harassed by its abuses, there is an urgent need for a diligent study of the subject in order to discover some fundamental principles whereby the instalment device would prove beneficial to all concerned.

That many abuses of the instalment plan exist is a matter of common knowledge and requires no elaboration. The responsibility for the unsound practices and abuses which have characterized and burrowed into the very heart of the instalment system must be shouldered both by the consumers who buy on that basis and by stores and manufacturers who sell on such plan. Both are guilty in varying degrees and it behooves them both to adopt remedial measures.

Consumers can do much to increase the soundness of the instalment plan. Every person ought to know whether or not he is entitled to buy certain goods and whether he is justified in paying the price asked for them merely because he pays for them at some future time. There is great need for care and judgment in making purchases. The art of living is fully as important as the art of making a living. Much of the shiftlessness and recklessness on the part of consumers must cease in order to avoid detrimental effects.

The lion's share of the responsibility for the successful operation of the instalment plan from both a business and social standpoint, however, rests squarely on the shoulders of the store management and others who sell goods on instalments. The credit managers in these establishments understand business conditions and credit risks sufficiently well to enable them to discard the unsound methods and replace them with practices that will prove beneficial because they have been tried elsewhere and proved satisfactory. Even on the basis of the meager data which have been gathered since the instalment plan came in vogue, supplemented by sound business logic, it is possible to formulate certain rules and principles that should govern the successful operation and management of instalment credit. Only through the application of such sound principles will many of the abuses disappear and the constructive possibilities of instalment credit be more fully realized.

PRINCIPLES IN THE SUCCESSFUL OPERATION OF THE INSTALMENT PLAN

The following factors which may be regarded as cardinal principles governing the operation of the instalment plan have evolved largely out of actual business experience covering the past two decades, during which instalment credit has experienced its greatest development. It is only during this period that instalment credit has been tested as a fundamentally sound credit policy. So far as is known, it has stood the

test, but with the clearing of the brush it has become apparent that in the successful use of the instalment device, as in all other business practices, there are essential factors to be considered. With the emergence from the depression of the early 1930's, as already pointed out in Chap. VII, and in a desire for more business, some of these principles have been disregarded. The danger of such procedure is now apparent and calls for greater scrutiny of what may be regarded as sound. The most important of these principles are presented in the following pages.

Kinds of Goods.—The first principle relates to the type of goods which may be sold successfully, in the long run, on the instalment plan. While there is considerable difference of opinion on the subject, most authorities agree that durable articles which are not used for immediate and temporary consumption lend themselves to such a method of operation. Goods bought for temporary use or immediate consumption should not be paid for out of future income. This raises the question as to the wisdom of selling so-called "soft" goods, or perishables, on deferred payments. Arguments for and against this practice have already been presented in Chap. VII. It is further generally agreed that, with but few exceptions, only articles of relatively high unit value should be sold on instalments. There is really little justification from the standpoint of consumer need for applying deferred payments to goods of small value for which a consumer should always be able to pay or to purchase on the regular charge-account basis.

Some authorities would limit the use of instalment credit to the purchase and sale of necessaries. This point, too, has already been discussed in Chap. VII. Other authorities would also insist that articles sold on the instalment plan must have a high resale value, in order that losses may be minimized when such articles are repossessed. This, of course, would exclude such commodities as men's clothing which do not have a high resale value.

The soundness of this position may be seriously questioned. The facts which are now available on this subject point in the opposite direction, namely, that generally the 10-payment plan of retailing men's clothing, for example, is in many ways superior to the open-credit method.[1] Credit on a 10-payment plan with 30 per cent of the retail price as down payment is equivalent to a credit on the whole amount outstanding for only 27 days, whereas the average outstandings for a large group of retail clothiers selling on the 30-day charge-account basis is approximately 90 days. It has been conservatively estimated that the 10-payment plan (weekly payments) has reduced outstandings at least 50 per cent. This would seem to indicate that if the other factors to be discussed presently are properly handled the instalment sale of articles with little repossess

[1] COMER, H. D., "The Ten-payment Plan of Retailing Men's Clothing."

value may be an improvement over existing conditions and hence highly desirable, so long as the articles are not used for temporary gratification.

Careful Investigation of Credit Risk.—The second principle requires that a thorough investigation be made by the credit manager of each applicant for credit. A "no questions asked" policy is anything but wholesome in its effect upon society. It sometimes proves disastrous to the store and certainly tends to lower the value of its line of merchandise. Public announcements by some stores to the effect that "your credit is good," and the policy of enticing prospects to the store through the use of "special discount pass cards," "gift checks," "certificates of credit," and the like, which are normally accepted as the first down payment, are devices subject to question. It is believed that so lenient a policy in credit extension is made possible only by an unusually high mark-up or through the sale of shoddy merchandise at exorbitant prices.

The credit investigation should be particularly thorough when goods are sold primarily on the basis of moral risk, as when they do not possess sufficient resale value. Leniency in credit granting is detrimental to all parties concerned. Too often is it said that the average man is honest and that it is cheaper in the long run to take a chance than to make investigations. This is faulty reasoning, and it is easy to make it a principle in instalment merchandising, especially when competition becomes too keen. Experience has shown, however, that a perfunctory investigation or no investigation at all is one of the greatest dangers of instalment selling. Good business practice dictates that as careful an investigation as possible be made of a person's ability and willingness to pay his instalments before he is allowed to make the purchase.

In fact, the investigation in such cases should be even more rigid than in the case of open credit accounts, particularly when little reliance is to be placed on the resale value of the goods. The amount extended to an instalment buyer is much larger on the average than the average charge account, hence the risk is greater. Then too, instalment transactions extend over a longer period. The longer the credit period the more difficult it is for the credit manager to foresee changes in conditions that might affect the risk adversely. Furthermore, people purchasing goods on the instalment plan usually have fewer financial resources at their command, hence the danger of defaults in payments when their earnings are somewhat reduced. This is especially true when attempts are made to reach down into the lower income groups, through the elimination of down payments and carrying charges, in the sale of expensive commodities like refrigerators. The right to repossess the goods by no means reduces the need for investigations, for repossessions are costly and annoying.

It is usually considered good policy to have an application form filled out for each applicant for credit on the instalment basis containing information similar to that shown in Fig. 58 and signed by the applicant. Such application would then serve as a basis for further investigation through the references given, the bank, and the retail credit bureau.

It is important that full information be obtained concerning the customer's existing obligations to be paid on the deferred plan. Only thus can one fully judge the customer's ability to assume additional obligations, for it is this factor that should determine the acceptance of a

DATE_____ NO._____ REC'D BY_____ O.K 'D BY_____

NAME	APPLICANT
MAIL ADDRESS	BUSINESS
RESIDENCE	BUSINESS ADDRESS
	HOW LONG
FORMER ADDRESS	
BUSINESS REFERENCES	
	BANK CHECKING SAVINGS
	R. E
PERSONAL REFERENCES	AUTHORIZED BUYERS

LIMIT	DATE	AMOUNT	ART. PD	TERMS	O.K. D BY
PHONOGRAPH					
CONTRACT					
ELECTRIC SERVICE					
PIANO					

LETTERS SENT

I hereby apply for a charge account and I agree to pay my bill in full on or before the 15th of the next month after the goods are purchased, unless otherwise arranged.

FIG. 58.—Application for an instalment credit account.

credit risk rather than the vendor's ability to obtain a prior lien, a wage assignment, a confession of judgment, or some other means of protection. It is frequently advocated that a good principle to follow in this respect is to keep the total instalment obligations of a customer, whether incurred in the purchase of merchandise or through personal loans, down to 10 per cent of his annual income, if the goods are sold on a basis calling for complete liquidation within a year, but in no case should they exceed 10 per cent of the income to be derived over a period of 2 years. When dealing with customers in the low income groups, even a smaller percentage should be set as the limit. To this end, all vendors in a community must cooperate and clear the information through a central bureau.

Minimum Sale.—Inasmuch as the direct costs on instalment business are relatively high there is a problem of determining the minimum sale

that can be made on that basis. Until recently this problem was practically nonexistent, since only goods of high unit value were sold in that manner. With the adoption of various budget plans and "store-wide" systems whereby all kinds of goods can be bought on deferred payments, a minimum must be set or else the purchases may be so small as to make the business definitely unprofitable. It is not suggested that every sale share its proportionate cost, any more than it would be suggested that every article in a store be sold at a profit. But it would be sound practice to have every instalment sale bear the direct costs and contribute as much as possible to the general overhead. For this purpose studies must be made to establish the "break-even" point on direct costs. Unfortunately, data of this sort are now almost totally lacking. Sensing this problem, some vendors have established a minimum of say $20 or $25 for the initial purchase on the instalment plan and, say, a $5 minimum for additional purchases, although many establish a minimum as low as $5 for initial as well as subsequent purchases.[1]

Reasonable Down Payment.—A principle that is now almost universally recognized by authorities on the subject is that the terms of sale on the instalment plan should be so arranged as not to allow the depreciation of the goods to outrun the liquidation of the account. In other words, the terms of sale must be constructed to prevent the goods from depreciating or declining in value faster than the account is being paid off. This may be accomplished by requiring a reasonable down payment and by making the necessary adjustments in connection with the length of time within which payments must be completed.

By requiring a reasonable down payment, the customer is made to feel that he has actually bought the goods and not merely borrowed them. Furthermore, if the down payment cannot be made, how can the buyer be expected to meet his instalments, especially when the initial payment is less than the amount of each of the future instalments. A sound policy therefore is to make the down payment at least as large as any of the subsequent instalments and, if possible, it should be large enough to cover all initial depreciation. In this manner, the customer will have a real equity in the product. He will feel the pride of ownership and enjoy the satisfaction that springs from real possession. He will feel more keenly the need for retaining possession, with the result that fewer repossessions will be made necessary.

In view of the foregoing it would appear that in the case of durable goods the reasonableness of the down payment should be governed by the extent of their immediate depreciation, the size of subsequent

[1] See "Report on Instalment Selling—Policies and Practices," by B. W. Wright, presented at the Convention of the Credit Management Division of the National Retail Dry Goods Association, June, 1936.

instalments, and the amount that will give the purchaser a feeling of ownership and thus discourage repossessions. For nondurable goods the proportion of the down payment should be even larger. Theoretically, it should be large enough to cover the retailer's cost of doing business and the immediate physical depreciation of the goods. Furthermore, it should not be below a certain absolute amount, especially when purchases are made in small amounts. Thus the down payment may be stipulated as 10 per cent, but not less than $5. In actual practice, all sorts of down payments are used with but a general trend in the direction indicated. On automobiles, for example, it varies from 25 per cent to one-third of the purchase price on new cars, and 40 per cent on used cars. On some of the other articles, the usual down payments are as indicated: 10 per cent on furniture, home furnishings, housewares, refrigerators, oil burners, leather goods, silverware, and radios; 10 to 25 per cent on furs; 20 per cent on women's apparel, stoves, and certain items of furniture; and 25 per cent on men's apparel and automobile tires. Many department stores seem to require a down payment of $5 to $10, others call for 6 to 10 per cent of the purchase price.[1]

Goods to Outlast Time of Payment.—Similarly, the goods sold on the instalment plan should outlast the time of payment or the length of the contract. When the number of instalments is strung out too far, the owner's equity is impaired and the article is worth less than what is owed on it. It is but natural for the customer under such circumstances to let the store repossess the product and thereby relieve him from further responsibility. A definite relationship seems to exist between the average loss on each article repossessed and the number of instalments required to complete payment for the purchase.

It would seem advisable to make buyers pay faster than the goods depreciate, so that their value may at any time exceed the liability of the purchaser. Above all, payments must end before the satisfaction from the goods disappears. The reluctance to pay for an object that has been consumed is too great an obstacle for the average instalment purchaser to overcome. The life of the contract must also be related to the customer's anticipated continuing ability to pay.

In general, long contracts are undesirable. They add to the uncertainty that the goods will at all times exceed in value the amount of the obligation and to the uncertainty of the customer's ability to pay. More capital is required to carry such contracts, the consumer pays more in carrying charges, and the losses from bad debts and repossessions are higher. They may also retard further purchases, even of perishable goods until the contract has been liquidated. A principle suggested by one authority in determining the length of the contract for nondurable

[1] *Ibid.*

or soft goods is that the down payment, the length of the contract, and the frequency of the instalment payments should be so arranged as to result in a collection percentage on this type of business equal to that obtained by the vendor on his regular charge accounts. Thus if a store has a collection percentage of its regular accounts of 50, the same percentage can be obtained on its deferred-payment business through a down payment of 20 per cent and four monthly payments of the balance or through a down payment of one third with five monthly payments of the balance.[1] The reason for this suggestion is that such goods are of the charge-account type and should not be sold on longer terms, lest the store suffer in its accounts-receivable turnover and jeopardize its seasonal business. The same principle naturally applies to the determinations of the down payment and the schedule of payments.

In the case of durable goods, the nature of the merchandise is a primary determinant of the size of the down payment and whether the period within which payments are to be completed should be long or short. Whereas most of the down payments on musical instruments are under 25 per cent of the purchase price, in the majority of cases the down payments on furs are 25 per cent and over. Furthermore, most of the furs are paid for within 6 months but on musical instruments payments are usually made in 12 months and over.

Goods which are of a seasonal nature, even though they may last more than one season, should be paid for during the first season. This applies to such commodities as cameras, hammocks, lawn swings, porch shades and swings, and similar articles. The down payment on such goods is usually about 25 per cent of the purchase price, with all payments to be completed within 3 to 6 months. The same is true of baby carriages, luggage, and the like. On the other hand, a 10 per cent down payment with from 6 to 12 months for the remaining instalments is more than adequate in the sale of such articles as cedar chests, clocks, kitchen cabinets, rugs, and silverware. The length of the contract on certain other goods usually is as follows: 6 to 18 months on automobiles, with an average of 12 months; 10 weekly payments on men's clothing; 6 months on draperies; 2 to 3 years on refrigerators; 9 to 12 months on radios; 12 to 18 months on general furniture; 1 to 2 years on washers and ironers; 12 to 18 months on vacuum cleaners; 1 to 2 years on sewing machines; and 5 to 10 months on fur coats.

Frequency of Instalments or Schedule of Payments.—The dates of payment of the instalments should coincide with the receipt of income by the customer. If the purchaser receives his wages weekly, his instalments should be arranged on a weekly basis. If most of the customers

[1] PHELPS, C. W., "Controlled Installment Credit," Household Finance Corporation, 1937.

buying a certain type of goods such as automobiles receive their income monthly, in the form of salaries, they should be required to pay their instalments monthly. Furthermore, the size of the payment must bear a close relationship to the amount of income which the buyer normally receives and to the frequency of the payments. The shorter the period between instalments, other things being equal, the smaller the amount of each instalment.

Some houses definitely encourage payment by the week. It brings customers to the store more frequently, thus giving the store an opportunity to make additional sales. It is also less burdensome for some people to pay in smaller amounts by the week than in larger sums once a month. Other people look favorably upon the idea because small payments weekly do not seem to disturb their budgets or normal mode of living and financing. Against these advantages must be weighed the tremendous amount of bookkeeping and additional collection effort incident to the weekly payment plan.

Reasonable but Adequate Carrying Charges.—One of the principles in instalment credit is to levy a reasonable but adequate carrying charge. This can be determined on the basis of studies so that each customer will pay his own way. The carrying charge may be expressed either as a percentage or, in the case of small purchases, as a flat amount in dollars and cents, preferably both. Thus it may be stipulated as 12 per cent per annum but not less than $3. It is believed that many vendors, despite the abuses cited in Chap. VII, charge too little for the instalment privilege on the ground that it is a sales builder or because they do not know what it costs them to operate on that basis as compared with regular charge-account business. While a so-called "6 per cent" charge in financing automobiles, which actually amounts to about 11 per cent per annum, may be adequate because of the size of the transaction, on a small purchase of but a few dollars such an annual levy would be altogether inadequate to cover actual costs. Failure to make a reasonable carrying charge may in the short run attract additional business but would cause resentment on the part of regular charge and cash customers who may transfer their business to cash stores or to competitors who make such a charge on instalment purchases; or they may insist on the same privilege of extended payments.

Once ascertained, the carrying charge should be expressed truthfully, as suggested in a previous discussion, not only in amounts but in percentages so that a customer may make comparisons of charges by different vendors. Furthermore, if the balance is paid before maturity, an equitable proportion of the carrying charge should be refunded. To encourage collections, a schedule of refunds can be established and made known to all customers.

Prompt Collections Essential.—It is essential that the vendor insist on compliance with the contract that has been executed at time of sale. When a customer becomes delinquent for a considerable period of time, then he fails to have an equity in the product, since the depreciation of the commodity reduces its value to a point where all equity is wiped out. Under such conditions he will not resent any attempt at repossession. An efficient and effective collection system will keep the percentage of repossessions and, hence, losses due to bad debts down to a minimum. It would prevent a customer, except under certain conditions as when he meets with some unforeseen misfortune, from becoming delinquent or from remaining delinquent over a considerable period of time. It is the practice of some firms and finance companies, even now, never to allow delinquency to extend over a period longer than two monthly instalments. Whether such a rigid practice is advisable will depend largely upon the rate of depreciation or length of life and usefulness of the product, and the extenuating circumstances responsible for the delinquency. According to a study of thousands of accounts, 90 per cent of all instalment customers violating their agreements had never made second payments.[1] This suggests the need for vigorous action if the first or second instalment is missed.

Many difficulties in the collection of instalments will be avoided if due care is exercised in the selection of credit risks and in the construction of the terms of sale. Good collections always begin with good credit extensions. The principles underlying instalment collections in no way differ from those that govern the collection of other past-due accounts, a more detailed discussion of which will be presented in subsequent chapters.

SPECIAL FEATURES OF INSTALMENT CREDIT MANAGEMENT

Form of Contract.—When goods are sold on the instalment plan credit is usually extended over a relatively long period, the goods are of a fairly high unit value, and the purchasers often lack in financial resources. These circumstances increase the danger of default in payments. To minimize losses incident to defaults in payments, two general types of legal devices have been brought into use: the conditional sales contract and the chattel mortgage.

Conditional Sales Contract.—A conditional sales contract provides that the seller retain title to the goods which have been sold and delivered to the purchaser until the full price agreed upon has been paid (see Fig. 59). The buyer does not acquire full right and legal title to the property until he has performed all the conditions of the contract, the title still vesting in the vendor. The property may then be repossessed if and when

[1] *Business Week*, July 31, 1937, p. 1.

any of the terms of the contract are violated.[1] Louisiana is the only state where a conditional bill of sale is not legally recognized.

Sometimes a lease contract is used in the place of a conditional sales contract. The lease provides for the payment of rentals until the full price of the goods is paid, at which time title to the goods passes to the lessee. In case of default in payment of rentals the lessor may repossess the goods, as in the case of any conditional sales contract. In fact, leases of this kind have been held by the Federal Courts and by the courts of 29 states and of the District of Columbia to be in every respect conditional sales contracts.[2] The same applies to "agreements to purchase" occasionally used in connection with instalment transactions.

The X Department Store

STORE No.

DEFERRED PAYMENT ACCOUNT—CONDITIONAL SALES ACCOUNT

DESCRIPTION OF MERCHANDISE ..... 19.....

..... Total Value $

..... Down-Payment $

..... Balance $

Carrying Charges at.....% per month for..... .....month to..... 19..... $

APPROVED BY	DATE

Net Total $

I hereby agree to pay the NET TOTAL above at $

per.....on the.....day of each.....at the Company's office, until the whole amount is paid.

Receipt of the above merchandise is hereby acknowledged. Said merchandise shall remain the property of The X Department Store until paid for in full (and shall not be removed from present residence of the undersigned without the written consent of the Company). In case of removal without such consent, or in case default of any payment shall continue for thirty (30) days, the entire balance shall become due, and the Company shall be entitled to take possession of the merchandise without legal process and to retain all prior payments as rentals for the use of the equipment while in the possession of the undersigned

No allowances, agreements or deviations (from prices shown hereon) not stated on this order are binding nor will they be recognized.

Make Checks, Drafts or Money Orders Payable to
THE X DEPARTMENT STORE

Address.....

Signed.....City.....Phone.....

Form 110-100 Pads-2 29-14828

FIG. 59.—Form of conditional sales contract.

Chattel Mortgage.—Under a purchase-money chattel mortgage, the legal title to the goods involved passes to the buyer at the time of the sale. At the same time the buyer conveys or transfers the title back to the vendor, on the condition that such title will again revest in the buyer when he has complied with the provisions of the mortgage. In some jurisdictions it is held that the mortgagee merely obtains a lien and that title still vests in the buyer. In case of default in payment of any of the instalments, the lien may be foreclosed; *viz.*, the goods may be recovered and disposed of as provided by the law of the state involved. Unless one is required by statute, no special form is necessary for a chattel mortgage (see Fig. 60).

[1] For further information on this subject and for forms of conditional sales contracts and chattel mortgages, see the "Credit Manual of Commercial Laws, 1937," the National Association of Credit Men, pp. 102–109, 539–543.

[2] *Ibid.*, p. 111.

Choosing the Form of Contract.—The most significant factor in determining whether to use a conditional sales contract or a chattel mort-

20 Main Street. Phone 1477

Four Months Time Same as Cash

Warren, Ohio ..... .192.....

The undersigned:

.....

Of the County of ..... State of Ohio, having the absolute and unqualified title to the following described personal property, to-wit:

DATE	QUAN	NO.	ARTICLE			CREDITS		BALANCE	

Located at ..... St. Ave. ....., Ohio

hereby sells, mortgages and transfers the same to doing business as , to have and to hold unto himself, his administrators and assigns.

PROVIDED NEVERTHELESS, that if said ..... (hereinafter called "Mortgagor") shall pay the said (hereinafter called "mortgagee") the sum of $....., the unpaid balance of the purchase price of said property, in ..... installments of $..... each on the ..... day (s) of each month until the full amount is paid, then this mortgage is to be void, otherwise to remain in full force and effect.

Said mortgagor further covenants that on default of payment of any of said installments, upon any misuse, sale or attempt to sell or remove from the premises where now located, or upon any seizure by any process of law of any of said property or if said mortgagee shall at any time before the debt becomes due, deem said claim insecure; then said mortgagee or his assigns may take said property into his possession and dispose of the same at public or private sale and deduct from the proceeds the expenses of such sale and the principal amount and interest then due on said claim, rendering the surplus money, if any, to said mortgagor; otherwise the property is to remain in the peaceable possession of said mortgagor.

Signed: .....

Witness:

Signed: .....

.....

FIG. 60.—Form of chattel mortgage.

gage lies in the provisions of the law with respect to these devices operative in the state or states in which the vendor is doing business. The

laws with regard to filing and recording, conditions of repossession, and other provisions may be such as to make one of the devices more convenient to use than the other, even though it may prove more expensive as far as fees are concerned or afford somewhat less protection than the alternative device.

The chattel mortgage instrument is superior in that other property, in addition to the goods sold, may, by agreement, be covered in the lien or mortgage. Ordinarily, in case of default in payment under the chattel mortgage the goods may be repossessed and sold at public or private sale as provided in the mortgage, and, if the proceeds are insufficient to cover the debt, the mortgagee may sue and obtain a deficiency judgment for the unrecovered balance. If more is recovered from the sale, however, the balance in excess of the indebtedness and the expenses incurred must be paid to the mortgagor.

While there is a high degree of uniformity in the various states with regard to the proper use of chattel mortgages, the rights and remedies of the seller under the conditional sales contract vary considerably in the different states. Where no statute law governs the conditional sales contract, the vendor may either sue to collect payment, in case of default, or he may retake possession of the goods. In the former instance, however, the vendor waives title and is estopped thereafter from recovering the property under the conditional sales contract. This feature as well as other points of law in connection with conditional sales contracts have been modified in many states by statute.[1]

Operation of Instalment Plan Illustrated.—The following illustration is deemed typical of the way in which department stores and many specialty shops operate in selling goods on deferred payments. The department store in question allows customers to purchase under its deferred-payment plan furniture, electric washers, irons, vacuum cleaners, rugs, carpets, victrolas, radios, refrigerators, kitchen cabinets, stoves, sewing machines, fur coats, and practically all other items of home furnishings. Chinaware, bedding, silverware, lamps, draperies, linoleums, wall paper, and window shades may be so purchased only when bought in conjunction with some of the items previously enumerated and when the latter represent but a small part of the entire purchase.

Every applicant is interviewed, an application is filled out, and the risk is investigated, although in many instances no exhaustive investigation is needed because the applicants are regular charge customers in the

[1] For a more comprehensive treatment of the subject, see H. W. Cordell, "Instalment Credit in the Retail Furniture Trade"; the "Credit Manual of Commercial Laws," National Association of Credit Men; and M. W. Adelson, "The Mechanics of the Instalment Credit Sale," *Law and Contemporary Problems*, School of Law, Duke University, April, 1935.

store. A minimum purchase of $25 is required except on special items offered from time to time. The down payment varies with the type of merchandise and the amount of the transaction and ranges from 10 to 25 per cent. The number of payments or length of the contract also varies with these two factors. Fur coats are sold on terms of from 4 to 12 months, but when a complete set of furniture is bought long terms may be arranged running up to 2 years. Weekly payments are arranged if deemed suitable, although most customers pay by the month. A carrying charge of 0.75 per cent per month is added to the purchase price less the down payment, for the entire length of the contract. If a customer pays the account within 60 days, the total carrying charge is remitted and if he pays in advance he is credited with the proportionate amount for the remaining period. The store uses a conditional sales contract, which accompanies the promissory note signed by the purchaser. If additional purchases are made, an "add-on" agreement is executed. In case of default, the store may repossess the goods without any legal process since it is the legal owner, but usually makes every effort to have the goods stay sold. An additional carrying charge is made if payment is not completed within the specified time.

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Questions and Problems

1. "Articles of an ephemeral nature should not be sold on the instalment plan." Is this sound? State your reasons.

2. Inasmuch as vendors ordinarily retain a lien on the goods they sell, is it necessary that they investigate the credit standing of their customers?

3. Can you show good reasons why a more careful investigation should be made of instalment credit purchasers than of purchasers on ordinary charge accounts?

4. What elements characterize a reasonable down payment?

5. What relation, if any, is there between the size of the down payment and repossessions? How do you explain it?

6. Account for the fact that pianos are sold on terms as long as 3 years, while rugs are ordinarily sold on terms of 6 months. What principle is used in making this differentiation?

7. Under what circumstances would you recommend that payments be made weekly? Monthly? May it ever be advisable to have payments made quarterly?

8. What are the essential differences between a chattel mortgage and a conditional sales contract?

9. Is it necessary to bring suit against a customer in order to repossess the goods sold to him on a conditional sales contract, when the terms of the contract are violated? If not, what steps must be taken to recover the goods?

10. A took possession of an article with the understanding that at the end of 30 days he was either to remit the cash price to the vendor or return the article. Is this a conditional sale? If not, what kind of sale is it and in whom does the title vest at time of purchase? Explain.

CHAPTER XXVI

OPERATIONS OF FINANCE COMPANIES—SALES AND PERSONAL

Essentially, finance companies are of two distinct types—sales and personal. The position which each type occupies in our credit structure has already been shown in Chap. V. In this chapter an attempt will be made to discuss the subject from the standpoint of internal operation and management.

Sales and personal finance companies are similar in that both types perform a financial function, both have developed largely since the World War, and to a certain extent both meet competition from the same sources, *viz.*, from commercial and industrial banks. The differences are greater, however, than the similarities. First, they differ in scope of activity. Most sales finance companies, commonly referred to as automobile finance or discount companies, although they may also handle paper arising from the sale of other products, finance the dealer on his purchases as well as the ultimate consumer who buys the goods from the dealer. Personal finance companies, on the other hand, deal only with consumers. Second, even in the consumer area the purpose of the former type is to facilitate the purchase, on the part of consumers, of costly commodities for which payment in a lump sum or on an ordinary charge-account basis cannot be made at all or is not convenient. In borrowing from a personal finance company, the consumer is usually forced to pay debts already contracted. Thus there is also frequently a difference in motive. In the first instance, the consumer wishes to raise his standard of living or to improve his lot, while in the second case he is forced by pressing creditors to ask the finance company for a loan.

Third, there is a vast difference in the size of the average transaction. The average loan from personal finance companies is around $150 to $175. The average loan from a sales finance company—especially when financing the purchase of an automobile, a heating plant, an air-conditioning unit, or even a refrigerator—is from twice to several times as high. Fourth, the principal security taken by a sales finance company is a chattel mortgage or a conditional sales contract, whereby the article financed can be repossessed. In the majority of cases the personal finance company secures the loan by a chattel mortgage on the borrower's furniture and other household goods, a type of security which

can seldom be taken in payment of the loan without incurring serious ill will in the community. Furthermore, a substantial percentage of the loans are entirely unsecured but are made on the signature of the borrower. Thus the risk assumed by personal finance companies is much greater.

Fifth, the risk of personal loans is further enhanced by the length of life of the average indebtedness of borrowers. On loans of more than $50 repayment of a loan is ordinarily allowed over a period of 20 months. Since many loans are renewed or additional amounts are borrowed before the first indebtedness is fully repaid, the average life of a borrower's indebtedness exceeds two years. This is a much longer period than is required, on the average, for the liquidation of a debt on merchandise bought on the instalment plan.

Sixth, largely on account of the above differences, the rates charged by the two types of institutions vary considerably, being more than twice as high in the case of personal finance companies, as will be shown later in the chapter. Finally, the personal finance business is subject to strict government supervision and regulation. No less than 26 states have already enacted legislation modeled after the Uniform Small Loan Law and several others have special laws governing the operations of companies in this field. Very little or no regulation of this type has so far been applied to the business of sales finance companies.

SALES FINANCE COMPANIES

A Typical Sales Finance Office.—Naturally, the organization of the offices operated by the different finance companies varies in some respects. On the whole, however, there is a high degree of uniformity and the differences are usually slight. A typical office is headed by a manager who supervises the work of the branch or office including passing on purchaser and dealer credits above certain brackets, routine office operations, bookkeeping, correspondence, collections, and adjustments. In some cases, a credit and collection manager is employed whose duty it is to pass on consumer and dealer credits up to a certain stipulated sum and to handle all collections. An outside sales manager or solicitor, usually coordinate with the credit and collection manager, to secure dealers' accounts is another member of the office staff. If a given make of automobile is financed through a single company, as in the case of Ford Automobiles which are financed through the Universal Credit Company, a former Ford subsidiary, the solicitor or outside sales manager's services can be dispensed with.

One or more adjusters or outside representatives are generally employed in a sales finance company office. It is their duty to investigate

delinquent accounts, make reports on them, and attempt to effect adjustments. This kind of individual is an important member of the personnel, for it is to him that the company looks for a future credit and collection manager, new business solicitor, or branch manager. Furthermore, he is the one who meets the customer under rather adverse circumstances. He must therefore be a man of considerable tact, friendly disposition, and supported by a good education. The last is essential for accuracy and speed in making various computations, such as interest rates and refunds. Above all, the outside man must be a good salesman. The product which the finance company has to sell at this stage is rather intangible; it is a desire on the part of the customer to maintain his credit standing. To do this it may be necessary to aid the delinquent through constructive changes in his budget, to help him find out where his money has gone, and to suggest ways in which his expenditures could be handled more efficiently. In a word, it is his task to collect or adjust the many delinquent accounts assigned to him without losing any of the customers' good will.

A clerk, stenographer, and accountant, who perform the office work and care for the files, complete the organization. Among the files maintained may be one for dealers' work sheets, one for mortgage or other contract duplicates, one for insurance policies, and one or more collection follow-up files.

Wholesale Financing.—Many of the sales finance companies purchase open accounts receivable, notes, and instalment lien obligations from manufacturers and distributors, in addition to financing the purchase by consumers of all sorts of articles. They also finance the purchase by dealers and distributors of merchandise, machinery and equipment, store and office fixtures, and the like. This is normally regarded as wholesale financing and may best be illustrated from the automobile field. The manufacturer of automobiles usually insists upon cash payment on delivery of his products to the dealer. This is done through a sight draft drawn on the dealer and payable by him on receipt of the goods. From the banker's point of view, automobile dealers have not been regarded as satisfactory risks for large loans. The banker's standards of credit are too strict as to size and length of maturity of the loan to be of much service to the average dealer. Then, too, most dealers wish to repay their loans in instalments, which many commercial banks do not like. The problem of securing the necessary capital to finance the inventories was particularly acute during the depression years when banks adopted an even stricter policy than formerly prevailed. So the dealer turned more and more to the sales finance company for assistance. Consequently, in 1935 no less than 74 per cent of the wholesale value of motor vehicles produced in the United States was financed in this manner,

representing 121 per cent of retail car financing through such institutions.[1] This does not mean, however, that more money was tied up in wholesale than in retail financing, because automobile wholesale financing notes are paid off on an average of 6 or 7 weeks, while the average maturity of retail instalment notes is something more than a year.

Under the ordinary wholesale or "floor" plan of financing, the dealer acquires the new cars, stores them in a warehouse or displays them in his showrooms, and executes a trust receipt for the benefit of the finance company. In this wise, the dealer remains in possession of the merchandise, which he can display and attempt to sell, but does not have legal title to it. Such title vests in the finance company, the dealer merely holding the goods in trust. The promissory note or trade acceptance given by the dealer may be secured by a warehouse receipt, a chattel mortgage, or some other type of wholesale lien instrument instead of the trust receipt.

When a sale is made, the proceeds must be immediately turned over to the finance company before the car can be moved off the floor. The amount loaned seldom exceeds 90 per cent of the invoice price of the article. Interest charged on such loans approximates 0.5 per cent per month, since the risk is comparatively small and the turnover of such loans fairly rapid.

Financing Purchases by Consumers.—Upon consummation of a sale, the dealer used to receive signed notes from the purchaser who agreed to pay the amount involved, in fractional sums at stated intervals. The notes were secured by a chattel mortgage or by a conditional sales contract. The dealer then borrowed from the finance company on the strength of these notes, when properly endorsed. Many dealers still operate in this fashion, especially in the financing of sales of commodities other than automobiles. For the most part, however, a separation of functions has taken place. Instead of financing the automobile dealer, finance companies today deal with the individual consumer, accepting or rejecting him as a credit risk on the basis of their own investigation.

Agreements with Dealers to Finance Retail Contracts.—The majority of the sales finance companies have no relations with the manufacturers of the products they finance. It is all subject to an agreement with the dealer to have his sales to consumers handled by a given finance company. It is for this purpose that finance companies employ solicitors or outside sales managers. In some cases, the finance company is intimately connected with the manufacturer and virtually forms a part of the latter's organization. Such is practically the case with some of the largest companies.

[1] AYRES, M. V., "Time-Sales Financing," the National Association of Sales Finance Companies, April, 1936.

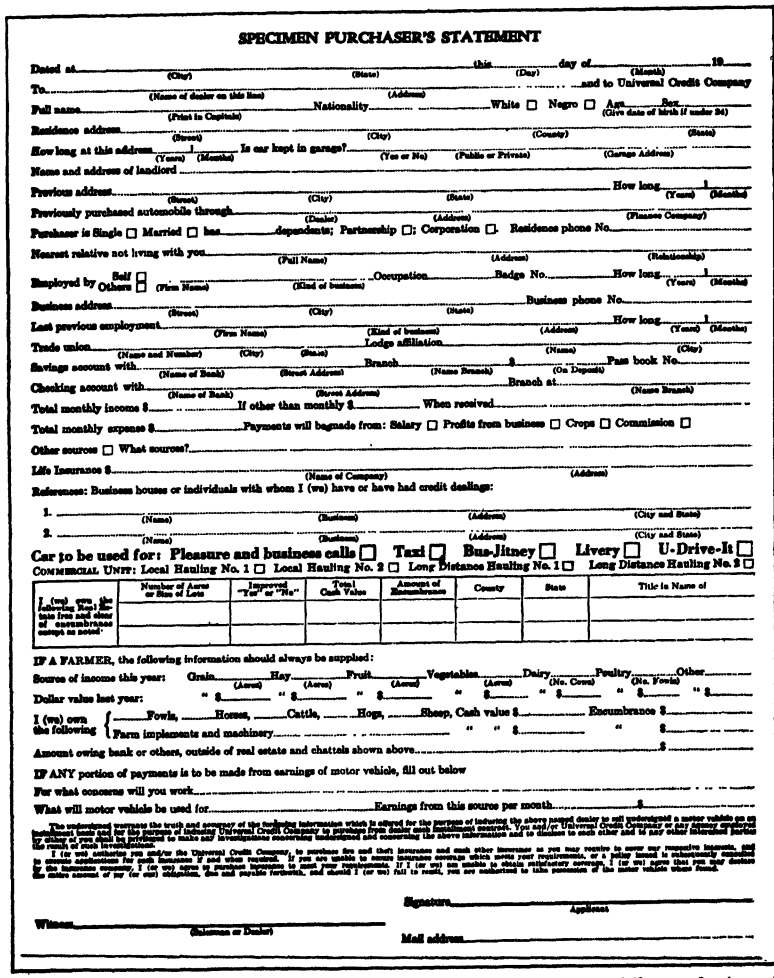
Of the more than 500 sales finance companies, four are generally considered national companies or the "big three" (Universal Credit Company, though retaining its identity, was acquired in 1933 by the Commercial Investment Trust Corporation) and the remainder are denominated local or independent companies although some of them operate a number of offices and may cover two or more states. All of the big three have direct factory connections. General Motors Acceptance Corporation is entirely owned by the General Motors Company and handles its products exclusively. In the case of the Universal Credit Company, formerly a Ford subsidiary, all Ford dealers have been required by the manufacturer to have their instalment sales financed through the designated company, unless a dealer could finance through another company at lower rates in which case he could secure the approval of the manufacturer. Commercial Credit Company, among other things, has been specializing in financing the sales of Chrysler cars. In the other cases, a finance company would handle only the products of certain manufacturers, provided that the dealer is acceptable to the finance company. In such instances there is no agreement with the producer. Instead, a contract must be entered into separately with each dealer and the agreements vary with the credit standing of the dealer, the type of product he sells, and its usual resale value.

The direct connection which the national finance companies have with certain automobile producers means that most of the business of the giant finance companies is secured without much active solicitation. It also gives them access to cheaper money than is available to the so-called independent finance companies, funds being borrowed sometimes at rates as low as 1 per cent per annum. Finally, most of the paper purchased by them is either indorsed with recourse to the dealer or the latter agrees to repurchase the repossessed car, thereby reducing the risk to a minimum.[1]

Of course, several different kinds of inducements are offered to dealers when they are required by the producer to handle their business through a given finance company. Since such a finance company does not generally serve competitors, it has an interest in the sale of the particular product it finances and thus many times helps dealers to effect more sales. It usually provides a special dealer reserve which is not made available to dealers in other products who may also be financed by the same company. These are often termed "bounties" or "kickbacks."

[1] For a more detailed discussion of this phase of the subject see: "Instalment Selling: The Real Situation," *Business Week*, November 13, 1937, pp. 46–53; also H. B. Dyer: "The Personal Finance Company in the Automotive Discount Field," 1937 Personal Finance & Industrial Banking Symposium, pp. 43–59.

For about a year and a half the United States Department of Justice has been gathering evidence against the Ford Motor Company, General Motors, and the Chrysler Corporation, involving alleged agreements requiring dealers to finance exclusively through specified companies.



SPECIMEN PURCHASER'S STATEMENT

Dated at ..... (City) ..... (State) ..... this ..... (Day) ..... day of ..... (Month) ..... 19....

To ..... (Name of dealer on this line) ..... (Address) ..... and to Universal Credit Company

Full name ..... (Print in Capitals) ..... Nationality ..... White ☐ Negro ☐ Age ..... Sex ..... (Give date of birth if under 24)

Residence address ..... (Street) ..... (City) ..... (County) ..... (State)

How long at this address ..... (Years) ..... (Months) Is car kept in garage? ..... (Yes or No) ..... (Public or Private) ..... (Garage Address)

Name and address of landlord .....

Previous address ..... (Street) ..... (City) ..... (State) ..... How long ..... (Years) ..... (Months)

Previously purchased automobile through ..... (Dealer) ..... (Address) ..... (Finance Company)

Purchaser is Single ☐ Married ☐ has ..... dependents; Partnership ☐; Corporation ☐. Residence phone No. .....

Nearest relative not living with you ..... (Full Name) ..... (Address) ..... (Relationship)

Employed by Self ☐ Others ☐ ..... (Firm Name) ..... (Kind of business) ..... Occupation ..... Badge No. ..... How long ..... (Years) ..... (Months)

Business address ..... (Street) ..... (City) ..... (State) ..... Business phone No. .....

Last previous employment ..... (Firm Name) ..... (Kind of business) ..... (Address) ..... How long ..... (Years) ..... (Months)

Trade union ..... (Name and Number) ..... (City) ..... (State) ..... Lodge affiliation ..... (Name) ..... (City)

Savings account with ..... (Name of Bank) ..... (Street Address) ..... Branch ..... $ ..... (On Deposit) ..... Pass book No. .....

Checking account with ..... (Name of Bank) ..... (Street Address) ..... Branch at ..... (Name Branch)

Total monthly income $ ..... If other than monthly $ ..... When received .....

Total monthly expense $ ..... Payments will be made from: Salary ☐ Profits from business ☐ Crops ☐ Commission ☐

Other sources ☐ What sources? .....

Life Insurance $ ..... (Name of Company) ..... (Address)

References: Business houses or individuals with whom I (we) have or have had credit dealings:

1. ..... (Name) ..... (Business) ..... (Address) ..... (City and State)

2. ..... (Name) ..... (Business) ..... (Address) ..... (City and State)

Car to be used for: Pleasure and business calls ☐ Taxi ☐ Bus-Jitney ☐ Livery ☐ U-Drive-It ☐

COMMERCIAL USE: Local Hauling No. 1 ☐ Local Hauling No. 2 ☐ Long Distance Hauling No. 1 ☐ Long Distance Hauling No. 2 ☐

	Number of Acres or Size of Lots	Improved "Yes" or "No"	Total Cash Value	Amount of Encumbrance	County	State	Title in Name of
I (we) own the following Real Estate free and clear of encumbrance except as noted:							

IF A FARMER, the following information should always be supplied:

Source of income this year: Grain ..... (Acres) Hay ..... (Acres) Fruit ..... (Acres) Vegetables ..... (Acres) Dairy ..... (No. Cows) Poultry ..... (No. Fowls) Other .....

Dollar value last year: " $ ..... " $ ..... " $ ..... " $ ..... " $ ..... " $ ..... " $ .....

I (we) own the following { ..... Fowls, ... Horses, ... Cattle, ... Hogs, ... Sheep, Cash value $ ..... Encumbrance $ ..... Farm implements and machinery ..... " " $ ..... " $ .....

Amount owing bank or others, outside of real estate and chattels shown above ..... $ .....

IF ANY portion of payments is to be made from earnings of motor vehicle, fill out below

For what concerns will you work .....

What will motor vehicle be used for ..... Earnings from this source per month ..... $ .....

The undersigned guarantees the truth and accuracy of the foregoing information which is offered for the purpose of inducing the above named dealer to sell undersigned a motor vehicle on an installment basis and for the purpose of inducing Universal Credit Company to purchase from dealer such installment contract. You and/or Universal Credit Company or any agency operating by authority of you shall be privileged to make any investigations concerning undersigned and concerning the above information and to disclose to each other and to any other interested parties the result of such investigations.

I (or we) authorize you and/or the Universal Credit Company, to purchase fire and theft insurance or you may receive in your own respective interests, and to execute endorsement for such insurance if and when received. If you are unable to secure insurance coverage which meets your requirements, or a policy issued is subsequently cancelled by the insurance company, I (or we) agree to purchase insurance to meet your requirements. If I (or we) am unable to obtain satisfactory coverage, I (or we) agree that you may declare the entire amount of my (or our) obligation, due and payable forthwith, and should I (or we) fail to remit, you are authorized to take possession of the motor vehicle where found.

Signature ..... Applicant

Witness ..... (Salesman or Dealer)

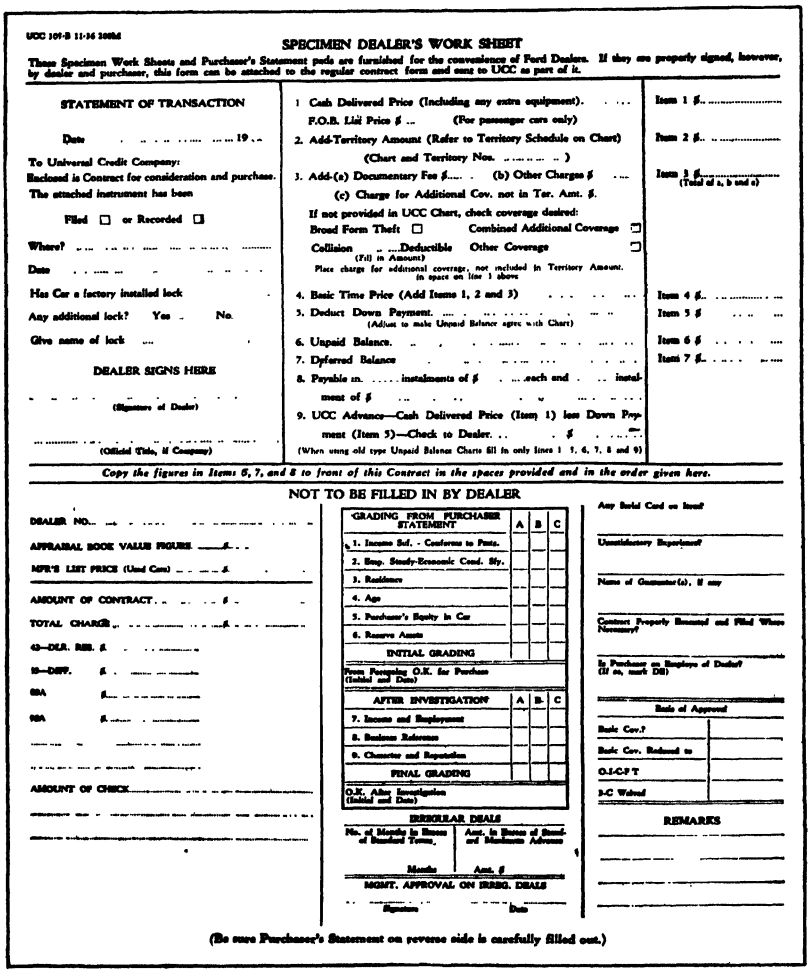
Mail address .....

FIG. 61*A*.—Application by a consumer for the purchase of an automobile on the instalment plan.

Both dealers and independent finance companies lodged complaints against this practice which is held to be in violation of the anti-trust laws. It is quite likely that a consent decree to cease and desist from such practices will settle the matter, although a Federal grand jury at Milwaukee had been investigating the violation until it was discharged

because of interference with the case on the part of the Department of Justice.[1]

Making the Loan.—The usual procedure in making a loan so that he may purchase the desired automobile is to have the consumer fill out an



SPECIMEN DEALER'S WORK SHEET

These Specimen Work Sheets and Purchaser's Statement pads are furnished for the convenience of Ford Dealers. If they are properly signed, however, by dealer and purchaser, this form can be attached to the regular contract form and sent to UCC as part of it.

STATEMENT OF TRANSACTION

Date . . . . . 19 . .

To Universal Credit Company:
Enclosed is Contract for consideration and purchase. The attached instrument has been

Filed ☐ or Recorded ☐

Where? . . . . . .

Date . . . . . .

Has Car a factory installed lock

Any additional lock? Yes . No.

Give name of lock . . .

DEALER SIGNS HERE

. . . . . .
(Signature of Dealer)

. . . . . .
(Official Title, if Company)

1 Cash Delivered Price (Including any extra equipment). . . . . Item 1 $. . . . . .
F.O.B. List Price $ . . (For passenger cars only)

2. Add-Territory Amount (Refer to Territory Schedule on Chart) Item 2 $. . . . . .
(Chart and Territory Nos. . . . .)

3. Add-(a) Documentary Fee $. . . . (b) Other Charges $ . . . Item 3 $. . . . . .
(c) Charge for Additional Cov. not in Ter. Amt. $. (Total of a, b and c)
If not provided in UCC Chart, check coverage desired:
Broad Form Theft ☐ Combined Additional Coverage ☐
Collision . . . .Deductible Other Coverage ☐
(Fill in Amount)
Place charge for additional coverage, not included in Territory Amount, in space on line 1 above

4. Basic Time Price (Add Items 1, 2 and 3) . . . . . Item 4 $. . . . . .

5. Deduct Down Payment. . . . . Item 5 $ . . . .
(Adjust to make Unpaid Balance agree with Chart)

6. Unpaid Balance. . . . . Item 6 $ . . . . .

7. Deferred Balance . . . . . Item 7 $. . . . . .

8. Payable in. . . . . instalments of $ . . . each and . . . instalment of $ . . . . . .

9. UCC Advance—Cash Delivered Price (Item 1) less Down Payment (Item 5)—Check to Dealer. . . . $ . . . .
(When using old type Unpaid Balance Charts fill in only lines 1 1, 6, 7, 8 and 9)

Copy the figures in Items 6, 7, and 8 to front of this Contract in the spaces provided and in the order given here.

NOT TO BE FILLED IN BY DEALER

DEALER NO. . . . . .
APPRAISAL BOOK VALUE FIGURE . . . . $. . .
MFR'S LIST PRICE (Used Cars) . . . . . $. . .
AMOUNT OF CONTRACT . . . . . $ . .
TOTAL CHARGE . . . . . $. . . .
43—DLR. RES. $ . . . . . .
19—DEPT. $ . . . . . .
69A $. . . . . .
98A $. . . . . .
. . . . . .
. . . . . .
AMOUNT OF CHECK . . . . . .

GRADING FROM PURCHASER STATEMENT	A	B	C
1. Income Sol. - Conforms to Pmts.			
2. Emp. Stndy-Economic Cond. Hy.			
3. Residence			
4. Age			
5. Purchaser's Equity in Car			
6. Reserve Assets			
INITIAL GRADING			
From Foregoing O.K. for Purchase (Initial and Date)			
AFTER INVESTIGATION	A	B	C
7. Income and Employment			
8. Business Reference			
9. Character and Reputation			
FINAL GRADING			
O.K. After Investigation (Initial and Date)			

IRREGULAR DEALS

No. of Months in Excess of Standard Terms	Amt. in Excess of Standard Maximum Advance
Months	Amt. $

MGMT. APPROVAL ON IRREG. DEALS

. . . . . Date

Any Serial Card on Hand?
. . . . . .
Unsatisfactory Experience?
. . . . . .
Name of Guarantor(s), if any
. . . . . .
Contract Properly Executed and Filed Where Necessary?
. . . . . .
Is Purchaser an Employee of Dealer? (If so, mark DE)
. . . . . .
Basis of Approval
Basic Cov.?
Basic Cov. Reduced to
O.I.C.P.T
I-C Waived

REMARKS
. . . . . .
. . . . . .
. . . . . .
. . . . . .

(Be sure Purchaser's Statement on reverse side is carefully filled out.)

FIG. 61*B*.—The automobile dealer's work sheet, on reverse side of the application on Fig. 61*A*.

application, giving in complete detail information concerning his status, source of income, and use to which the car is to be put (see Fig. 61*A*). The application is signed and witnessed by the salesman or dealer. At the same time, the dealer fills out a work sheet that contains a full statement of the transaction and terms of the sale, showing also the amount

[1] *The Columbus Citizen*, November 23, 1937.

which the finance company is to deliver to the dealer if the deal is approved (see Fig. 61*B*). The usual contract is prepared, which may be a chattel mortgage on the vehicle or a conditional sales agreement (see Figs. 59 and 60), and a negotiable promissory note is executed by the purchaser

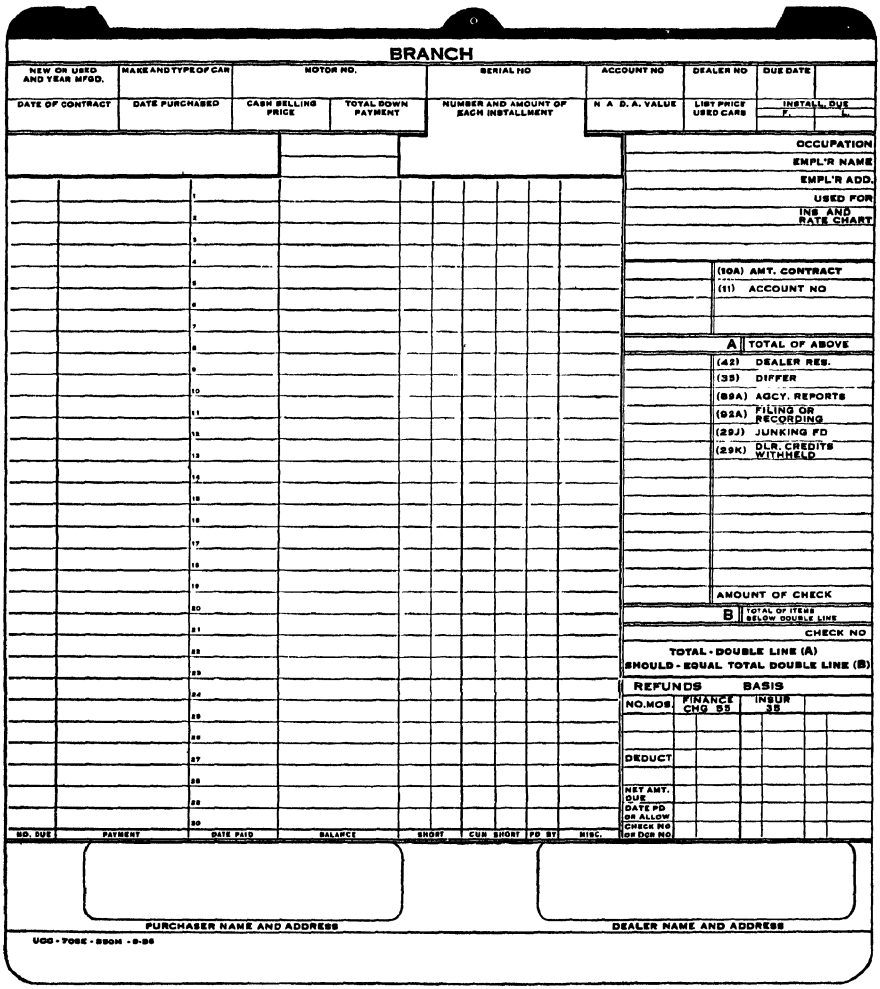


FIG. 62.—Sales finance company office record for each transaction until final payment is made.

which specifies the number of instalments and the amount of each payment. All of these documents are then turned over to the finance company. The risk is then investigated through the dealer's salesman and through reports from a credit bureau or agency, references are cleared including the purchaser's bank, and all other pertinent information concerning the risk is obtained from court records and other sources. A

summary of the results is made on the dealer's work sheet and the decision rendered is recorded thereon. If the transaction is approved, the account is opened, and a record for the customer is established, as shown in Fig. 62. The chattel mortgage or the conditional sales contract, as the case may be, is placed in the credit folder where all papers bearing the customer's signature are kept. A copy of the contract is filed with the proper court, one copy is retained in the files of the dealer, one in the files of the finance company, and one copy is given to the purchaser. At the same time the finance company notifies the consumer that his note has been purchased, advises him of the insurance coverage, and supplies him with a book of coupons indicating payment dates and the amount of each payment.

Collecting the Instalments.—Consumers usually make their payments at the office of the finance company, and their accounts are credited accordingly. When the final payment is made, the original copy of the chattel mortgage or sales agreement is returned to the purchaser and the duplicate original filed at the court is canceled. If the customer defaults on a payment, his record is tabbed, and a form letter is usually sent inquiring whether a coupon book has been given to the customer, reason for default, etc. Upon failure to receive payment or a reply in 3 or 4 days, notices similar to those shown in Fig. 63 are sent. Some finance companies have a series of three, others of four, such notices, which are ordinarily sent at intervals of 3 or 4 days.

If the notices fail to produce results, the account is classed as delinquent and placed in the follow-up file. At regular intervals, usually every 3 or 4 days, depending upon the policy of the company, the credit and collection manager refers to it and takes the necessary collection steps by correspondence, making one appeal after another. If no reaction is obtained as a result of these communications, a field representative or adjuster may be directed to make a personal call on the delinquent and report on the case. If a satisfactory adjustment is not effected during this call, the credit manager may, on the basis of the report, attempt to straighten out the account through further correspondence or a personal interview. If no satisfactory results can be obtained, the car is repossessed. In practically all cases the dealer is kept informed of delinquencies through a list furnished him at stated intervals.

Handling Repossessions.—The customer's promissory notes, which are handed over to the finance company by the dealer, may be indorsed with or without recourse. If the former obtains, the dealer himself may repossess the car on order from the finance company, or else the repossessed car is turned over to him by the company and the dealer is required to pay the balance due, less rebates allowed for finance and insurance charges for the unexpired period. He then reconditions

COMMERCIAL CREDIT COMPANY

SECOND PAST DUE NOTICE

SPECIAL NOTICE

PLEASE GIVE ATTENTION NOW

The Contract You Signed Is Now In Default. Unless Immediate Remittance Is Received By Us For Amount Shown Below, Charges And Expenses Will Accrue.

Buyer _____ PAST DUE SINCE _____

Address _____ AMOUNT OF PAYMENT $_____

_____ INTEREST & EXPENSES $_____

Dealer _____ TOTAL AMOUNT DUE $_____

Mail Today Your Remittance For Total Amount Owing Shown Above Returning This Notice with Your Payment. This Requires Your Immediate Attention. Do It Now.

FORM 501. PRINTED IN U. S. A. (READ REVERSE SIDE CAREFULLY)

FINAL NOTICE

Important!

Account and Dealer No._____

Payment was due on_____

Amount Past Due_____

Past Due Charge_____

Total Past Due_____

This is the *fourth notice* that we have sent you in connection with this past due payment. Under the terms of your contract we reserve the right to declare the full outstanding amount due and payable. Send your remittance at once, so that it will not be necessary for us to have to proceed further.

UNIVERSAL CREDIT COMPANY

GENERAL MOTORS ACCEPTANCE CORPORATION

TREASURER'S NOTICE

Amount Past Due $.....

.....

Date Due .....

Account No. .....

Dealer .....

Our records indicate we have not received the payment due as above. If you have not already remitted, will you please take care of this TODAY? Thank you. If your remittance is now in the mail, please disregard this notice.

4 36 *For PROPER IDENTIFICATION, return this slip or regular payment coupon with your remittance*

FIG. 63.—Collection notices in general use by sales finance companies during the early stages of delinquency.

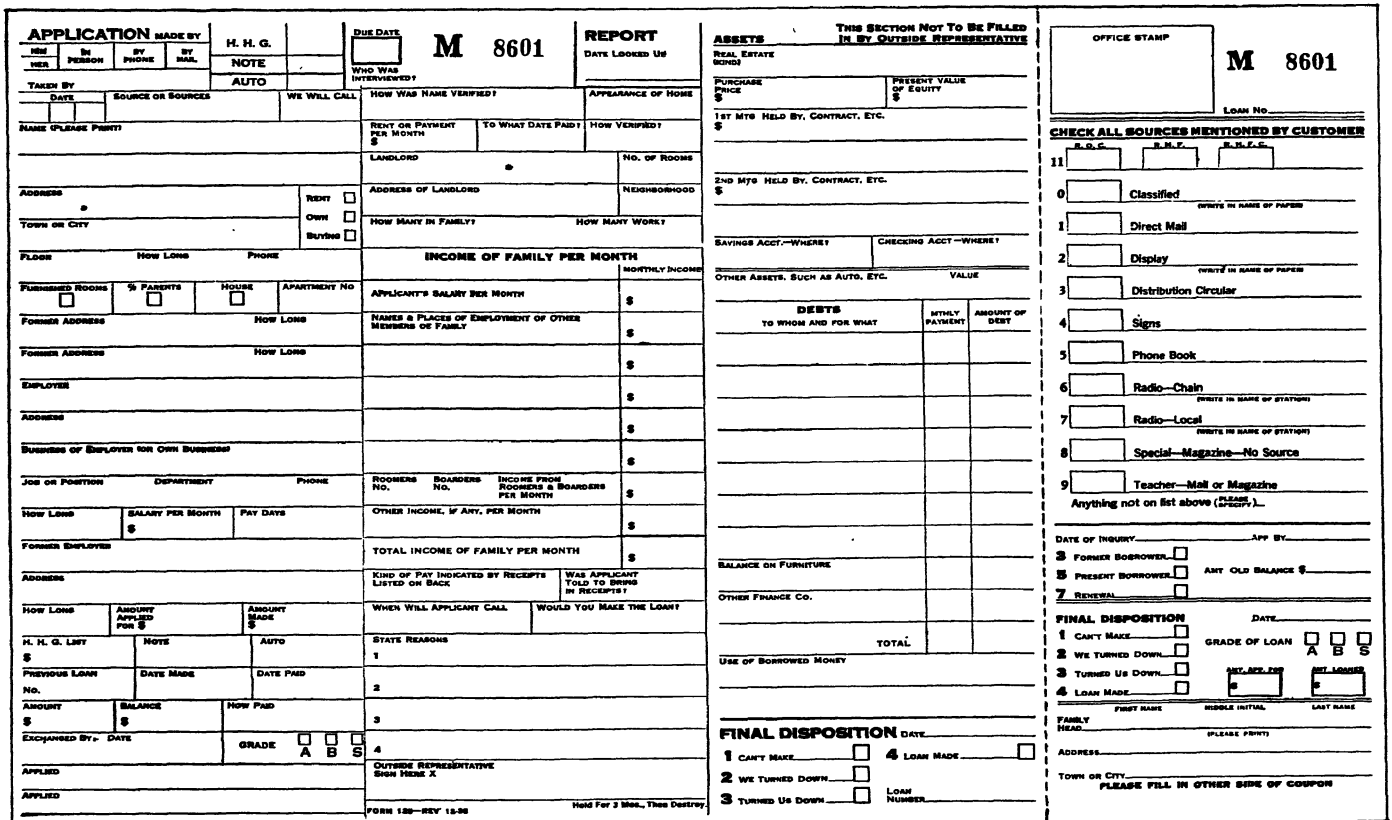
and sells the car, retaining all proceeds for himself. Under the non-recourse plan, the repossessed car remains in the hands of the finance company, which must assume full responsibility for the uncollected amount and the reconditioning and resale of the vehicle. A third plan, known as the repurchase system, has developed, whereby the finance company has no recourse to the dealer but enters into an agreement with him to repurchase from the finance company the repossessed product. This relieves the finance company from handling used cars in competition with the dealers whose car sales it finances and obviates the necessity for maintaining garages, repair and sales personnel and equipment.

In connection with the recourse plan of financing, a number of finance companies are attempting to protect the dealer against losses by special dealer reserves. In the first place, the company usually agrees to recover the car for the dealer free and clear of encumbrances, and the car must be delivered to the dealer's place of business. The dealer reserve is accumulated from amounts set aside out of the finance charges collected from customers. It ordinarily amounts to about 1½ per cent on the amounts advanced on new cars and approximately 5 per cent on amounts advanced on used cars. The reserve is set up on the books of the finance company and, when it is declared earned, is paid to dealers in good standing. Payments are made periodically so that the dealer may be reimbursed on repossessions from two regular sources, the resale of the car and the accumulated dealer reserve.

PERSONAL FINANCE COMPANIES

A Typical Small-loan Office.—A personal finance company office is normally located on an upper floor of a modern office building in or near a shopping district. Such location makes it conveniently accessible to large numbers of borrowers and affords the customer a certain degree of privacy. In some states, as in Ohio, there is a definite trend toward ground floor locations. The arrangement of the office resembles that of a small bank but, like some of the industrial banks, it has in addition some small rooms for the interviewing of applicants.

The average or typical small-loan office has about 2,000 loans outstanding at any given time, aggregating from $100,000 to $200,000. It operates with a minimum staff of three employees—a manager, an outside man, and a stenographer-clerk. The manager interviews applicants, passes on loans, and supervises the work of the office including collections. The outside man investigates applicants for loans and makes reports on delinquents. One or more stenographers and clerks receive callers, accept payments, maintain office records, and handle the correspondence. In some of the larger offices, a cashier may be employed to round out the personnel. A typical office operates at a cost of 20 to 25 per cent of the



APPLICATION MADE BY: HIM/HER | IN PERSON | BY PHONE | BY MAIL
TAKEN BY
H. H. G.
NOTE
AUTO
DUE DATE
WHO WAS INTERVIEWED?
M 8601
REPORT
DATE LOOKED UP
DATE | SOURCE OR SOURCES | WE WILL CALL
NAME (PLEASE PRINT)
ADDRESS
TOWN OR CITY
RENT
OWN
BUYING
FLOOR | HOW LONG | PHONE
FURNISHED ROOMS | % PARENTS | HOUSE | APARTMENT NO
FORMER ADDRESS | HOW LONG
FORMER ADDRESS | HOW LONG
EMPLOYER
ADDRESS
BUSINESS OF EMPLOYER (OR OWN BUSINESS)
JOB OR POSITION | DEPARTMENT | PHONE
HOW LONG | SALARY PER MONTH $ | PAY DAYS
FORMER EMPLOYER
ADDRESS
HOW LONG | AMOUNT APPLIED FOR $ | AMOUNT MADE $
H. H. G. LIST $ | NOTE | AUTO
PREVIOUS LOAN NO. | DATE MADE | DATE PAID
AMOUNT $ | BALANCE $ | HOW PAID
EXCHANGED BY | DATE | GRADE A B S
APPLIED
APPLIED
HOW WAS NAME VERIFIED? | APPEARANCE OF HOME
RENT OR PAYMENT PER MONTH $ | TO WHAT DATE PAID? | HOW VERIFIED?
LANDLORD | NO. OF ROOMS
ADDRESS OF LANDLORD | NEIGHBORHOOD
HOW MANY IN FAMILY? | HOW MANY WORK?
INCOME OF FAMILY PER MONTH | MONTHLY INCOME
APPLICANT'S SALARY PER MONTH $
NAMES & PLACES OF EMPLOYMENT OF OTHER MEMBERS OF FAMILY $
$
$
$
$
ROOMERS NO. | BOARDERS NO. | INCOME FROM ROOMERS & BOARDERS PER MONTH $
OTHER INCOME, IF ANY, PER MONTH $
TOTAL INCOME OF FAMILY PER MONTH $
KIND OF PAY INDICATED BY RECEIPTS LISTED ON BACK | WAS APPLICANT TOLD TO BRING IN RECEIPTS?
WHEN WILL APPLICANT CALL | WOULD YOU MAKE THE LOAN?
STATE REASONS
1
2
3
4
OUTSIDE REPRESENTATIVE SIGN HERE X
FORM 128—REV 12-36 | Hold For 3 Mos., Then Destroy
ASSETS — THIS SECTION NOT TO BE FILLED IN BY OUTSIDE REPRESENTATIVE
REAL ESTATE (KIND)
PURCHASE PRICE $ | PRESENT VALUE OF EQUITY $
1ST MTG HELD BY, CONTRACT, ETC. $
2ND MTG HELD BY, CONTRACT, ETC. $
SAVINGS ACCT.—WHERE? | CHECKING ACCT.—WHERE?
OTHER ASSETS, SUCH AS AUTO, ETC. | VALUE
DEBTS TO WHOM AND FOR WHAT | MTHLY PAYMENT | AMOUNT OF DEBT
BALANCE ON FURNITURE
OTHER FINANCE CO.
TOTAL
USE OF BORROWED MONEY
FINAL DISPOSITION DATE
1 CAN'T MAKE
2 WE TURNED DOWN
3 TURNED US DOWN
4 LOAN MADE
LOAN NUMBER
OFFICE STAMP
M 8601
LOAN NO.
CHECK ALL SOURCES MENTIONED BY CUSTOMER
R. O. C. | R. M. F. | R. M. F. C.
11
0 Classified (WRITE IN NAME OF PAPER)
1 Direct Mail
2 Display (WRITE IN NAME OF PAPER)
3 Distribution Circular
4 Signs
5 Phone Book
6 Radio—Chain (WRITE IN NAME OF STATION)
7 Radio—Local (WRITE IN NAME OF STATION)
8 Special—Magazine—No Source
9 Teacher—Mail or Magazine
Anything not on list above (PLEASE SPECIFY)
DATE OF INQUIRY | APP BY
3 FORMER BORROWER
5 PRESENT BORROWER | AMT OLD BALANCE $
7 RENEWAL
FINAL DISPOSITION DATE
1 CAN'T MAKE
2 WE TURNED DOWN
3 TURNED US DOWN
4 LOAN MADE
GRADE OF LOAN A B S
AMT. APP. FOR $ | AMT. LOANED $
FIRST NAME | MIDDLE INITIAL | LAST NAME
FAMILY HEAD (PLEASE PRINT)
ADDRESS
TOWN OR CITY
PLEASE FILL IN OTHER SIDE OF COUPON

FIG. 64.—Application for a loan from a personal finance company. The reverse side of this form provides spaces for the itemization of household goods taken as security and the report by the outside man.

average amount of loans outstanding, and earns a net profit from 5 to 10 per cent of such outstandings. Frequently, these percentages are expressed on the basis of the average amount of assets employed which is made up of what is sometimes termed "money used and useful."

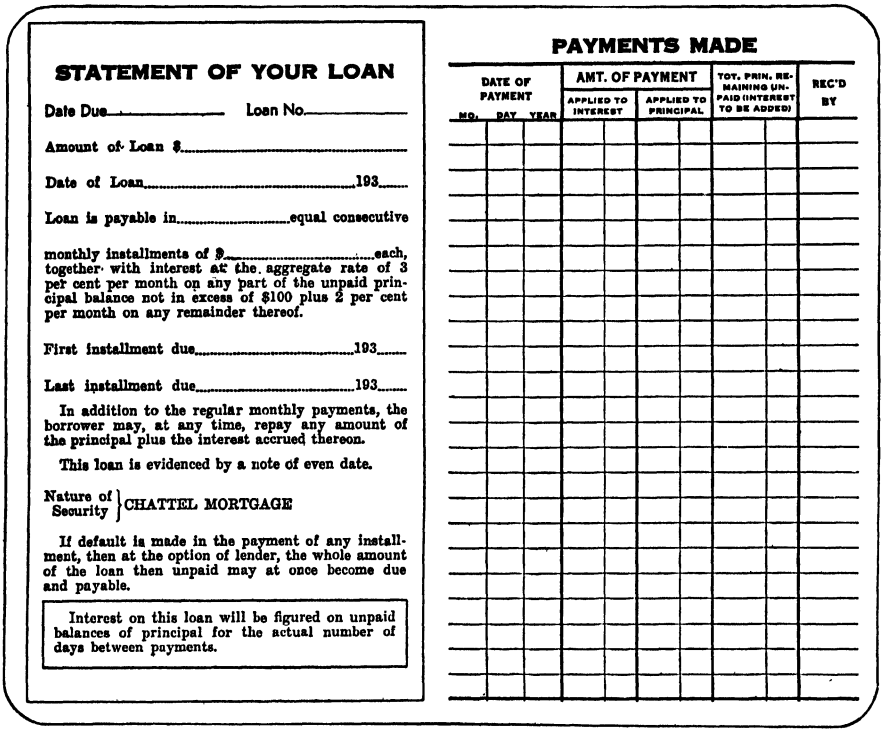
Procedure in Making a Loan.—The process of making a loan is fairly well standardized. The prospective borrower who needs financial assistance may be attracted to a personal finance company by some form of advertising or on the recommendation of others. He calls at the company's office, where he is interviewed by the manager or an assistant. An attempt is made during the interview to ascertain the purpose of the loan, the prospect's financial condition, and the possibility of meeting the instalments as they become due (see Fig. 64).

If the case appears satisfactory, arrangements are made for the company's outside man to call at the applicant's home. It is this representative's duty to determine the general condition of the home and its contents, to examine receipted bills for household goods, and to make a complete inventory of each item of furniture to which the applicant has clear title and which is to be offered as security. An accurate description of these household goods, together with the number of pieces and their approximate worth, is given on the reverse side of the application and investigation form shown in Fig. 64. It also contains a list of receipts seen by the company's representative and the manager's impression as to the causes for the borrowing. The use of the chattel mortgage on household goods has proved superior to the straight signature and co-maker loans, not so much because of the security itself but because it gives the lender's representative an opportunity to visit the applicant's home, to see the last rent receipt and other receipted bills, to go into all rooms including those that are normally locked, to see how the housewife keeps house, to make sure that the value of the goods offered as security is, in the estimation of the applicant, considerably higher than the amount of the loan requested, and in general to size up the type of persons and family with whom the lender will have to deal. This interview may be in the nature of an ordeal to the family, although the representative is trained to use much tact; hence it is made as brief as possible, but long enough to form definite impressions and opinions of the character of the risk to be undertaken.

The outside man then makes his report to the office, including a recommendation on whether the loan should be approved or rejected and reasons for such a conclusion. From the office additional investigations may be conducted. A report may be requested from the lenders' exchange bureaus, of which 38 are listed in the 1937 "Roster of Personal Finance Companies," or from a retail credit bureau or credit reporting agency. An attempt is made in this way to determine the applicant's

paying habits, total indebtedness, and nature of his income and character. Approximately one-fourth of all applications are rejected as a result of all these investigations.

If the applicant is deemed worthy of the consideration, he and his wife are asked to come to the office, where the manager reviews the applicant's financial condition, suggests a tentative budget of expenditures, and offers advice on methods of reducing expenses. He repeats



STATEMENT OF YOUR LOAN

Date Due..... Loan No.....

Amount of Loan $.....

Date of Loan.....193.....

Loan is payable in.....equal consecutive monthly installments of $.....each, together with interest at the aggregate rate of 3 per cent per month on any part of the unpaid principal balance not in excess of $100 plus 2 per cent per month on any remainder thereof.

First installment due.....193.....

Last installment due.....193.....

In addition to the regular monthly payments, the borrower may, at any time, repay any amount of the principal plus the interest accrued thereon.

This loan is evidenced by a note of even date.

Nature of Security } CHATTEL MORTGAGE

If default is made in the payment of any installment, then at the option of lender, the whole amount of the loan then unpaid may at once become due and payable.

Interest on this loan will be figured on unpaid balances of principal for the actual number of days between payments.

PAYMENTS MADE

DATE OF PAYMENT			AMT. OF PAYMENT		TOT. PRIN. REMAINING UNPAID (INTEREST TO BE ADDED)		REC'D BY
MO.	DAY	YEAR	APPLIED TO INTEREST	APPLIED TO PRINCIPAL			

FIG. 65.—Inside of customer's loan pass book obtained when borrowing from the Household Finance Corporation. Similar statements of the loan are given to the customer by other personal finance companies.

the terms of the contract, calls attention to the rights of the company against the security, and impresses upon the borrower the need for prompt payment and the desirability of extricating himself from his present financial difficulty. The borrower executes a promissory note, signs the contract, and receives the amount of the loan, together with a customer's loan passbook which contains a statement of the loan and on which are recorded the payments as they are made (see Fig. 65). At the same time a record for the account is prepared for the office files, showing, among other things, just what the borrower is paying in interest and how much he is paying on the principal amount of the

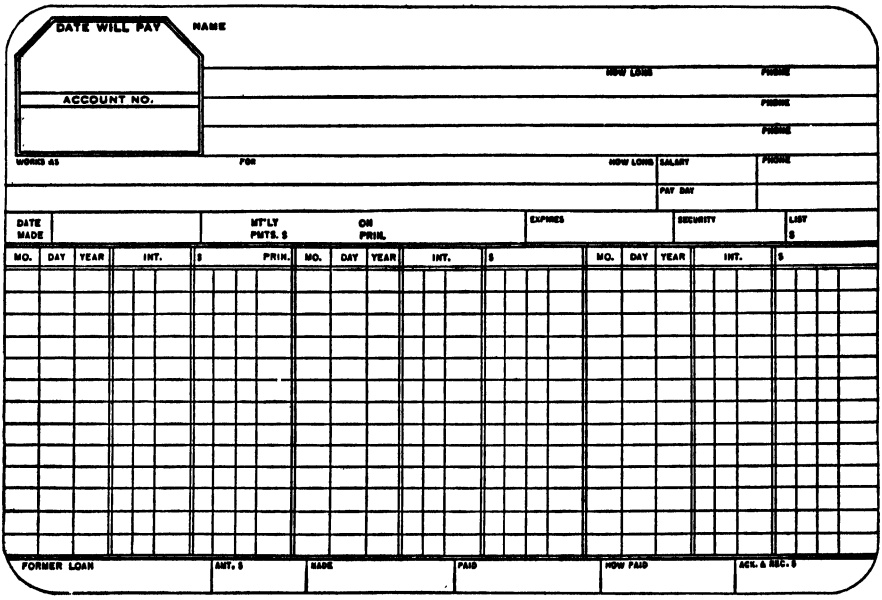


FIG. 66*A*.—Office account record maintained by personal finance companies.

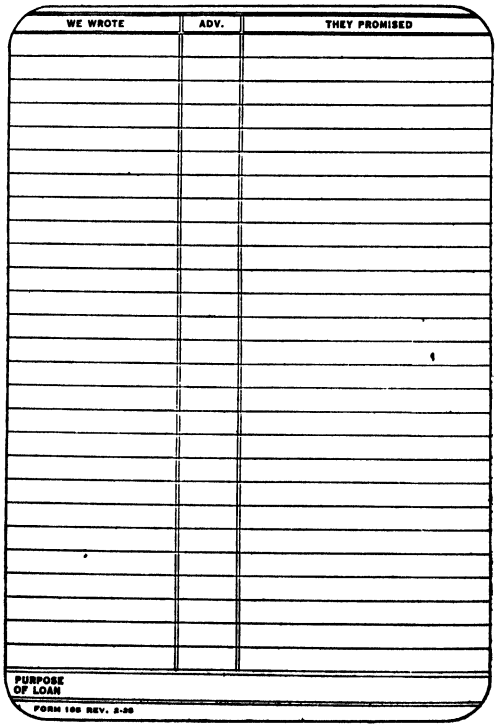


FIG. 66*B*.—Reverse side of Fig. 66*A*.

debt. This record also serves as a collection follow-up, for on it are indicated the various methods used in collecting overdue instalments (see Figs. 66*A* and 66*B*).

Collecting the Account.—Loans made by personal finance companies are usually repayable in monthly instalments over a period of 10 to 20 months, with the latter arrangement most commonly utilized. If the borrower's income is received weekly and he finds it more convenient to make payments on that basis, such an arrangement can be effected without difficulty. As a payment is made it is recorded on the customer's passbook as well as on the company's record for the account, and the customer is also given a signed receipt which shows the balance due.

While most borrowers pay the various instalments promptly, there are those who need to be reminded of their indebtedness by telephone and by mail but who generally respond and keep their payments up to date. There are also those borrowers who are chronically delinquent. In an effort to collect from them, systems of four to ten notices and letters have been devised by the various finance companies. If these fail to produce results, an outside man or collector is sent to call on the borrower at which time a promise is extracted that it will be made on a certain specified date at the company's office. Failure to act as promised may necessitate a second call from the outside representative. If an adequate reason for non-payment is given, an extension may be made in order to retain the good will of the customer; otherwise foreclosure on the chattel mortgage is threatened and occasionally carried through, although generally the finance company does not wish to obtain possession of the furniture the resale value of which is commonly very low.

RATES CHARGED BY FINANCE COMPANIES

Nominal versus Actual Rates.—The difference between nominal rates quoted on instalment transactions and the actual rates of simple interest paid has been discussed in detail in Chap. VII. There is even a slight difference between the two kinds of interest rates when borrowing from an ordinary commercial bank at regular bank rates. If the interest is deducted in advance, the rate paid is somewhat higher than that quoted. Thus instead of 6 or 8 per cent charged by such banks, the actual rate is 6.38 or 8.7 per cent, respectively. On some loans, and when borrowers are scarce and funds plentiful, commercial banks may, of course, charge less than the mythical 6 per cent, but even then if interest is deducted in advance there is a difference between the rate quoted and that actually paid.

In the sales finance field, this difference is accentuated. On automobile loans the leading companies charge 6 per cent on new cars, which in reality is a little over 11 per cent, because at the end of each month

an instalment is paid whereas the 6 per cent charge is on the full amount loaned. The so-called independent sales finance companies charge a much higher rate on automobile loans. All types of sales finance companies charge a higher rate on the financing of products other than automobiles, such a rate varying from 13 per cent per annum to more than 36 per cent, depending upon the company, the type of merchandise financed, and the class of customers served.

In the 26 states which have adopted the major features of the Uniform Small Loan Law, the rate allowed to be charged by licensed lenders varies from 2½ to 3½ per cent per month for the actual amount owed by the borrower. This is equivalent to from 30 to 42 per cent per annum, although in no case does the borrower pay $30 to $42 per hundred dollars of a loan. For example, if 3 per cent is charged per month on a loan of $100 repayable in 12 monthly instalments, the amount of interest or service charge is actually $19.50, since the 3 per cent is charged only on the amount outstanding at any given time, so that $3 is paid at the end of the first month and only 25 cents at the end of the twelfth month. Nevertheless, the rate is 36 per cent per annum. In actual practice, most of the personal finance companies charge less than either the maximum rate allowed by law or that recommended by the Russell Sage Foundation. For example, one of the leading companies operating in a number of states charges lower rates in each of these states than the maximum provided by law, especially on amounts in excess of $100. In general, no additional charges whatever for investigation or in the form of fines on delinquencies are made on loans other than the rate stated.

Comparative Rates.—If the rates charged by either sales finance companies or personal finance companies are compared with those charged on commercial accounts by regular banks, the former appear to be out of line. If, however, the comparison is made with the rates charged by industrial banks, it is more favorable and when the comparison is made with the rates charged by pawnbrokers and loan sharks, the charges of the finance companies pale into insignificance. Nevertheless, an attempt will be made in the following paragraphs to indicate some of the reasons why there are such differences in the rates charged by finance companies in comparison with the going rates on business loans obtained from commercial banks, since it is with the latter that comparisons are usually made. In making this explanation, at least six factors need be considered, including the cost of capital to the lender, cost of making the investigation, size of the average loan, risk involved, service performed, and the profit needed to sustain the institution.[1]

[1] For a detailed discussion of some of these points, see M. R. Neifeld, "The Anatomy of the Interest Rate," in "Financing the Consumer," edited by John H. Cover, University of Chicago Press, 1937.

Cost of Capital.—Commercial banks obtain much of their capital through deposits. Most of these are demand deposits on which no or very little interest is paid to depositors. Even on so-called "time deposits" little interest is being paid by such banks. Usually, a bank has eight times as much in deposits as in its own capital and surplus, which means that it has practically no cost on eight-ninths of the funds which it can loan. Industrial banks of the Morris Plan type are also favorably situated in this regard. They attract deposits, often obtained through the sale of certificates of investment, to the extent of two to four times their own capital. On these deposits but 2½ or 3 per cent interest is paid. Finance companies, on the other hand, cannot accept deposits, but must supply their own funds or borrow from banks. With regard to the latter, sales finance companies are better situated than the personal finance companies because their business is well established and the security offered is superior. Consequently, they may borrow from banks three or four times the amount of their own capital, but must pay on such loans rates that are higher than those given to depositors. The personal finance company is relatively new and has not been well understood or favorably regarded. Borrowings from banks are therefore limited, often to but one-fifth of the company's own capital. Higher rates also have to be offered to attract capital from investors. Thus there is no pyramiding of their capital through deposits, and no cheap funds can be obtained through liberal borrowing.

Cost of Investigation.—Relatively little expense is incurred by a commercial bank in investigating the risk. An audited financial statement is usually demanded and secured and other information is obtained from the applicant, all at the latter's expense. Finance companies can obtain but little information directly from the risk when the application is made. A complete investigation must be conducted at the lender's expense which must be included in the charge. This is, however, a relatively minor item of expense.

Size of the Loan.—In a recent confidential report by one of the leading personal finance companies it was shown that the average size of loan made by a large bank is $12,000, and that made by a relatively small bank located in one of our large cities is $3,000. On the basis of data published in "Automobile Facts and Figures," the average automobile note purchased by a sales finance company is around $500 or $600, varying from year to year with the price levels of the cars. On wholesale transactions, the loans are considerably higher, but on products other than automobiles the retail contracts bought are much below that figure, so that the average size of loan made by such companies is probably in the neighborhood of $500. For personal finance companies, the average size of loan made is less than $200.

This means that for every loan made by a large bank, a sales finance company makes 20 loans and a personal finance company makes over 60 loans. For every loan made by a relatively small bank in a large city, approximately 5 and 15 loans, respectively, are made by the two types of finance companies. There are many more investigations to be made and other expenses that must be incurred each time an account is opened or a loan is made. Thus it may be said that the banks do a "wholesale" business while finance companies "retail" their services.

Risk Incurred.—Except in years of depression, the losses suffered by well-managed commercial banks are very small, compared to those of either sales finance or personal finance companies. Even when depression years are included, the banks are still favored in this respect. For the period from 1930 to 1935, the losses of commercial banks were about 2 per cent for loans and bond portfolios combined, while the loss ratio of personal finance companies for the same period was about 4 per cent of average outstandings.[1] In computing the rate to be charged, losses from bad debts must be taken into consideration.

Service Rendered.—In the first place, finance companies give the customer the privilege to repay the loan in instalments rather than in a lump sum as required by a commercial bank on a business loan. This requires much additional work of a clerical nature. Each payment must be recorded and handled. The customer must be reminded of delinquencies, for he has many more opportunities to become slow in meeting his obligations. An elaborate system must be devised to handle this kind of business, which the commercial bank avoids. Second, finance companies often render services to dealers whose sales they finance, or to the ultimate consumers. Some of the companies have gone to considerable length in educating consumers to the need for budgeting their expenses and improving their buying of various goods, in order that they may get their money's worth and extricate themselves from the financial embarrassment which usually brings them to seek aid from these companies. In this connection the various state associations of personal finance companies are rendering a notable service. Their educational activities have been emulated by individual companies and their incessant efforts are constantly raising the level of service in the business.

Net Profit.—This may be regarded as the compensation for managerial ability and entrepreneural capacity. An adequate net profit must be provided to attract the efficient management needed to run the business and to attract the capital required. The newer the type of enterprise, the greater the risks assumed, and the less prestige a business enjoys in the public mind, the higher the net profit required to attract both capital and management.

[1] *Ibid.*, p. 105.

Summary.—From the above discussion it should not be inferred that all of the rates now charged by finance companies are justified and that no possible reduction can be effected. As a matter of fact, some companies may charge rates that are as low as conditions permit, while others may charge rates that are too high, although within the brackets permitted by law. Rather is this discussion offered as an explanation of differences in rates now existing as between different types of lenders. There is no doubt that these rates may in some instances be reduced through a greater volume of business per office, through a better selection of risks, through improved collection techniques, as a result of better business conditions and more regular employment, and through a more sympathetic attitude on the part of the community and the government to this kind of business.

Questions and Problems

1. Compare and contrast personal finance companies with sales finance companies.

2. Chart the organization of an office maintained by a:

a. Sales finance company

b. Personal finance company.

3. Describe the operations incident to financing a dealer's inventories on the basis of trust receipts.

4. How does the volume of wholesale financing of automobiles compare with that of retail financing? Explain.

5. Outline the procedure followed in financing the purchase of an automobile on the instalment plan.

6. A car was repossessed by the finance company on which a balance of $325 was still owing. What action would follow and how would the finance company be affected if the dealer who sold the car:

a. Endorsed the note with recourse?

b. Endorsed the note without recourse?

c. Agreed to repurchase the car?

7. Explain the nature of a "dealer reserve," and indicate under what conditions it is best used.

8. Why is so much stress being laid by a personal finance company on the interview at the applicant's home? Explain.

9. In what respects is a loan secured by a chattel mortgage on household goods superior to a straight signature or co-maker loan?

10. Differentiate between nominal and actual rates of interest, and give several examples.

11. Why are the rates charged by sales finance companies higher than those charged by commercial banks on business loans?

12. Why are the rates charged by personal finance companies usually higher than those charged by sales finance companies? Is this difference justified? Explain.

PART IV

TECHNICAL AND LEGAL ASPECTS OF COLLECTIONS

CHAPTER XXVII

COLLECTIONS

Purpose and Functions of the Collection Department.—All credit transactions involve a transfer of commodities and services for a promised equivalent payable at a future time. To secure this equivalent, practically all business organizations that sell on time are compelled to maintain a collection department or otherwise to perform the functions of such a department. This is so because not all debtors pay promptly the bills they have contracted. Even many good customers need to be reminded of their delinquency in taking care of their obligations. It is but human nature to postpone payment and put off the inevitable day of reckoning as long as possible. Some customers are forgetful; some are unable to meet their obligations at maturity, because of sickness, mismanagement, or other unforeseen contingencies; others never had any intention of paying their debts. To secure payment of accounts that are past due because of various reasons is the chief purpose of the collection department.

The efficiency of a collection department, however, is not to be measured by the percentage of collections alone. It is relatively easy to secure payment of approximately 100 per cent of all overdue accounts merely by sending to all delinquent debtors when their accounts first become overdue a drastic letter threatening legal action. Almost all debtors would no doubt pay their obligations immediately, but almost all of these customers would also discontinue their patronage. Hence, the importance of securing a maximum of collections with a resulting minimum loss of trade. The second object is not only no less important than the first but may easily become of greater significance because the profit derivable from future transactions with a delinquent debtor may greatly exceed the amount due on a particular bill. Nevertheless, the first object is extremely vital, for failure to collect the full amount due will cause the customer to take advantage of the credit grantor's leniency and make future dealings troublesome.

Thus the problem of the collection department or collection man is to collect the overdue accounts without at the same time offending the customer, a task far from easy to achieve. If the customer is pushed too hard, there is danger of repelling and losing trade. On the other hand, there is the possibility of treating him so leniently that he becomes

careless and in this manner makes his accounts cost more to collect than they are actually worth. Because of this dilemma the average creditor is led to believe that collections are a hopeless task, or else he feels that it is a problem extremely difficult to solve. To be sure, it is no easy task to determine upon the maintenance of so nice a balance as to result in the collection of the largest possible number of overdue accounts as quickly as feasible and at the same time lose as few customers as possible.

Importance of Prompt Collections.—It is impossible to overemphasize the value of constantly but properly driving after money due and not paid in time. Profits are dependent to no small extent upon the number of times a merchant can turn over his invested capital, and prompt or "close" collections are invariably accompanied by a rapid capital turnover. The rapidity with which a merchant may turn over his working capital, for example, depends partly upon the rapidity with which he can market his products and partly upon the speed with which he converts his accounts receivable into cash. Furthermore, prompt collections increase the working capital of credit grantors and save them large sums in bank interest, whereas slow collections cause a loss in the use of a concern's capital which is tied up in past-due "outstandings." Prompt collections are also vital because they enable creditors to take advantage of discounts offered for cash payments on purchases. Concerns with a limited line of credit at the bank frequently find it impossible to borrow further sums with which to discount their bills. It is, consequently, essential from their standpoint to collect overdue accounts as promptly as possible in order to effect savings incident to discounting bills for purchases.

It should also be remembered that insufficient working capital is responsible for practically one-third of all business failures. This lack of capital can be traced in many instances either to indiscriminate credit granting or to inefficiency of the collection department, or both. Slow collections are, therefore, apt to cause undue embarrassment to credit grantors through insufficiency of working capital. Moreover, slow accounts increase losses from bad debts. It is believed that the bulk of accounts finally written off could be collected if followed up promptly. Collection expenses are likewise increased through slow accounts, and because of them the creditor is often placed in a dangerous position that may lead to bankruptcy if left unchecked.

Two other significant results are obtained by a proper policy of enforcing prompt payments. In the first place, a debtor whose account is already overdue is not likely to place additional orders with such house. Instead, he will be encouraged to buy from houses where his credit standing is unimpaired. The effect of such action is to diminish the volume of sales of those houses which allow their debtors to run up large overdue accounts and to increase the sales volume of concerns more drastic in

their collection methods. Finally, vendors are more highly respected by debtors when their accounts are closely watched and promptly collected. Customers soon learn which concern is lenient and which concern will insist that its bills be met promptly, with the result that they pay the latter and let the former wait for its money. Hence, the importance of training customers to pay their obligations promptly. When this aim is accomplished, the collection department has less actual collection work to perform than the inefficient department whose lack of system is responsible to no small degree for the negligence of its customers in paying their bills according to terms of sale.

Importance of Regularity.—Whatever the system employed, it should provide for promptness in reminding a customer of his obligations and for regularity with respect to the dates when some form of collection effort should be made. If considerable time elapses between the date the bill is due and that on which he is reminded of his obligation, the effect is to allow the debt to fade from the customer's mind and to give little thought to the delinquency. Too great an interval between the various other steps in the collection series has a similar effect. Few customers, if any, will object to being reminded of their obligations, provided the reminder is prompt, regular, and courteous. On the contrary, a house which pays business-like attention to the collection of its accounts gains the respect of customers. Furthermore, such procedure helps to keep debtors in a sound and healthy financial condition. The effect of this is to increase sales, for, when customers know they do not have a long overdue account at a certain house, their conscience is easy and, knowing that they will be welcome, they take satisfaction in buying from that concern.

Factors in a Collection System.—In formulating a collection system for any enterprise, several factors must be given due consideration. First of all comes the matter of determining upon a collection follow-up system, so that a record of all steps taken in the collection of the account may be properly kept. The three systems in use at the present time will be discussed later in this chapter.

The second point deals with the difference in treatment to be accorded the different types of customers who become delinquent. It is obvious that not all delinquents can be treated alike, because of differences in temperament and other personal characteristics, differences in the quality of the risk, past experience, and the value to the house of the different types of accounts. All accounts should be classified into several groups so that each group can be treated in a distinctive manner which will be most fruitful of beneficial results.

The third step is to determine the kinds of effort to be taken in the collection of overdue accounts. This involves a thorough knowledge of all the possibilities available and a careful sifting of these possible meas-

ures in order to select those that are most likely to produce desired results. It deals with the question as to how many statements are to be used before other steps are taken, and whether or not to resort to the use of drafts, personal calls, and numerous other collection methods.

Fourth, the number of steps to be taken is of some significance. The answer to this query will depend much upon the policy of the house with regard to leniency or strictness in the handling of delinquent accounts. The more lenient the policy of the house in this respect, the larger the number of measures used in completing the collection process, and vice versa. Such policy, again, will depend upon the keenness of competition in the particular field in which the vendor is operating, his desire and need for greater volume of business, and the margin of profit obtained.

Once the kinds of effort have been decided upon, as well as their number, the next problem is one of sequence. Just how should these various steps be arranged, or in what order should they be called into service? The principle to bear in mind in this connection is that, to be successful, a collection system should be so worked out that the milder measures will be used first so as not to offend the more sensitive delinquents in any given group, followed by the more stringent methods arranged in the order of their severity. It is useless to take a strong step first and then apologize for it by the use of more lenient measures. The probability is that the customer has been so offended that it would be difficult to retain his good will or that he is so calloused to "duns" that more lenient means will be utterly wasted if the stringent measure has been disregarded.

Finally, it is also necessary to determine the frequency with which the various collection efforts should be used or the interval elapsing between the different steps. If a relatively lenient policy is followed in the collection of accounts, not only is the number of collection steps relatively large, but the interval between the different measures is likewise lengthened. In all cases, the interval is shortened as the stage of delinquency advances. Whereas as much as a month or 15 days may be allowed between any two steps in the early stages of the collection process, the interval is shortened usually to about 5 days, just to allow for an immediate reply, before the process is brought to completion.

Classification of Debtors.—In order to handle customers rapidly and intelligently, they are generally divided into three classes, consisting of good risks, fair risks, and poor risks. Some credit managers divide delinquent accounts into those who can and intend to pay, those who can but won't pay, and those who can't pay. For credit-granting purposes a more elaborate classification of risks is usually made comprising discounting customers, prompt-pay accounts, slow but good customers, slow and unsatisfactory, and just plain "deadbeats."

The good risk is a customer who is highly rated in regard to his financial ability to pay and is so eager to keep his credit intact that he will make satisfactory arrangements the moment he finds himself unable to meet his bills. He is a good-pay customer, has a high credit limit, and is entirely reliable. Such a customer must be treated with the utmost courtesy in case of delinquency. A little pressure and a proper appeal may be all that is necessary in order to bring about payment of the bill. The delinquency is in all probability due to negligence and not so much to lack of financial resources. Customers in this class are highly sensitive; the treatment must be mild, lenient, and courteous, lest they become offended and withdraw their patronage. No drastic measures whatever need be resorted to and the time between the various letters in the collection series is the longest allowed for the various classes of delinquents.

The fair risk is a customer who is probably good but slow. He has a medium rating in regard to his ability to pay and is entirely willing to meet his bills, but through carelessness or through the happening of unforeseen contingencies beyond his control, he postpones payment of his obligations. Such customers have a medium credit limit and, in spite of their occasional delinquency, do not belong to the dishonest category of debtors. They constitute the largest percentage of a retail store's accounts and form the large body of small merchants over whom the credit manager must keep close watch. Many of these delinquents may be finally educated into the first class of debtors. Because of their honesty and good intentions, these cases require careful and special consideration, necessitating a study of conditions responsible for the delinquency before pushing the claim and thereby adding to the confusion and embarrassment of the debtor and further delaying payment. The collection system must allow a longer period of time to elapse between the various letters of the collection series and the other methods forming a part of the anticipated plan.

The poor risk is a customer who apparently has just enough ability to pay and just enough reputation of meeting his obligations with fair promptness to deserve the privilege of an open account involving a small credit limit. In this class are included those customers who can pay but do not intend to do so until forced, as well as customers without conscience or financial responsibility, commonly known as professional "deadbeats." So long as these risks are kept within the credit limit placed on their accounts, they may pay with fair promptness. No credit manager can be certain that he has not extended to some of them more than is warranted by actual conditions, partly because of failure to investigate a customer's reliability thoroughly and partly because even the most careful investigation sometimes fails to disclose the weak-

ness of an applicant for credit. Among these delinquents are persons who are absolutely indifferent to unfavorable credit opinions and upon whom "duns" all the way from pleading persuasiveness to threats to take drastic action have no effect. In dealing with these accounts, the collection system must operate rapidly. Little time should elapse between the first notification and the letter threatening suit. No sympathy should be shown to persons who have earned a reputation as chronic bad-pay customers, because such risks are habituated to strict treatment and will take no offense at the promptness with which they are followed up. Drastic treatment should be reserved, however, until the credit manager has overwhelming proof of the unworthiness of the delinquent. Otherwise, persons in this class should be treated as if they belonged to the class comprising the fair risks.

In view of the foregoing, it is apparent that each of the three classes of delinquent debtors requires somewhat different treatment. It is, therefore, essential to ascertain the reason for the delinquency as early as possible in the collection proceedings, so that each account may be properly classified and accorded the treatment which that class deserves.

The value of a debtor's future patronage and his past record with the house should always be given adequate consideration in determining upon the course of action to be pursued in enforcing payment. Obviously, it is to the interest of a credit grantor to give more consideration and relatively lenient treatment to one whose annual patronage is worth $5,000 than to one whose trade is limited to $500 per year. It is equally obvious that a customer who has been prompt in meeting his obligations in the past should be shown more consideration than one with whom past experiences are few or unsatisfactory.

Value of a Collection System.—Notwithstanding differences in treatment of various classes of delinquents, it is nevertheless possible and essential to have a proper system for insuring the prompt and orderly handling of accounts when they become due and for preventing them from being overlooked. To be sure, the most efficient method of collecting delinquent accounts is the one which affords individual treatment to each of these accounts by someone who is thoroughly acquainted with the debtor and with the reasons for his delinquency. In large organizations in which thousands of accounts must be kept under the constant supervision of the credit or collection manager, the method is entirely impractical and some sort of a system must be employed. Haphazard methods in following up accounts inevitably lead to carelessness and neglect on the part of debtors to make remittances and, incidentally, invite losses. Such methods also preclude the possibility of clerks handling matters of mere routine without first consulting the credit manager. The collection system is a regular method or order of procedure whereby

the pressure on delinquents is increased gradually but surely until payment is received or until a climax is reached in the use of forceful and drastic means. It is more or less mechanical and automatic in regard to the various steps to be taken and in respect to the dates and types of collection notices, letters, and so on.

The system adopted should nevertheless be sufficiently flexible so that in its operation due allowance will be made for differences in personality, past record, financial condition, and the value of future patronage of debtors. It should not be so rigid as to cause the credit or collection manager to sacrifice his individuality and allow his work to become a mere mechanical process. Thus, its effectiveness lies in its flexibility and cumulative influence. The impression made upon the debtor by one step or process of the system should be deepened by the next step or process until remittance is made or the account is written off as bad and uncollectible and finally placed in the graveyard where all the unfortunate mistakes of the credit manager are buried.

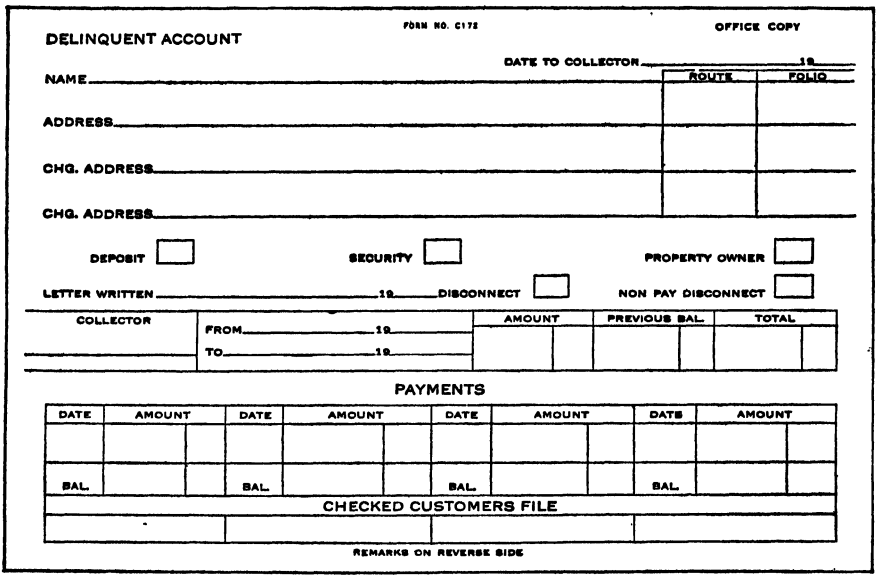
FOLLOW-UP SYSTEMS

To facilitate following up overdue accounts and to avoid mistakes, a careful record should be kept of all collection efforts made, so as to place before the collection manager or his clerks and correspondents all the necessary information on a specific item, for intelligent action. Not a little of the success in collecting may be attributed to a good follow-up system. To accomplish this end, several devices are employed. Of these the three major plans of recording such data, and making them accessible when needed, are the ledger plan, the card tickler system, and the duplicate invoice method.

The Ledger Plan.—Where the number of accounts is small, and even in some large business organizations, credit managers prefer to inspect the ledger at frequent intervals, possibly every week or twice a month, in order to learn the exact status of each account. A standardized series of notations is then made on the ledger opposite each overdue account of all steps taken in enforcing payment. The chief advantage of this plan lies in the ability of the credit manager to keep better posted on the progress and development of each account carried on the books. Furthermore, this system obviates the necessity of keeping a separate record from that appearing on the ledger as is required by the use of any other plan. One record suffices for both the bookkeeping and collection departments and duplication is completely avoided.

Obviously such a plan of following up overdue accounts is confined to the smaller houses and to those concerns in which the credit and bookkeeping departments are located side by side. Where the number of accounts is considerable, the advantages claimed for the plan are

more than offset by its disadvantages. The chief of these disadvantages is the possibility of sending out statements and making other collection efforts in an haphazard manner and at irregular intervals. There is an incentive for the credit manager to defer running through the ledger until all other matters are disposed of. Thus the work of following up accounts becomes secondary in importance to the other functions of the department, with the result that collections are neglected and eventually become slow and difficult. Moreover, while it is desirable that a credit manager become acquainted with the development of all accounts carried, an inspection of all of them at frequent intervals imposes on


DELINQUENT ACCOUNT

FORM NO. C172

OFFICE COPY

DATE TO COLLECTOR _____ 19__

NAME _____ ROUTE | FOLIO

ADDRESS _____

CHG. ADDRESS _____

CHG. ADDRESS _____

DEPOSIT ☐ SECURITY ☐ PROPERTY OWNER ☐

LETTER WRITTEN _____ 19__ DISCONNECT ☐ NON PAY DISCONNECT ☐

COLLECTOR		AMOUNT	PREVIOUS BAL.	TOTAL
	FROM ____ 19__			
	TO ____ 19__			

PAYMENTS

DATE	AMOUNT	DATE	AMOUNT	DATE	AMOUNT	DATE	AMOUNT
BAL.		BAL.		BAL.		BAL.	

CHECKED CUSTOMERS FILE

REMARKS ON REVERSE SIDE

FIG. 67.—Tickler card follow-up for a delinquent account in use by a public utility company.

him a burden too heavy to carry. Much of the time thus consumed could no doubt be spent to better advantage in handling more serious and difficult credit problems. Then, too, an inspection of the ledger at frequent intervals necessarily involves constant interruption and delay to the work of the bookkeeping department. It also causes a loss of time to the credit manager in going back and forth from the credit to the bookkeeping department in order to check up frequently on the standing and progress of the various accounts and to note the effect of collection efforts.

The Card Tickler System.—To overcome the objections incident to the use of the ledger plan of recording collection efforts, a card tickler system is employed (see Fig. 67). It is sometimes termed the "diary dating

system." It consists of two or more sets of files or folders numbered consecutively from 1 to 31. Each set represents one month, with one division or folder for each day. The aim of any such system is to provide a daily reminder to the credit manager of all overdue accounts which require his attention, by placing such matters before him in accordance with a prearranged plan of procedure.

To accomplish this result a follow-up file containing a folder for each day and divided with monthly guides is established. A separate collection card is made out for each delinquent debtor, containing the amount, terms, and due date of invoice in question. These cards are then arranged in the tickler files according to the action to be taken in collecting the account.

Under this system, a clerk goes through, daily, all the cards contained in the appropriate subdivision and checks them against the ledger, in order to determine whether payment has been made on them. Remittances received since the last step in the collection series are posted on the card and brought to the credit manager or his assistant for further treatment. If remittances have not been received, the cards are placed on the manager's or correspondent's desk, as the case may be. The proper collection effort is made and a notation to that effect is placed on the card, which is then advanced ahead in the tickler under the date set for further treatment, should the delinquency continue. The same procedure applies to all collection steps taken, including statements sent to the delinquent, all collection letters, granting of extensions, drafts drawn on the debtor, and so on, until remittance is received or the account is written off as bad and uncollectible.

When all cards scheduled for a given day have had attention, the guides or folders are rotated so that the current date is always in front. Nothing is left to chance under this plan. All matters turn up automatically on the desk at the desired time and overdue accounts are handled systematically and at regular intervals. The plan requires little labor to operate, saves the time and energy of the credit manager, and obviates all difficulties experienced under the ledger system of following up accounts. It does necessitate, however, more or less of a duplication of records and somewhat additional clerical labor.

Tickler collection cards should be carefully retained for future reference, for they indicate at a glance any troublesome experiences the concern has previously had with any one customer, thereby suggesting the proper action that should be taken in case of repeated delinquency.

The Duplicate Invoice System.—This method is essentially the same as the card tickler system, except that a duplicate copy of the original invoice is substituted for the card and such duplicates are prepared for each invoice despite the fact that but a small percentage of them may

become past due and require the use of the collection copy of the invoice. Where invoicing is done on billing machines it is possible to make an extra carbon copy for use as a collection copy without any additional work. These invoices are filed in a tickler of one or more drawers, bill size, vertical style, and equipped with cardboard division cards or folders numbered from 1 to 31, according to maturities, so as to appear on the due date or a few days prior. When the invoice copy appears, it is checked against the ledger to determine whether it has been paid, in which case it is destroyed or filed permanently in the general office files. Otherwise, the prearranged collection campaign is started and every action recorded on the invoice, which is then returned to the file a specified number of days in advance, when it automatically reappears and again compels the credit manager's attention. The duplicate invoice is to be recommended only when the creditor finds that a large percentage of his accounts regularly become past due and require some collection effort; otherwise the cost not only of making the extra copy of each invoice but of filing it and keeping track of payments would be greater than warranted.

Mercantile and Retail Collections.—All the principles that apply to collecting past-due accounts of a wholesaler or manufacturer apply, essentially, to the collection problems of the retailer. The methods and procedure are similar in many respects. Both are governed by the same considerations, both attempt to collect the amount owed them without offending delinquents; both try to train customers to pay their bills promptly, and each one is following a general plan similar in many respects. In some ways, however, the collection systems of the two differ. These differences are due at least partly to the loose methods of credit extension on the part of many retail stores, and partly to the fact that retailers see their customers more frequently. Loose methods in granting credit are obviously a source of weakness and are largely responsible for the relatively large number of poor risks carried on the books. Ability to see the customer more often is nevertheless an advantage which, if rightly used, tends to offset the weakness mentioned. Differences in collection methods of the two institutions are also accounted for to a certain extent by the size of the accounts carried by the respective organizations.

In view of these fundamental differences, the time allowed a customer by the wholesaler or manufacturer in which to make remittance is much shorter because the credit terms are more definitely stated. Furthermore, a wholesaler stresses the appeal to self-interest in his correspondence with a delinquent, because his customers are themselves engaged in business, and usually realize the importance of keeping their credit standing unimpaired. Retailers, on the other hand, sometimes obtain

most satisfactory results by placing chief reliance upon appeals to pride, justice, and sympathy.

Again, drafts are quite commonly used by wholesalers, but seldom employed by retail stores as a means of enforcing payment. Finally, wholesalers make greater attempts than do retailers to induce debtors to make part payments, probably because the amounts involved in many of the accounts carried on the books of the former are much larger. For the same reason, many more requests for extensions are received from delinquent customers by wholesale concerns. Retailers, on the other hand, until recent years have been loath to encourage part payments, because it is rather difficult later to object to this method of settlement once a customer has been allowed to develop the habit.

Peculiar Features of Instalment Collections.—In some respects, collecting on instalment accounts represents a simpler task than in other types of collections, especially when a note was signed at the time of the purchase or when the seller retains the right to repossess the goods. On the other hand, the process is complicated by several considerations, although for the most part the same technique and similar appeals are used in collecting instalment payments as any other kind of payment in the retail field. First, there is the reselling task. After succumbing to the lure of "easy terms" the customer may have regretted the purchase or may have lost his original enthusiasm for the article. Consequently, the principle of resale must be emphasized in the collection correspondence, by reawakening the customer's interest in the goods. Second, prompt and systematic treatment becomes more important in collecting overdue instalments, because there are a number of payments on each account and several possibilities of the customer's becoming delinquent. The payment schedule must be definitely arranged in advance. If the amount is large and payments are made monthly, several days in advance of each instalment notices are sent. It is especially important not to allow a customer to miss the first payment, lest he form the habit and rely on the creditor's lenient treatment. Experience has shown that by insisting on the first instalment promptly, later delinquencies and ultimate losses are greatly reduced. Mailing dates must be rigidly followed and all collection efforts must be punctiliously pursued.

Third, there is the possibility for a readjusted schedule, since the original transaction is already of the convenient type. Fourth, personal collections play a larger role, either regular collectors are employed who make their calls regularly to collect due and past-due accounts or adjusters are used to handle so-called "last resort" cases. Fifth, form letters must be changed frequently, so that the same customer will not, on repeated delinquency, receive and thus learn to expect identical messages.

Finally, there is the repossession procedure which is totally absent in connection with regular charge accounts.

Collecting Interest on Past-due Accounts.—Charging interest on overdue accounts is one means of discouraging extended delinquency, but it often backfires, as when the debtor feels that so long as he pays interest he need not worry about delayed payment. This is one of the more difficult and delicate problems that arise in the collection of past-due accounts, involving a question of business policy. From the standpoint of justice and equity it would seem imperative that interest be charged on all overdue accounts. At time of sale, definite terms are agreed upon by both parties, on the basis of which the seller arrives at the selling price of his product. Thus, the money belongs to the seller from the date on which the terms of sale expire. If the debtor fails to pay the bill at maturity, and refuses at the same time to pay interest for the use of the money, he unjustly appropriates property belonging to the creditor, which he could not do under any other circumstances without rendering himself liable to punishment. In this manner, the debtor commits two wrongs: one by using the creditor's property without the latter's consent; the other, by refusing to compensate him in a manner similar to what would be required of him were he to borrow the funds elsewhere.

Failure to charge interest on overdue accounts not only results in unfairness to the creditor himself, but it also involves unfair discrimination against customers who pay their bills promptly. In order to pay their bills at maturity, prompt-pay customers borrow at the banks and pay interest on the funds thus obtained; whereas the slow-pay debtors, by paying nothing for the funds which they employ and by obtaining the same prices from the seller, secure an undue advantage, inasmuch as the terms of sale to them are actually extended by the period of slowness. This naturally places a premium upon delinquency, which may well be taken advantage of even by customers who could and would otherwise pay their obligations with great promptness, the corollary of which is that insistence upon the payment of interest on overdue accounts necessarily results in improved collections.

In order to collect interest on all overdue accounts, several methods may be employed. Words to the effect that interest is charged on overdue accounts may be printed on all statements, and actually added to the amount owed. Another way is to attach a printed sticker to all past-due statements, and either add the interest to the amount of the bill or send a separate bill for it. The total amount owed, including the interest item, should thereafter be given in all communications in which attempts are made to collect the account.

Suspending Delinquents.—A policy frequently advocated as a method of speeding up collections and reducing slow accounts is to suspend delinquent customers by refusing further credit purchases after a certain period of grace. For some concerns this period may be 30 days, for others it may be 90 days, depending upon the rate of consumption of the goods for which payments are in arrears and the strictness or leniency of the creditor's policy. This policy is especially potent in lines of business where purchases are made continuously and goods are of the so-called "necessity" type.

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Questions and Problems

1. "The function of the collection department is to collect all overdue accounts." Do you agree? Why or why not?

2. Why do authorities on credit advocate promptness in collecting accounts?

3. Is promptness in collections synonymous with strictness? If not, what is the difference?

4. When does an account become a collection?

5. Assume that you have been called in, in the capacity of consultant, to work out a collection system for a mercantile institution. What factors would you have to consider in accomplishing your purpose?

6. In what ways would these factors differ from the normal in the event that a strict collection policy is to be pursued?

7. How would these factors differ in the preparation of a collection system for a retail establishment?

8. Point out the logic in arranging the appeals to be used by the collection department in a certain sequence.

9. What is meant by a follow-up system? Is it necessary?

10. Which follow-up system do you prefer? Why?

11. Would your choice of a follow-up system be the same if the enterprise of the creditor were small?

12. List the essential differences and similarities between retail and wholesale collections; between regular charge-account collections and collections on instalment purchases.

13. Would you advocate charging interest on past-due accounts? What can be gained by such a policy?

14. List at least six disadvantages to a creditor from carrying slow accounts? What can be done to overcome them?

CHAPTER XXVIII

COLLECTION METHODS AND PROCEDURE

In this chapter an attempt will be made to present all possible methods that can be used to advantage in the collection of overdue accounts. While some attention is given to the order in the collection procedure in which these methods will be normally utilized, it is not intended that this treatment be anything more than suggestive. Neither is it intended that all of the steps or methods discussed be used in any single case or by any one vendor. As indicated in a previous connection, all such matters must be left to the discretion of each individual credit manager.

Statements.—Regardless of the collection system employed, the first step consists of sending a bill at the time the goods are shipped to the customer. The purpose of this kind of statement is to give the customer information, to let him know how much he owes. This step is then followed by sending statements reminding the customer that payment is due and suggesting that action has no doubt been overlooked. Practices differ widely with respect to the time such statements are sent. Some houses have adopted a "monthly statement" plan, under which statements are sent to all customers once a month, usually on the first. Where the accounts are not yet due, they serve as a reminder that remittance is expected when due. These statements are mailed directly by the bookkeeping department. Those covering overdue accounts are submitted to the credit manager or his assistant, and a stamp is applied to the face of the statement with the wording "Past due; please remit," or other words to the same effect.

Printed reminders with reference to accompanying statements are used by some houses, while in still others a different style of make-up of formal notifications is employed; this may consist of a printed, typewritten, or multigraphed form containing blank spaces to be filled in with the name and address of the customer, the date and month in which the purchases were made, and the amount owed. The purpose of all of these notifications is to call the matter to the attention of the recipient. These reminders should be courteous, because the first proper assumption to make when an account lapses into slowness is that the matter has probably escaped the customer's attention.

Houses operating under the monthly statement plan sometimes forward two or three such reminders at monthly intervals before proceeding

with the next step in the series. The usual plan is to make out a tickler card for the follow-up system, as soon as the first statement is forwarded bearing the rubber-stamped notation or accompanied by some formal notification.

The chief drawback of this plan is that the overdue accounts are brought to the attention of the credit or collection manager only at certain definite intervals, with the result that negligent debtors are not trained to make prompt remittances, while dishonest debtors are afforded too much time, thereby enabling them to perpetrate contemplated frauds against their creditors. Furthermore, it has been proved almost conclusively by the experiences of a number of houses that merchants who are able and willing to pay strictly at maturity will do so without a reminder in the form of a monthly statement, and those who are chronically slow will require a statement at maturity anyway, regardless of whether they have received a form statement on the first or not. Much could be saved in time and expense if monthly statements to all open accounts on the ledger, save overdue accounts, were entirely eliminated.

Many houses have adopted a plan which requires that, in addition to monthly statements forwarded to all customers whose bills are not yet due, other statements be sent to all debtors immediately after the accounts become due. The former serve as reminders that the bill is becoming due and assist the debtor in bringing about an understanding concerning differences that may have arisen respecting the amount of the bill and also forestall any possible excuse that the matter has slipped his attention; while the latter serve as an indirect demand for payment and become more forcible and effective by the various styles of notification which accompany them.

Collection Letters.—The next most commonly used method in collecting overdue accounts is the collection letter. It is probably the most satisfactory of all available methods in accomplishing the general results sought, namely, of bringing previous transactions to a satisfactory end, and of paving the way for future business by developing good will. In these letters the appeal is first to the customer's fairness and pride. An attempt is made to secure some explanation for non-payment by words like the following: "You have our goods; you used them; they must have been satisfactory or we would have received a complaint from you." An effort is then made to shame the customer, and if all these fail, threats of one type or another are utilized. Because of the tremendous importance of letters in collection work, the whole of the following chapter is devoted to the subject.

The Personal Call.—Next to the collection letter, the personal call is probably the most common method of collecting overdue accounts. This method is more commonly employed by wholesalers and manu-

facturers than by retailers, save when the latter sell on the instalment plan, so much so that many wholesale houses rely almost entirely upon their salesmen to make the necessary collections from customers in their respective territories. In this manner, no extra expense is incurred, for collections are made by the salesmen during their regular visits. Then, too, because of their intimate knowledge of customers and circumstances, they often make good collectors.

In the ordinary retail trade, personal collectors are becoming more uncommon because of the expense in sending personal representatives to collect small bills, and partly because of the practical impossibility of securing collectors who combine the various essential characteristics in the correct proportion for the salary which is ordinarily paid for such services. Poor collectors are sometimes worse than none, for at best they only injure the customer's good will. Personal effort is frequently effective, however, after the resources of correspondence have been exhausted. For this reason, collectors are still to be found in some of the larger retail concerns. Where goods are sold on the instalment plan, personal collectors are commonly resorted to as a means of collecting both due and overdue instalments. In general, collecting by personal representatives is much more efficient than any of the other methods available, as far as the actual sums collected are concerned. In a majority of cases, however, it results in a loss of trade and good will, which more than offsets the advantage of collecting a larger percentage of overdue accounts, except where it is customary so to collect accounts. Many instalment houses and practically all finance companies employ personal collectors, usually called adjusters.

Where the salesmen of a wholesale house fail in their efforts to collect an overdue account, and assuming that a draft upon the debtor has been dishonored, the next step would be to hand over the account to an attorney or collection agency for further and more drastic treatment. If the amount involved is considerable, however, and the good will of the delinquent important, a personal visit by the credit manager himself is highly desirable, provided the distance to be traveled is not too great.

Before calling upon the debtor, the credit manager should be prepared with all necessary information. He should ascertain from the files the exact circumstances in the case and characteristics of the person whom he is to visit, for he has a particularly difficult task to perform, *viz.*, of convincing the debtor that the bill must be paid without, at the same time, antagonizing him and thus losing his good will and future business.

Collecting by Drafts.—The draft is quite commonly used by wholesalers and manufacturers as a means of enforcing payment. It is one of the more urgent steps in the collection series. In some lines of business

the first or second letter may be followed by a draft; in other lines of trade the terms of credit stipulate that if the account remains unpaid after a certain time, a draft will be drawn upon the customer without further notice. It is the common practice in most branches, however, to resort to the use of drafts only after most of the collection letters have failed to bring the desired response. Since the draft is one of the more forcible methods, except in trades where payment is commonly made by draft, it is generally advisable to call the customer's attention by letter or special form, in advance, of the intention to draw upon him. Such letter usually contains a simple statement reviewing the steps already taken and stating that unless a response is made by a certain date a draft will be forwarded to the delinquent's bank. This will frequently have the desired effect and bring the remittance. This letter also affords the debtor sufficient time in which to prepare to meet the draft when it is presented by the bank for collection. Sometimes a sharp letter may be sent with the notice in order to emphasize the step.

The chief purpose of drawing a draft upon a delinquent debtor is to make the bank the creditor's collecting agency, with an implied notice to the debtor's bank and locality that the drawee's credit standing is somewhat impaired. For this reason a draft should be almost as effective as a letter from an attorney or collection agency. Unfortunately, however, the widespread use of the draft during the past decade against persons who were not really delinquent has had the tendency to weaken its power and largely to remove the sting from it. Thus when a draft is dishonored today it no longer menaces the drawee's credit, for such act is no longer a confession of insolvency. Drafts are returned now without any misgiving, for a somewhat different significance attaches thereto, except where they are dishonored consistently and in large numbers. Under these circumstances the debtor's credit standing will suffer, particularly at his local bank. Nevertheless, the draft should never be used without due notice, for many customers still consider it a serious reflection on their credit responsibility, and once offended they are likely to carry a grudge against the house.

Although there is no way of compelling a drawee to honor a draft, such step is nevertheless valuable even when the draft is dishonored, in that it makes an urgent suggestion to pay. Furthermore, when a draft is dishonored it is usually returned to the creditor with an indorsement or notation stating briefly the reason for the drawee's failure to pay. This gives the draft a strategic value, for the way it is treated by the debtor gives the creditor information concerning the following step that should be taken. From these notations the creditor occasionally learns of the debtor's intentions, thus furnishing a better basis for further treatment. If the debtor gives the bank a reason or excuse for non-payment, such

reason or excuse can be met logically in the next creditor's letter, thereby putting him in such a position that he cannot defend himself, but must either settle the claim or brand himself a bad-paying customer. If the notation on the slip attached to the draft indicates that the debtor was unprepared at the time to make payment, a second draft may be sent immediately, together with a letter announcing that fact, calling attention to the first draft and suggesting forcibly that the debtor be prepared to meet his obligation when the draft is presented by the bank for payment.

When used, the draft is either deposited in the creditor's own bank; which, in turn, forwards it to a bank in the customer's locality, or is sent directly to the bank in the debtor's vicinity. Many credit managers prefer to send the draft to the debtor's bank, if it is known; while others prefer to send it to another bank in the debtor's town on the assumption that the stranger bank will more promptly present the draft for payment. On the other hand, a delinquent is more likely to be induced to make payment if the draft is presented through his own bank. The name and locality of the bank with which the debtor in all probability has dealings may be ascertained from checks sent by him, from mercantile agency rating books, or from law lists, which generally include a list of banks.

When the draft is collected, an exchange charge is made by the bank; otherwise nothing is charged for the service. Since, however, the increased use of drafts in the collection of accounts caused many to be returned unpaid, the service became increasingly burdensome, so that now many banks refuse to handle drafts free of charge. In order to cause banks to give more careful attention to the presentation and return of drafts, with notice of reason for non-payment when the draft is dishonored, it is advisable that a small fee, anywhere from 10 to 25 cents, be enclosed with the draft.

Why Drafts Are Returned.—Drafts may be returned unpaid for one or more of the following reasons. The bank may have neglected to present the draft. Some debtors may be temporarily out of funds and unable to meet their obligations at the time the drafts are presented for payment. Many debtors resent the use of drafts drawn upon them and show their attitude by ignoring them. They may consider payment by draft a serious reflection on their credit and, consequently, prefer to make remittance by other means. Finally, there are debtors who are either unable to pay their bills or unwilling to do so.

Telephone Calls.—The effect of telephone calls is often as good as that resulting from a personal interview. Matters that could not be written without liability for libel can safely be talked about over the telephone, for, to prove a telephone conversation with a given person,

the plaintiff must prove a previous conversation face to face, with the defendant, and swear that he would recognize that voice when heard. This is very difficult to prove, for voices in many cases do not sound the same over the telephone as in personal conversation.

The conversation over the telephone may be as short or as long as thought desirable. Several kinds of appeals may be made in rapid succession within a brief time. Compared to correspondence, a telephone call saves both time and expense. These savings are much greater when compared with personal calls. In recent years, collection by telephone has proved popular and effective. The only disadvantage over personal interviews is that payment cannot be secured immediately, even though the debtor's mind is brought up to that point. If a promise to pay is made, however, the debtor is likely to fulfill it or else lay himself open to a repetition of the ever-menacing telephone call. This is especially annoying to debtors such as farmers who are usually on party lines, for fear that neighbors might overhear the dunning conversation.

Settlement by Note.—When it is impossible to secure cash, settlement may frequently be made by notes, provided the debtor really intends to pay at some future time. In taking notes in settlement, a creditor must carefully consider, in addition to the advantages, the disadvantages incident thereto. To be sure, a note serves practically as conclusive evidence of the indebtedness and facilitates proof if suit is subsequently brought against the debtor. Furthermore, debtors have more respect for their obligations when evidenced by a written instrument. They are more likely to meet their notes at maturity than pay the debt represented by open book accounts. A third advantage is that notes may be discounted at the bank and the proceeds employed in the business. Notes are also sometimes deposited with the bank for collection. Because of the semipublic character of a bank and its position in the community, a debtor will be more apt to make arrangements to meet his obligations when the note matures.

On the other hand, many creditors who are reluctant to accept notes in temporary settlement of open accounts claim that the practice is highly objectionable. In the first place, they contend that it is not true that notes are usually paid at maturity, that it is not uncommon for debtors to offer only part payment on the due date and to request an extension of time on the balance, for which another note is tendered. This situation is particularly true of the smaller merchants. They claim that, on the contrary, open accounts are paid more promptly than notes or their renewals, especially when arrangements are made for partial payments at definite intervals.

In the second place, it is argued that the acceptance of notes in settlement of an open account establishes a bad and undesirable precedent.

It later becomes somewhat difficult to take objection to this method of payment once the customer has been permitted to develop the habit.

A third argument advanced against the plan is that once a note is accepted a creditor waives all rights to demand or expect payment until the instrument becomes due. He cannot resort to any means of enforcing payment, even though such action were desirable, until the due date. Because of this fact, it becomes highly desirable for the creditor to require the debtor to secure the signature of a responsible party as indorser of the note, wherever that is possible.

At this point in the collection process attempts may also be made to effect other friendly adjustments and keep away from legal action. This subject is discussed in detail in a subsequent chapter.

Attorneys and Collection Agencies.—After all means have been exhausted, and assuming that the creditor stands ready to sever his business relations with the delinquent, a letter is sent to the debtor threatening to place his account in the hands of an attorney or collection agency unless remittance is received within a specified time. If the delinquent customer fails to respond to the letter threatening such action, the account is handed over to an attorney or collection agency, where the collection system is taken up at the point the seller left off.

This step should not be taken until and unless all reasonable methods have failed and the debtor is no longer deemed a desirable customer. Once an account is handed over to an attorney or collection agency, all friendly relations with the debtor are necessarily ruptured beyond repair and additional costs are incurred in the form of commissions and fees.

Methods Employed.—The methods of collection agencies and attorneys consist simply in a more forcible application of the principles underlying the procedure used by merchants themselves. They usually write one or more letters to the debtor, urging him to make payment and pointing out the unpleasant consequences of his neglect to do so. Whereas merchants are tactful and use mild means, these representatives are harsh and employ forcible measures. They care little for keeping the customer; their chief aim is to collect the account by resorting to veiled or open threats and harsh language. If the debtor lives or conducts his business in the same vicinity as the attorney or agency, a collector is usually sent to make a personal demand.

Collection Agencies.—Many credit managers prefer to utilize collection agencies in place of attorneys. The former are, as a rule, more systematic in following up accounts and usually write a whole series of letters before forwarding the account to a correspondent attorney. On the other hand, there are numerous irresponsible collection agencies which need thorough investigation before placing an account in their hands. For this reason, trade credit bureaus have been formed, one of the functions of which is to

collect accounts for their members. Dun & Bradstreet, credit insurance companies, and the adjustment bureaus affiliated with the National Association of Credit Men are also equipped to render a collection service for members and subscribers as well as for others. The larger agencies and bureaus are not only entirely responsible but also exercise a powerful moral influence on the delinquent debtor. Failure to pay an account placed in the hands of the large agencies or bureaus works to the detriment of the debtor, for the entire business community soon learns that fact through the credit reports which they also render. Debtors know that and are, consequently, more likely to make payment before suit is brought against them.

House Collection Agencies.—Many business houses are so eager to retain control of their bad accounts and save the commission charged by collection agencies that they have attempted to imitate *bona fide* collection agencies by the establishment of what is known as "house" collection agencies, which are in reality bogus concerns. An appropriate name suggestive of its activities is chosen, suitable stationery is printed, and a collection agency blossoms forth. Every attempt is made to convey the impression that this so-called "agency" is independent and entirely apart from the creditor firm.

While the use of house collection agencies has proved successful from a financial standpoint, it is subject to question from an ethical point of view, especially when there are sufficient logical and ethical methods available for securing the collection or adjustment of an overdue account.

Attorneys.—In the case of an out-of-town claim, probably the most commonly used method is for a creditor to place the claim in the hands of a local attorney. This attorney usually makes a few collection efforts by correspondence, and if they bring no satisfactory response, the claim is forwarded to a correspondent attorney in the home town of the debtor. Under such circumstances the fee is divided, the forwarding lawyer retaining one third and the receiving attorney getting two thirds of the total fee charged for making the collection.

Another method of placing the claim in the hands of an attorney is by forwarding it directly to a lawyer located in the debtor's town. The name of a competent and responsible attorney may be secured for this purpose through the assistance of "bonded attorney lists," "guaranteed attorney lists," or "law lists." Several concerns publish such lists and some of them assume full responsibility for any claims collected by any attorney appearing on their lists, provided the creditor complies with certain requirements of the publishing house. Some of these lists even rate each attorney on the basis of integrity, financial responsibility, ability, and promptness in remitting claims collected. Notwithstanding all these guarantees by publishing houses, many credit managers still

follow the practice of compiling their own lists of attorneys on the basis of their own investigations and experiences.

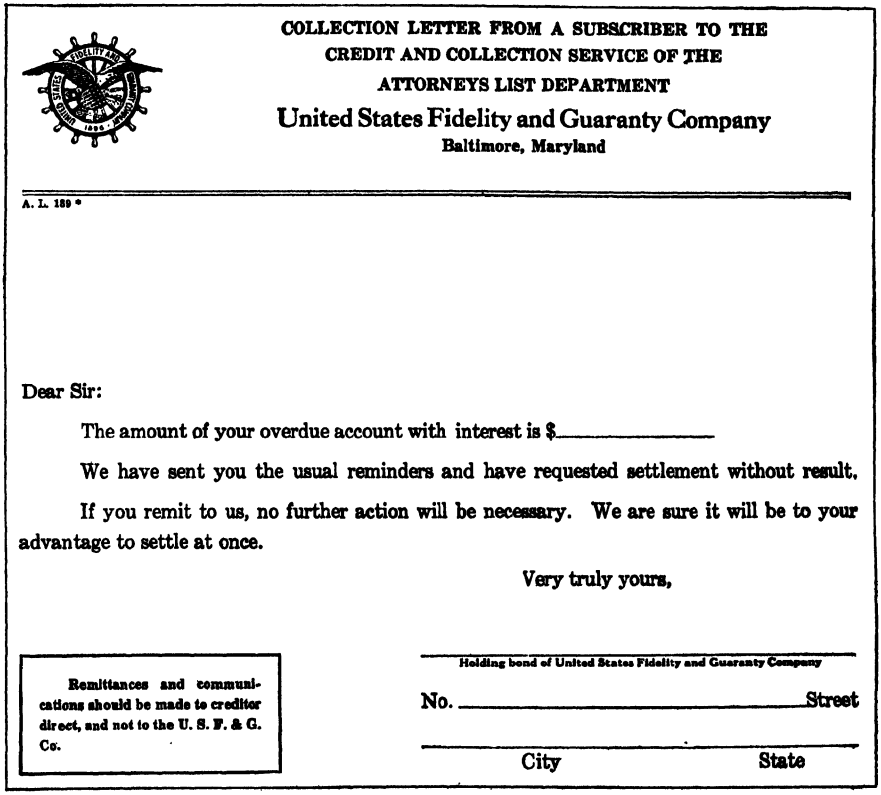
Advantages of Forwarding Attorneys.—Two distinct advantages are claimed for the method of placing out-of-town claims in the hands of attorneys residing in the city where the creditor is located. In the first place, the creditor is relieved of the necessity of carrying on an enormous amount of correspondence in order to keep in touch with the attorney and be informed as to the progress of the account, although a limited amount of correspondence must be carried on even with the attorney who resides in the creditor's town. The other advantage is that the receiving attorney pays correspondingly closer attention to claims received from a forwarding attorney and renders more satisfactory service. This is largely because a forwarding attorney has occasion to forward more claims for collection than the average creditor. The business received from a forwarding attorney thus becomes relatively more valuable to the receiving attorney, notwithstanding the fact that he receives only two-thirds of the total fee.

Agency Substitutes.—Some collection agencies, trade organizations, law-list publishers, and collection-letter houses have devised a series of forms of collection letters for the use of subscribers. These "collection agency" devices are used considerably as a last resort prior to bringing suit against the debtor or before turning the account over for collection. These forms are sold or given to creditors who are subscribing for the services of the company, who fill in the blanks and forward them to the delinquent debtors. The forms bearing the name of the collecting agency, consist of a letter or a series of letters in decided contrast to the tone of the usual reminders and personal letters of the creditor, containing veiled or open threats couched in business-like and insistent language. The purpose is to impress the debtor with the idea that these letters are sent by the agency which may advertise his delinquency, with the result that he is sometimes scared into paying the bill and it thus obviates the necessity for more drastic measures.

It is quite obvious that most of such forms should not be used until after all other reasonable measures have failed to bring a satisfactory response or unless the account is thought undesirable and the creditor stands ready to sever business relations with the delinquent. They are recommended as a means preceding that of actually bringing suit or prior to handing the account over to an agency or attorney, primarily because of their inexpensiveness.

Probably one of the most widely used collection services along these lines is that furnished by the United States Fidelity & Guaranty Company. It is in many respects more complete than most services of the same type and is designed in such a way that certain phases of it may be

used at different stages in the debtor's delinquency. The usual collection service consists of a guaranteed attorneys list containing the names of about 4,000 attorneys in this and other countries and a number of banks to be used in sending drafts for collection; a $5,000 bond indemnifying the subscriber against embezzlement of funds or overcharges by the



COLLECTION LETTER FROM A SUBSCRIBER TO THE CREDIT AND COLLECTION SERVICE OF THE ATTORNEYS LIST DEPARTMENT

United States Fidelity and Guaranty Company

Baltimore, Maryland

A. L. 189 *

Dear Sir:

The amount of your overdue account with interest is $_____

We have sent you the usual reminders and have requested settlement without result.

If you remit to us, no further action will be necessary. We are sure it will be to your advantage to settle at once.

Very truly yours,

Remittances and communications should be made to creditor direct, and not to the U. S. F. & G. Co.

Holding bond of United States Fidelity and Guaranty Company

No. _____ Street

City State

FIG. 68.—One of three collection letters supplied to the subscribers of the United States Fidelity and Guaranty Company.

attorneys listed in the directory; three letters (see Fig. 68), which may be used in any combination desired; and a draft system comprising an advance notice of draft and the draft itself, as shown in Figs. 69 and 70. Thereafter the account is automatically handed over to one of the attorneys selected from the published list.[1]

Partial Attorney Substitutes.—The same reasons that motivate the creation of house collection agencies also prompt some concerns to estab-

[1] Much of the information concerning the U. S. Fidelity & Guaranty Company was obtained from the Baltimore Headquarters of the Company through the courtesy of W. E. Moore, Manager of the Attorneys List Department and through the cooperation of R. J. Williamson, superintendent of the Cleveland, Ohio, division.

lish fictitious legal departments on whose stationery one or more letters are written to the delinquents, urging them to make remittance within a specified time, if legal action in court is to be avoided. Another device is to send such letters on stationery bearing the letterhead of some law firm whose permission has been secured for the purpose. In addition to some remuneration for this privilege the law firm whose letterhead is used by the creditor is generally given all the collection business which requires some legal action.[1]

Suing the Debtor.—Should attorneys or collection agencies fail in their attempts to effect a settlement by amicable means, they will in all probability ask the creditor for authority to summon the debtor into

ADVANCE NOTICE OF DRAFT FROM A SUBSCRIBER TO THE CREDIT AND COLLECTION SERVICE OF THE ATTORNEYS LIST DEPARTMENT

United States Fidelity and Guaranty Company

Baltimore, Maryland

To .....

.....

Dear Sir:—If we do not receive remittance to cover your overdue {note / bill} by ..... 19..... we shall on that date draw upon you through .....Bank of .....

for..... Dollars, with instructions to Bank, if our draft is not paid on presentation, to hand our claim for collection to an Attorney who will, on our notice, be covered by the bond of the United States Fidelity and Guaranty Company, which we hold.

Signed .....

Holding bond of United States Fidelity and Guaranty Company.

Street and No.....

Date..... 19 City and State .....

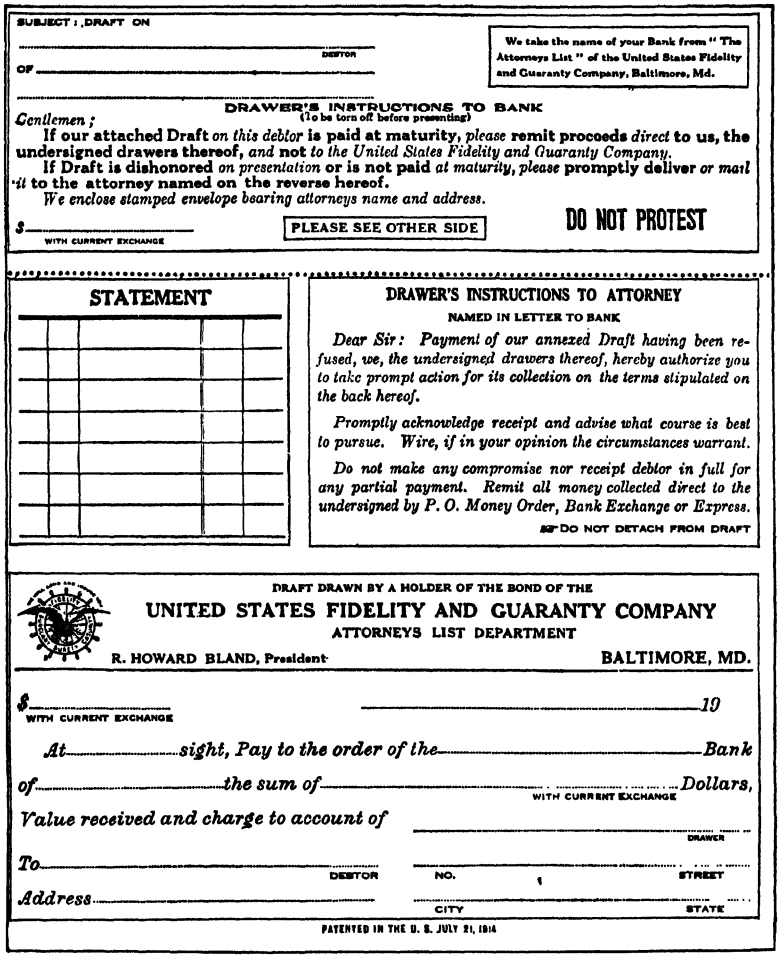
FIG. 69.—Advance notice of draft.

court. Before granting such authority, the credit manager should satisfy himself that the debtor possesses unencumbered property on which to levy in case a judgment is secured sufficient in amount to cover the value of the claim and expenses incident to the suit. Otherwise, he will, by advancing money for costs of the suit, be throwing good money after bad. Oftentimes, the attorney or the agency may be able to furnish the requisite information and, if *bona fide*, their recommendation concerning the advisability of suit should be followed.

Once authority to sue is granted, the credit manager must follow the case closely until the date for trial is set. In most states, the parties are entitled to a trial by jury, but it is usually waived. If a judgment is entered for the plaintiff, a few days are normally given the debtor in which he may make the necessary arrangement to pay the judgment,

[1] For a more elaborate treatment of the subject of agencies and attorneys in the collection process, see T. N. Beckman, and F. E. Held, "Collection Correspondence and Agency Practice," Chaps. 7–12.

including interest charges and court costs. If payment is not made, execution of the judgment is issued to the proper court officer, who levies upon the property of the defendant. A public sale is advertised and the proceeds therefrom, not exceeding the amount of the judgment, are



SUBJECT: DRAFT ON

DEBTOR

OF

We take the name of your Bank from "The Attorneys List" of the United States Fidelity and Guaranty Company, Baltimore, Md.

DRAWER'S INSTRUCTIONS TO BANK
(To be torn off before presenting)

Gentlemen:

If our attached Draft *on this debtor* is paid at maturity, *please* remit proceeds *direct* to us, the undersigned drawers thereof, *and* not *to the United States Fidelity and Guaranty Company.*

If Draft is dishonored *on presentation* or is not paid *at maturity, please* promptly deliver *or mail it* to the attorney named on the reverse hereof.

We enclose stamped envelope bearing attorneys name and address.

$ WITH CURRENT EXCHANGE

PLEASE SEE OTHER SIDE

DO NOT PROTEST

STATEMENT

DRAWER'S INSTRUCTIONS TO ATTORNEY
NAMED IN LETTER TO BANK

Dear Sir: Payment of our annexed Draft having been refused, we, the undersigned drawers thereof, hereby authorize you to take prompt action for its collection on the terms stipulated on the back hereof.

Promptly acknowledge receipt and advise what course is best to pursue. Wire, if in your opinion the circumstances warrant.

Do not make any compromise nor receipt debtor in full for any partial payment. Remit all money collected direct to the undersigned by P. O. Money Order, Bank Exchange or Express.

DO NOT DETACH FROM DRAFT

DRAFT DRAWN BY A HOLDER OF THE BOND OF THE
UNITED STATES FIDELITY AND GUARANTY COMPANY
ATTORNEYS LIST DEPARTMENT
R. HOWARD BLAND, President
BALTIMORE, MD.

$ WITH CURRENT EXCHANGE _____ 19

At ____ *sight, Pay to the order of the* ____ *Bank*

of ____ *the sum of* ____ WITH CURRENT EXCHANGE ____ *Dollars,*

Value received and charge to account of ____ DRAWER

To ____ DEBTOR NO. ____ STREET

Address ____ CITY ____ STATE

PATENTED IN THE U. S. JULY 21, 1914

FIG. 70.—Draft drawn by a subscriber for the U. S. Fidelity & Guaranty Company service, with instruction to the bank that if it is dishonored it should be turned over to the attorney named for legal action.

turned over to the attorney for the benefit of the creditor and the debtor is given an instrument known as a "satisfaction piece" acknowledging payment in full.

Should there be no property upon which to levy, it becomes advisable to docket the judgment after the execution is returned to the court unsatisfied, by filing a transcript with the county clerk, for which a

nominal fee is paid. In this manner, the judgment becomes a lien against any real property which may be acquired by the debtor any time thereafter within a certain number of years, or it can be used as a basis for garnishment, as explained in Chap. XXX.

Every state and the District of Columbia have what is known commonly as a "statute of limitations" for civil actions specifying when certain obligations are outlawed by sheer virtue of the passage of time. In the state of Ohio, for example, the law can be invoked to collect on a promissory note within a period of 15 years; open accounts can be enforced within 6 years; written contracts, within 15 years; domestic judgments in courts not of record can be kept alive for a period of 15 years, and domestic judgments in courts of record have 21 years to run, provided the judgments are kept alive by execution every 5 years; and foreign judgments can be enforced within a maximum time limit of 15 years. The law limiting action varies greatly from state to state, but action of the statute of limitations may be delayed by securing a written acknowledgment from the customer that he owes the money, by obtaining part payment on the account, by securing a promise to pay, or by showing that the customer has remained beyond jurisdiction for a long time.[1]

Compensation of Agencies and Attorneys.—The fees or rates that are generally charged by attorneys and collection agencies for complete collection service are governed by the schedule adopted in 1927 by the Commercial Law League of America, as follows:

15 per cent on the first $500 or less collected.
10 per cent on the excess up to $1,000.
5 per cent on amounts collected in excess of $1,000.

A minimum suit fee of $7.50 may be charged, and in no case must the fees and commissions exceed 50 per cent of the claim.

Where partial services are rendered by collection agencies, the rates are modified accordingly. Thus, some agencies, in addition to the regular collection service, also render what is known as direct demand service for which a charge of only 1 per cent may be made, and a special service that does not require personal calls or litigation for which a charge equivalent to one half the regular schedule is made to the client.

In the retail field, fees charged by collection agencies and attorneys usually range from 25 per cent for all accounts that can be settled without personal calls or litigation and for accounts that are in the same locality to as high as 33 and 50 per cent for all other accounts. In both the retail and mercantile fields, when accounts are forwarded by the agency or

[1] For a list of the principal provisions of the various statutes of limitations, see the tabular arrangements on the subject in the "Credit Manual of Commercial Laws," published annually by the National Association of Credit Men.

attorney, the practice is for the forwarder to retain one third of the fee and to give two thirds to the receiving agency or attorney.

UNUSUAL COLLECTION METHODS

Every credit manager finds it necessary sometimes to resort to extraordinary measures in addition to regular methods used in collecting overdue accounts. These methods are so uncommon as to be unexpected and, consequently, effective. In using these methods the delinquent should be singled out and made to feel the necessity of meeting his obligation at once. This can be accomplished by using one or more of the methods described below, in case the usual procedure fails to bring results. Thus even the most hardened offenders may be reached if sufficient originality, tact, judgment, and imagination are brought into play.

Dunning by Wire.—As long as proper precaution is taken in the wording of the telegram, dunning by wire is permitted by law. The wire should be largely in the form of an inquiry as to when payment will be made. Payment may be demanded and even suit threatened, but nothing which would tend to convey the impression that the debtor is a cheat, or a fraud, or that he unnecessarily or without cause delays the payment of the bill is permissible. Any such inferences, as well as threats of bankruptcy or criminal prosecution, might subject the sender to an action for libel, and in some states are construed as attempted extortion. A telegram or night letter requesting an immediate explanation for the delay in sending a remittance and expressing surprise at such delay is usually a very effective means of emphasizing the importance of giving the subject immediate consideration.[1]

[1] The Western Union Telegraph Company has prepared the following telegrams that might be used for ordinary collection purposes:

1. Expected remittance not received. Cannot wait longer. Please remit immediately.
2. Your old account must be paid. Unwilling to wait longer.
3. Our patience is exhausted. Must have account paid at once.
4. Unwilling to wait longer, account overdue. Please remit at once.
5. Will draw on you (time given) unless we receive remittance.
6. Our account long past due. Please remit at once.
7. Please remit for account due. Imperative need. Thank you.
8. Our account long overdue. Please remit by return mail.
9. We call your attention to our account.
10. Your delay in remitting very annoying. Your prompt attention requested.
11. Expect payment on account without further delay. Don't disappoint.
12. Regret cannot extend further credit until account is paid.
13. Pleased to fill order when you remit for account due.
14. A remittance for our bill of.....much appreciated.
15. Unless remittance is received promptly must decline further credit.
16. Have you overlooked us? Oblige us with check if possible.
17. Why don't you answer our letters? Account must be paid without further

One of the purposes of a telegram is speed, another is emphasis, and a third is its public nature. Few debtors will tolerate the irritation caused by the publicity of successive telegrams asking for a settlement of an account. Sometimes, the wire may be used in an indirect manner, as when it is sent to the local bank of the debtor requesting the name of a reputable attorney who can take possession of the article, if sold on the instalment plan and subject to repossession, or otherwise handle the case satisfactorily. The creditor may further inquire whether the bank thinks that a judgment against the debtor can be collected. A reply by wire is usually called for to add emphasis. Ordinarily, the bank telephones the debtor to come in and discuss the matter, calling to his attention the seriousness of it and, if his credit is good, the bank may even advance the necessary amount to liquidate the indebtedness.

For the collection of instalment accounts, a number of appropriate messages have been prepared, as illustrated by the following:

1. Check for ..... instalment has not reached this office. When was it mailed?
2. Has check for ..... been mailed? Wire answer.
3. Action pending. Has check been mailed? Wire "Yes" or "No."
4. Has check been mailed or shall we act as authorized by contract?
5. Have you mailed check for $\$\ldots$? If not, it will be necessary to send our special representative to call on you, in which case fee for services will be added to amount you owe.

Registered Letters.—A registered letter sent with the express direction to deliver it to the addressee only, and requiring a return receipt, forcibly calls to the attention of the delinquent debtor the condition of the account and gives evidence that great importance is attached thereto and that the creditor insists upon payment. Upon receipt of such a letter, the debtor will conclude in most instances that his neglect to meet the bill is becoming more serious than it previously appeared to be. Usually such letters are in the form of an ultimatum. Sometimes it consists of a final notice before legal action, as shown in Fig. 71.

Advertising Accounts for Sale.—A practice followed by some collection agencies and certain associations of merchants is to offer stubborn accounts for sale. When this practice is followed, all delinquent accounts

---

delay.

18. Why have you not paid.....bills? Remittance greatly appreciated.
19. Should not telegraph unless very imperative. Kindly send check on account.
20. Disappointed no remittance from you. Please send check at once.
21. Very important remittance reach us on..... Large payments to meet.
22. Understand your collections are good. Kindly let us have check on account.
23. Wire our expense if we can have remittance by..... Your help appreciated.
24. A check for account by return mail will be of great assistance.

in a given community or in a certain geographic section, as the case may be, are listed on a form provided for the purpose, giving the names, addresses, and amounts due on all such accounts. These lists are given wide distribution among prospective bidders or placed in newspaper advertisements. Sometimes only the initials of the delinquents are inserted in the advertisements.

The courts have generally held that the listing of one's name as a delinquent and advertising the indebtedness for sale is libelous per se,[1]

DEMAND FOR PAYMENT

VS

Creditor Debtor

TO THE ABOVE NAMED DEBTOR

TAKE NOTICE! That the above named CREDITOR hereby makes demand for the sum of $

with interest at the rate of per cent per Annum.

NOW THEREFORE, unless said amount is paid to the creditor in the City of

County of State of on or before the

day of A. D. 19 or you SHOW REASON why said claim is unpaid and make arrangements for settlement thereof, Court action will be necessary, incurring costs and disbursements in addition to amount of said claim.

Dated this day of A. D. 19

FINAL NOTICE

FIG. 71.—Final notice before suit, demanding payment.

especially because the facts indicated in all cases that have come up that the advertising of the accounts was not so much for the purpose of selling them as it was to force payment by the delinquent. It would seem, therefore, inadvisable for any creditor to become a party to any such collection scheme in justification of which it appears to be necessary to prove that the exact amount indicated is due and unpaid and that the debtor is unworthy of trust and would not respond to the ordinary methods of collection.

[1] "Credit Manual of Commercial Laws," 1937, pp. 176–177, National Association of Credit Men.

COLLECTING FOREIGN ACCOUNTS

Foreign and Domestic Collections.—Practically the same principles and considerations apply to the collection of foreign accounts as in making domestic collections. A prompt and systematic follow-up of each account is even more essential here, for the tendency of many foreign customers is to delay payment until greatly pressed. Similarly, sellers who employ prompt and efficient collection methods command the respect of many foreign buyers, while those who allow their accounts to drift along are apt to be taken advantage of by their customers.

Statements and Notifications.—As in domestic practice, some exporters send out statements or bills to all of their customers monthly. These serve as reminders that the bills are becoming due and are also used for purposes of verification of the correctness of the amounts involved. Notwithstanding the advantages to which they may be put, monthly statements are not as a rule desirable in foreign trade. They are at best cold and formal, and, besides, many foreign customers, being less efficient and systematic in their business dealings, feel insulted at the idea of being reminded in such a formal manner long before the bill is due.

To eliminate all possible friction and at the same time to call the debtor's attention to the fact that the draft will soon be presented to him by the bank for payment, it is advisable to send, instead of a statement, a personal or form letter, requesting a verification of the figures, so as to avoid all complaints at maturity of the draft and to call the customer's attention to the approaching due date. When tactfully written and in the proper tone, such a letter serves to convert what might have been an overdue account into a prompt payment. To be of maximum benefit, the letter must be dispatched to reach the recipient two or three weeks before maturity of the draft. This will enable him to make the necessary preparations to honor it.

Collection Cables and Letters.—If the draft is dishonored when presented for payment, immediate action should be taken, lest the customer be led to believe the creditor afraid to protest for various reasons. If the amount is considerable, the customer may be addressed by a cable, in which surprise is expressed at his refusal to pay and an explanation is requested. It is not uncommon to express confidence in the customer's willingness to rectify the mistake immediately. If the account is small, a letter of similar contents is substituted for the cable. As a result of the use of such letters or cables, immediate settlement is secured on many accounts.

At the same time that an explanation for refusing to honor the draft is demanded from the customer, the collecting bank should be instructed as to the action it should take in regard to the draft. The bank may at

this point be of invaluable assistance in ascertaining the reason for non-payment. It may also suggest means of enforcing payment.

If payment is not forthcoming and a reply to the cable or first letter is not received within a reasonable time, a second letter somewhat more harsh should be dispatched to the stubborn debtor. In this letter a suggestion of the credit grantor's willingness to grant an extension, if the debtor is temporarily out of funds, may be made. At any rate, he is asked to explain the reasons for his refusal to meet his obligations, with the assurance that reasonable cooperation will be extended him in order to bring about a settlement which is mutually satisfactory.

Enforcing Payment.—Reliable collection agencies in foreign countries are scarce. Much help can be gained through the moral-suasion letters written for members by the Foreign Credit Interchange Bureau of the National Association of Credit Men. Even a personal call may be arranged through one of the Bureau's foreign representatives. The American Chamber of Commerce in the foreign community may also be of some assistance in collecting overdue accounts.

It is extremely difficult to force payment of foreign accounts by legal means. In the first place, exporters know much less about collection laws of foreign countries than the customers themselves. Hence, in order to display force effectively and make threats, the exporter must be sure that the threat can be fulfilled. Furthermore, collection by legal means is almost impossible in some countries on account of the inadequacy of the laws. Then, too, suits are very expensive.

Nevertheless it would be wise for every export credit manager to familiarize himself with at least two types of laws of the countries in which he is interested: those relating to the collection of accounts, and those dealing with the form of business organization. In practically every country there is to be found at least one form of business organization which is peculiar to that country, just as the corporate type of business organization is coming to prevail in the United States. Thus the prevailing form of business organization in France is the *société anonyme;* in Mexico, the *sociedad anónima,* abbreviated S. A.; in Cuba, the *sociedad en comandita,* abbreviated S. en C.; etc.

Knowledge of the particular form of organization of a customer is essential in order to determine a creditor's rights and limitations in enforcing payment. In many countries there is a definite limit placed on the liability on the various members of the firm, as, for example, in case of the Cuban Sociedad en Comandita, where the liabilities of the general partners must not exceed the amount of their respective investments in the business, whereas the liabilities of the special partners equal all of their outside resources in addition to the sums invested in the business. Obviously, many legal complications will arise out of an attempt to

enforce payment by legal means, unless much thought has been given to the exact legal status of the various members of the delinquent firm prior to such action.

Foreign commercial laws are so numerous, bulky, inadequate from the standpoint of protection to the creditor, and are changing so frequently that it becomes rather difficult to keep so well informed of the proper steps to be taken in enforcing payment by legal pressure as to cause one to doubt the wisdom of attempts to collect accounts in this manner.

In view of the foregoing, it is advisable to secure a settlement through amicable means by compromising with the debtor, not necessarily as to the amount of the bill but also in regard to terms or the time of payment. Once a willingness on the part of the seller to compromise is evidenced, it is said that in most cases it will result in the payment of the bill and in the retention of the customer's good will and patronage.

Whenever legal action does become necessary as the only means of settling an account, it is advisable to consult the Division of Commercial Laws of the Bureau of Foreign and Domestic Commerce. This division has prepared articles on the subject of collecting overdue accounts in foreign countries. It also has compiled lists of names of reputable attorneys in foreign countries who specialize in serving American creditors and is otherwise prepared to assist creditors in adjusting cases involving errors or misunderstandings.

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Questions and Problems

1. List all possible methods that can be used in the collection of overdue accounts by:

a. Wholesalers and manufacturers.

b. Retailers selling on regular charge account; on the instalment plan.

c. Exporters.

2. Arrange these collection methods in the order in which they are likely to be applied.

3. When does the use of collection letters begin and when does it end in the collection process?

4. Why is the draft regarded as a fairly effective collection device? How do you explain the failure of some drafts to result in payment?

5. Indicate the reasons for advance notices of drafts. Which of these reasons, in your opinion, is the most important?

6. A draft may be returned because the bank has neglected to present it. Can you suggest any reasons for the bank's action?

7. Is the personal call equally adaptable to the retail and mercantile fields? At what stage in the collection process should a personal call be made and by whom? Would the answer to this question be the same for all cases, regardless of whether collection is to be made from a consumer or from a business establishment?

8. At what stage in the collection process would you recommend the employment of a collection agency or an attorney? Why?

9. What may be done by a creditor who desires to hold on to an account as long as possible before turning it over to an outside agency for collection?

10. Cite the leading advantages accruing to a creditor from services such as rendered by the U.S. Fidelity and Guaranty Company:

a. Over a house collection agency?

b. Over a regular collection agency?

11. In selecting a collection agency or an attorney, what precautions must be exercised and why? What facilities are available for the purpose?

12. When an account has reached the stage when the employment of an outside agency is demanded, what would govern your choice between an attorney or a collection agency?

13. Assuming that a judgment has been obtained against the delinquent debtor, what is the procedure in enforcing it? Suppose no property is available at the time, what can be done with the judgment and for how long a period can the judgment be kept alive?

14. What makes the forceful collection of accounts especially difficult in the foreign field? What is the alternative? To what agencies in this country and abroad may a creditor turn for assistance in securing payment?

15. How may an account, barred by the statute of limitations, be revived?

CHAPTER XXIX

COLLECTION CORRESPONDENCE

GENERAL PRINCIPLES

Assumptions.—When payment is not forthcoming on the due date, the first assumption to make is that the indebtedness has escaped the customer's attention. He is, therefore, entitled to courteous reminders, in which he is at the same time requested to verify the correctness of the bill. Failing to receive a reply to the reminders, it is natural to assume that the customer is in financial difficulty. Accordingly, he should be sent letters of discussion in which he is requested to point out the reason for the delay in making settlement. He is also impressed with the seriousness of the situation and with the reasons why payment should be made immediately. If no explanation is forthcoming after several attempts to secure one have been made, it is natural to suppose that the customer is unreasonable and unwilling to meet his obligations. At this point friendly relations may be ruptured and the customer made to feel that his obligations must be met, otherwise he should be prepared to suffer the consequences of more drastic measures taken against him.

Tone in Collection Letters.—Within the limits of the above assumptions there is, no doubt, room for the greatest variety of letters. It is important, however, that the sequence of these assumptions should not be reversed. After a customer has been threatened, or his obligation urged, it is too late effectively to assume a friendly attitude and offer assistance. Accordingly, friendly relations should not be broken until all reasonable means of bringing about an amicable settlement have been exhausted.

Collection letters when improperly used can easily result in serious injury to the collecting house. If they are too harsh in tone, many customers will be repelled. It is also much less difficult to secure payment from delinquent debtors by courteous, tactful, and friendly collection letters than by harsh and sharp ones. Writers of collection letters often produce a sharp effect when they mean to be courteous and mild, because they fail to realize the effect of the expressions they use, as when they unintentionally use the words "must," "demand," "insist," "require," "be compelled to," "delinquent," etc. This is accentuated by the fact that many customers are only too ready to read into a letter

meanings that the writer did not intend. Consequently, every collection correspondent should keep in mind those phrases which produce a sharp effect, and carefully guard against ambiguous statements or unpleasant implications. Sharp language should be reserved till more courteous methods have failed. This is so because the aim of collection letters, as of the collection system in general, is to accomplish not one but two definite objects. They must bring previous transactions to a satisfactory conclusion and at the same time retain the good will of the customer and pave the way for continued profitable business relations. Good collection letters are not only money-getters but are business-builders as well.

The tone of a collection letter should be dignified and courteous. Undignified language and methods invariably result in lowering the reputation and standing of the creditor in the eyes of the customer. Furthermore, statements which are merely insulting are ineffective because they arouse anger and destroy the value of whatever appeal is made in the letter. Accordingly, correspondents should refrain from the use of statements which in any way imply that the customer deliberately delays remittance or refuses to reply to previous communications or that his credit standing is inferior. Discourteous language when written is far more stinging than the same language spoken. It is much more effective to assume that the debtor intends to pay and to emphasize the desirability of his paying immediately.

Avoid Excuses.—An apologetic or begging tone seldom produces results. To offer excuses for requesting payment of overdue accounts implies that promptness is illogical. Furthermore, excuses often produce a bad effect upon the customer, resulting in a loss of respect for the house. In writing letters to delinquents, no apologies need be made for seeking settlement. There is nothing to beg and nothing for which to apologize. The money is due and should be paid without further delay. The debtor knows that, and excuses simply weaken the creditor's demands and encourage undue procrastination.

It should be understood at the time credit is first granted that the terms agreed upon are to be maintained and that the creditor will follow up any delinquency with regularity and promptness. A creditor need, therefore, ask for no favor from the debtor. It is an obligation which a customer has assumed voluntarily, its payment is necessary in order to obtain further credit from the house, the bill is due for value rendered, and the creditor needs the funds for the conduct of his own business. These are sufficient reasons for demanding payment of an overdue account. They can be effectively stated in the letters and thus provide the correspondent with adequate material for his correspondence that is logical and requires no apologies.

Flexibility.—No set of collection letters will serve for all customers, at least not beyond the point of formal notifications and reminders. Some customers must be coaxed, some cajoled; others require an appeal to self-interest; while still others can be talked into making remittance by playing upon their sense of business fairness. Some debtors require "jogging," while others demand "dunning." Some debtors are sensitive and must be handled with the utmost care, while others are negligent and indifferent and will respond only to unusual treatment. Because of this, a correspondent, before commencing to write any of the personal appeal letters, should carefully study his debtors individually. Good collection letters are original, and carry with them a living and personal message. Writing a letter merely as a communication, without thinking of the objective, will defeat its very purpose. To be successful and accomplish the object intended, the letter must establish a point of contact with the recipient.

To accomplish this end, a correspondent should have before him a complete record of the case, showing the history and development of the account and the number and kind of collection efforts that have already been made. He should at this time recall his impressions of the customer when met personally on a previous occasion, and should also gather all possible information concerning his characteristics and idiosyncrasies through the salesman who had the opportunity of knowing and meeting him on the ground. All this information will safeguard him from making serious mistakes in the treatment he accords the delinquent debtor in the collection letter that he writes. With all facts before him, he can definitely decide upon the choice of the appeal to be used and the degree of persuasiveness and diplomacy that should be injected.

Personality.—Every collection letter of the personal appeal type should express the personality of the writer, if it is to establish a point of contact. A common defect of many letters is that they lack the grip of personality. Consequently, they do not sound natural or anything like the spoken language used by the correspondent. Unfortunately, too many letter writers indulge in expressions not characteristic of them and which they would not use when the debtor is personally before them. Instead, they should make letters personal, human, write in such a tone as befits a man of responsibility and conservative character, avoid, wherever possible, stilted or conventional phrases or long, involved sentences and paragraphs, and use the "conversational" style of writing.

Component Elements.—In every collection system, of which collection letters naturally form an important part and to which they necessarily must conform, there are at least three variable elements. The first deals with the time taken for the complete operation of the system, as well as the time that is allowed to elapse between any two steps in the

series of collection efforts. The second element deals with the number of notices and letters to be sent and other steps to be taken. The third element has to do with the kind of appeals and nature of consideration and treatment to be accorded various classes of delinquents.

Obviously, all three are interdependent, each one varying in accordance with the nature of the other elements. The time allowed to elapse between any two notices or letters to be forwarded, for example, varies directly with the nature of the risk. Not only is the interval between any two efforts shorter when collecting from the poor risk, but the time taken for the complete operation of the system until the climax is reached is correspondingly brief. Again, fewer notices or letters are generally sent to the poor risks than to otherwise prompt-paying customers.

Stages in Collection Correspondence.—It is not intended to convey the impression that every account in the collection process necessarily passes through the various stages to be presently discussed. The particular circumstances of a given account may, for example, justify a prompt transition from the first to the last stage without reminding the customer of his delinquency or without any discussion concerning his reason for the delay in making settlement. Due recognition is also given to the importance of handling each individual case on its own merits. Nevertheless, there are certain well-defined stages through which accounts most frequently pass in the collection process. They are as follows:

1. *Stage of Notification.*—The customer is notified first that the account is becoming due, and, second, that the bill is already due. The first step is accomplished by a statement sent with the invoice at the time of shipment. At the same time it also serves the purpose of verifying the amount as to correctness and forestalls possibilities for mistakes, misunderstandings, or excuses. The second step is accomplished by sending another statement timed to arrive the day the account becomes due.

2. *Stage of Reminder.*—This begins with the date the account matures, when it automatically becomes a "collection." During this stage of the collection process the matter is brought to the debtor's attention by means of additional statements accompanied by brief notices, stamped, mimeographed, printed, or typewritten; also by one or more short and impersonal letters which courteously refer him to the overdue account, which is usually attributed to neglect or oversight.

3. *Stage of Discussion.*—In this stage, personal collection letters are employed, in which the appeals are graded in strength and in the tone of insistency. The creditor here labors under the assumption that the delinquent debtor has good reason for the delay in settlement, or is in difficulties. Accordingly, attempts are made at this point to secure a response explaining the reasons for the delay. The customer's confidence

is invited and the house may either offer to allow additional time or else become more insistent and proceed to the next and last stage of the collection process.

4. *Stage of Urgency and Compulsion.*—Here the creditor forcefully points out the customer's obligation and the consequences that might result from continued delinquency. It is at this point that a draft is employed as a means of enforcing payment. It is then followed by a letter threatening to place the account in the hands of an attorney or a collection agency, and actual suit may be brought against the debtor should they fail in their efforts to effect an amicable settlement.

TYPES OF COLLECTION LETTERS

All through the stages previously outlined, three distinct types of collection letters are resorted to, each of which has its peculiar characteristics designed to produce the proper effect on the recipient. They consist of formal reminders, personal appeal letters, and letters threatening suit.

Formal Reminders.—The principal aim of these collection efforts is to remind the debtor that his account is overdue. As a whole, they are mild and inoffensive. With many delinquents, formal reminders are all that are needed to bring a settlement.

Formal reminders have the following characteristics: they are short, impersonal in tone, stereotyped in language, and courteously refer the customer to the overdue account. In this way the recipient is made to realize that he is not being "dunned," but is simply reminded of his obligation formally and as a matter of customary routine, in a manner not unlike the even less distinctive and impersonal typewritten statement.

Types of Reminders.—Formal reminders may take one of four forms. They may consist of a mere statement of varying length, such as "reminder," "past due; please remit" or "the above account is past due, which fact has no doubt escaped your attention. A prompt remittance will be appreciated." A reminder containing such words may be stamped on the statement which it accompanies by means of a rubber stamp, attached to it in printed form, or printed on the body of the statement.

The second type is a more elaborate printed form which accompanies the statement. It is frequently printed on a card, which is then clipped to the statement. It may read somewhat as follows: "The ——— company respectfully calls attention to the accompanying (or inclosed) statement, which, no doubt, has escaped your attention (or has been overlooked)."

The third type consists of a printed or lithographed form with no introductory address or complimentary close, containing blank spaces for the insertion of the name and address of the customer, the amount

owed, and the period in which the purchases were made. It is an obvious form and is intended to make an impersonal impression. The blank spaces are filled in with ink or on the typewriter. This form may also be printed on a card. Its probable contents are: "We beg to call attention to your account of ——— amounting to $———. Your prompt attention will be appreciated"; or "We wish to call attention to your account for ——— (month, etc.), amounting to $———. We trust it will have your immediate attention."

The fourth style of impersonal reminders consists of a series of typewritten or multigraphed forms of letters with blank spaces in which all necessary information may be inserted. These letters are, as a rule, carefully watched and personally signed, and contain a salutation and complimentary close. Where this style of letter is employed, the first reminder is very courteous and mild, excluding all sharp phrases. It is based on the assumption that the debtor has overlooked the account, and all blame for possible mistakes is taken by the creditor. Following are illustrations of the first formal reminder of this type:

Dear Sir:

We are sending you a copy of your invoice of ..... amounting to $....., in order that we may have your check as to its correctness. Our books show the amount as unpaid.

If there is any error please let us know, and we will gladly correct it.

Respectfully yours,

Dear Sir:

We feel sure that we need only to remind you that this account is past due.

Just pin your check to this letter, enclose in the attached envelope, and forward to us in the next mail.

Yours very truly,

Should this secure no response, one or more formal reminders, the exact number of which will depend upon considerations mentioned in the earlier part of the present chapter, are sent to the delinquent debtor at intervals determined by the timing and dating plan of the collection system of the house. Although courteous assumptions are still proper, these reminders are made somewhat stronger in tone by the inclusion of a sharp phrase, making the request for payment more definite and insistent. Following are illustrations of such reminders:

Dear Sir:

Your invoice of ..... for $..... has now been past due for two months and is still unpaid. We wrote you regarding this matter on ..... but have received no reply. We desire to call your attention again to the need for settlement.

If there is any error or misunderstanding, we hope that you will let us know immediately.

Respectfully yours,

Dear Sir:

We wish again to call your attention to your past-due account of ..... for $....., a detailed statement of which we have previously mailed to you. We shall appreciate receiving a remittance in settlement of this amount by return mail.

Very truly yours,

In order unmistakably to impress the debtor that all of these reminders are mere forms and do not apply to him alone, some concerns avoid the use of the word "we" by substituting for it the name of the company. The word "you" is frequently omitted for similar reasons by substituting for it "our customers."

To accentuate still further the formal and impersonal character of reminders, stilted and conventional phrases are resorted to. In fact, it is advisable to eliminate all personality and originality in language and use instead expressions that are hackneyed. Only in this manner is it possible to collect overdue accounts without giving offense to customers who are very sensitive about collection matters. To be sure, the appeal made by formal reminders is rather weak on account of their formality, but that may be all that is needed in the majority of cases, and where customers are more stubborn these are essential preliminaries preparing them for more drastic measures.

Personal Collection Letters.—These letters begin with the most important stage in the collection process, the stage of discussion. Personal letters are written only after reminders have been used unsuccessfully as long as the creditor saw fit. To secure the best results, each succeeding letter must lead gradually to a climax. Accordingly, it is necessary that their tone and the appeals they make be definitely graded in strength and insistency. As a result of such a course, many delinquent debtors will be moved to action before the stronger and more insistent and, consequently, offensive communications are employed, whereas, if the stronger appeal were made in the first of the series of personal letters, many customers would, no doubt, pay immediately but would at the same time withdraw their patronage. On the other hand, the more stubborn customers who were not affected by the strong appeal will become callous and uninfluenced by subsequent and weaker communications.

In order to make the first of the personal letters as mild as possible, a short sales talk is oftentimes included. Not only is the collection impression made less sharp than if it were sent alone, but the sales material also suggests the value of continuing business relations with the creditor by maintaining with him a good standing. The sales material may consist of a sentence to the effect that an early order is expected, or it may involve an entire paragraph calling the recipient's attention to a special sale or some regular or seasonal offering. Sales matter should

always come at the end of the letter, for it generally provides a pleasant conclusion.

Since at this stage in the collection process accounts call for personal and individual treatment, it becomes essential that a correspondent, before starting to write any of them, familiarize himself with the actual condition of the account, the personal characteristics of the debtor, and so on. Only after such knowledge has been gained can he proceed intelligently to select the appeal and determine upon the general tone of the letter. Furthermore, it is necessary that these letters possess the grip of personality; that they become personal messages. Consequently, stilted, ordinary, hackneyed, and uninteresting sentences should be avoided, particularly at the beginning. This is because it is but natural for people to dislike to read "duns." If the beginning is sufficiently interesting, personal, and original, however, it will grip the attention of the reader so that he will read the whole message.

Following the beginning or opening statement there comes the main body of the letter, wherein attempts are made, by proper appeals, to make the debtor feel that he ought to make remittance. Once this stage has been reached it is necessary to stimulate him to such an extent as to secure immediate attention. This is accomplished by the ending or conclusion of the letter, which is, of course, varied in strength and insistency in accordance with the position of the letter in the entire series. The more advanced the letter is in the collection series, the more sting the ending contains, and vice versa.

Collection Letter Appeals.—The five appeals most commonly employed in collecting accounts are, in the order of strength, sympathy, pride, justice, self-interest, and fear.

Appeal to Sympathy.—The purpose of the appeal to sympathy is to make the customer feel that the concern which has favored him with credit extensions is now suffering financially on account of his delinquency. It is no doubt the weakest and at the same time the most misused of the appeals. If the organization using this appeal is large, the average debtor believes that the reason given is fictitious and that it does not sound plausible, thus involving a loss of dignity. When the organization is small, however, the debtor is flattered by his financial superiority and will make payment.

The appeal to sympathy may also be used successfully in the first or second of the personal letters, by calling attention to the fact that, although this particular customer's account is small, the sum owed by the several thousands of such accounts which the house carries is considerable. A credit manager may also employ this appeal by explaining that he desires or is asked by his superiors to collect the overdue accounts and

make a respectable showing. A letter illustrating some of these points follows:

Dear Sir:

Your check for $..... to cover the invoice of ..... has not yet been received. Your failure to meet this obligation has been probably caused by an oversight.

Although in itself the amount is insignificant, nevertheless the total owed by several thousand similar accounts amounts to a considerable sum. We are quite certain that our customers will realize the hardship that is worked upon us when we are forced to bring the matter constantly to their attention.

If you will, therefore, let us have your check promptly to cover, we shall consider it an accommodation to us.

Very truly yours,

Appeal to Pride.—Pride is one of the strongest emotions and, therefore, one of the strongest incentives to action. When skilfully used, it is almost certain to produce satisfactory results. The following is an example of an appeal to the customer's pride:

Dear Sir:

As you have been in the past most punctual in the matter of payments, we feel that we may rely upon you now to maintain your usual standard. Prompt remittances help us to give the very best service to our customers.

If you will, therefore, let us have your check to cover your account of ..... amounting to $....., you will be helping us materially to this worth-while end. We are counting on your cooperation.

Sincerely yours,

Appeal to Justice.—This appeal has for its purpose to make the customer feel that he is not dealing with the house fairly. In these letters it is usually pointed out that the bill is due for value rendered, that the creditor has carried the account long after it became due, and that it is not fair and just to compel him to wait any longer for payment. Following is an example of a letter appealing to the sense of justice:

Dear Sir:

We confidently expected a remittance on your account of ..... for $....., as a response to our communication of .....

Obviously, we were disappointed, but it is quite impossible for us to believe that you would intentionally impose.

It has been our pleasure to have the opportunity of rendering you a service. However, there is a sense of reciprocity that should manifest itself in the nature of a remittance.

May we not, therefore, ask that this account be settled now? The return envelope is for your convenience.

Very truly yours,

Appeal to Self-interest.—The letter containing this appeal is stronger and more insistent in tone than any of the letters previously discussed. Logic and argument become more effective. The customer can be shown

that it is to his own interest to pay his overdue bills immediately, that prompt payment improves his credit standing and enables the house to sell at reduced prices. A letter illustrating the appeal to self-interest follows:

Dear Sir:

On referring to your account with us we find that we are still without a remittance in settlement of the invoice of ....., amounting to $..... The matter has been called to your attention on several occasions, but for some reason we have heard nothing from you in this connection.

Obviously, we are disappointed. When you came to us we placed confidence in you, but unfortunately you have not done your share toward upholding it. It is unnecessary to point out that only by meeting its just obligations can a firm maintain its credit standing in the eyes of the business community.

You surely cannot afford to lose the good will of our house. It must be worth something to you, as it is worth something to all of our customers, whether their purchases are large or small. We therefore hope that you will enable us to continue the confidence we placed in you and that you will do your part toward maintaining cordial relations with us.

Please favor us with your remittance by return mail for the above amount and we shall promptly dismiss the incident from our memory and start anew.

Very truly yours,

Another way in which an appeal to self-interest may be made effectively is that employed by a large number of retailers, who are members of some retail merchants' association. In a letter which they forward to the delinquent, it is explained that the members are required to report periodically all delinquents, but it is felt that the debtor should be given an opportunity to protect himself against any possible embarrassment that might result therefrom by making settlement on or before a specified date. Needless to say, any resort to threats or expedients of this sort must be used with great caution, because in some states such letters may render the creditor liable to punishment. Even where permitted by law, the plan has the disadvantage of implying a process of blacklisting, which is, on the whole, a bad and undesirable practice, although it may under these circumstances be fully justifiable. Following is an example of a letter of the type under consideration:

Dear Customer:

It is not our thought to harass or injure you in any way, but to assist you by calling your attention to an important matter which you have, for some unknown reason, neglected.

At the next meeting of the ..... Credit Association it will be necessary to report your name among those who have been owing merchants for a considerable length of time. This is in line with the rules of the Association and leaves us no choice in the matter.

To prevent us from bringing your name to the attention of the membership, it is to your advantage to give this matter your immediate attention and protect your

credit standing in this community. Unless satisfactory arrangements are made by (date), your name will be reported.

The ..... Credit Association was formed by a number of the city's leading credit men and women to bring about better credit and collection conditions and to help all customers who are in arrears with their accounts. The members of the group consist of the leading stores in town, dairies, coal dealers, doctors, dentists, hospitals, etc.

We trust that you will take prompt action in this case and clear up your account with us.

Very truly yours,

Part Payment.—At this point it may be advisable, as a precaution, to send what is generally known as a letter of courtesy, in which the customer is given one more opportunity to explain his neglect to make payment. When this fails to secure a response, an attempt may be made to secure part payment and arrange for other payments at definite intervals. A suggestion to this effect rarely fails to bring a reply, since it is plausible and appeals to the debtor. This method is usually resorted to by wholesalers and manufacturers where the accounts carried involve relatively large amounts. In such instances a real service is rendered the debtor who is unable to accumulate an amount large enough to pay his bills in their entirety.

Dear Customer:

If one of your customers owed you $25 and offered to pay $10 today and the remainder next week, you would feel that he was trying to do the right thing, wouldn't you?

Why not do the same for us? If you cannot pay in full, please send a check for half the amount today and let us know when we may expect the balance.

Very truly yours,

Use of Drafts.—One of the more urgent steps taken at this point, particularly by wholesalers and manufacturers, is the sending of a draft. The purpose of this step, and its advantages, have already been treated in the preceding chapter. The letter announcing the sending of a draft consists of a simple statement reviewing the action already taken and stating that unless a response is made within a certain time a draft will be dispatched to the debtor's bank, or it may be a long and sharp letter emphasizing the seriousness involved in dishonoring the draft.

Dear Sir:

Your account amounting to $150 is now 95 days overdue.

We have written you several letters calling it to your attention. We have attempted to be as helpful to you in this regard as we could and have allowed the account to run as long as it is really fair for you to have us do. We are sure that you appreciate this fact.

If we do not hear from you by ....., we shall assume that we have your permission to draw a draft on you for the above amount. It will be drawn through the First National Bank at .....

We sincerely hope that you will avoid this inconvenient and roundabout method of paying your bill and prevent the reflection on your credit standing at the bank by

remitting to us directly before the date indicated. Let us hear from you by return mail.

Yours truly,

Appeal to Fear.—If the draft has been dishonored and all of the personal appeal letters have failed to secure a response or payment of the obligation, the creditor may send a personal collector, or the credit manager himself may call upon the debtor under certain circumstances. If none of these are feasible, threat letters are resorted to. They make an appeal to fear and are the harshest of all collection letters. The debtor is usually threatened that he will be sued immediately, unless payment is forthcoming on or before a specified date or that the account will be placed in the hands of an attorney or a collection agency. Its purpose is to point out the disagreeable consequences that will result from further delay and that the debtor cannot escape payment of his just obligations. It is, therefore, desirable to write a rather lengthy letter in which the seriousness of the matter may be dwelt upon sufficiently. It is sometimes advisable to use sharp language with a veiled threat to take drastic measures in the hope of moving the delinquent into action; and if this fails to bring a response, the threat is made openly and at length as pointed out above. An example follows:

Dear Sir:

Despite the fact that we have sent you numerous notices and letters regarding your past-due bill of $..... for ....., we have heard nothing from you and we are at a loss to understand the situation. We, therefore, feel that we have waited long and patiently and now urgently request your immediate attention.

We assure you that we have no desire to embarrass or trouble you, but it is necessary that this account be settled at once, and we trust that you will make satisfactory arrangements so that the matter may be adjusted without delay.

Very truly yours,

Where permitted by law, retailers who are members of some merchants' association are furnished with one or two form letters that are supposed to have been sent by the bureau which the association maintains and which read as though coming from the bureau. These letters have been found very effective. They read somewhat as follows:

Dear Mr. .....:

In preparing the files of this bureau organized for the mutual interchange of credit information, we find that (name of store) reports an account against you which is past due.

We would suggest that you make settlement with your creditor at once so that your record may be clear in our files.

Members of the bureau will, under our rules, report to us within five days as to whether or not settlement has been made.

Very truly yours,

Dear Mr. .....:

We wrote you under date of ....., stating that (name of store) had reported an account against you which is past due.

Our letter showed clearly that it was sent in order to give you an opportunity to make settlement with your creditor in order to avoid an unfavorable credit report with us.

Operated, as our bureau is, by the leading retail merchants of ....., our aim is to conduct negotiations with you in confidence and with utmost fairness. It is our business to give accurate and truthful information as to the paying habit of customers when inquiry is received from members of the bureau, and we feel sure you will appreciate the value of a good credit standing with these merchants.

We shall expect you to make settlement with your creditor at once. Under the rules of our bureau, unless this is done within five days, the matter will be turned over to our attorneys for whatever action they deem necessary.

Very truly yours,

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Questions and Problems

1. List the stages in collection correspondence and show opposite each stage the assumption or assumptions involved and the appeals that can be used to greatest advantage.

2. To what extent would you recommend the use of form collection letters? Why?

3. Should a creditor ever attempt to give the impression that a form letter is being used, instead of concealing that fact, as it is normally done?

4. To what extent are so-called "personal" collection letters personal?

5. Write a series of three letters for a mercantile concern that follows a strict collection policy and wishes to reduce the number of letters to a minimum.

6. Suppose a creditor desired to have at least seven letters in the collection series, what additional appeals would you use in connection with the letters you have written?

7. Prepare a group of collection letters for a retailer who wishes to be lenient with his customers.

CHAPTER XXX

GENERAL RIGHTS AND REMEDIES OF CREDITORS

Under certain circumstances and conditions, unpaid sellers of merchandise may exercise special rights against the goods and resort to certain remedies, even though title to the goods has passed to the purchaser. A seller of merchandise is deemed unpaid, if the whole of the purchase price has not been paid or tendered to him; when a negotiable instrument has been given as a conditional payment in the form of a check, draft, or note, and it has been dishonored; or when the buyer becomes insolvent before the bill is paid.

UNPAID SELLER'S LIEN

Nature of Lien.—A lien constitutes a right of one party to retain in his possession goods belonging to another party until the demands of the holder of the lien have been satisfied. In the case of an unpaid seller's lien, it is implied that the buyer, to whom title to the goods has passed, retains ownership of the merchandise but that the seller or holder of the lien possesses a claim or right, not to ownership, but to hold the goods as security until the obligations of the purchaser have been discharged in accordance with the agreement governing the transaction. Whether or not title to the goods has actually passed depends upon the intention of the parties to the transaction, according to the Uniform Sales Act, which has been adopted by 34 states and which also sets forth certain rules to be observed in determining intent, when it is otherwise difficult to prove.

When Right May Be Exercised.—According to Sections 54 to 56 of the Uniform Sales Act, the right to a seller's lien may be exercised under two distinct circumstances. Where merchandise is sold on a strictly cash basis, *i.e.*, without any agreement involving the extension of credit to the purchaser, the seller may retain possession of the goods until they are paid for, even though the title to the goods passes immediately. The other possibility for the exercise of a lien is when goods are sold on credit.

In this latter case the seller may exercise his right of lien when the term of credit has expired before delivery of the goods, or when the buyer becomes insolvent while the goods are still in possession of the seller. This is obviously based on the theory that in extending credit the seller waived his right of lien on the implied condition that the buyer's financial and credit responsibility would remain unimpaired. Upon breach of this implied condition, the seller has the privilege of exercising his right of

lien. It is also specifically provided that his right of lien may be exercised even though the seller is "in possession of the goods as agent or bailee for the buyer." Where the unpaid seller has made part delivery of the goods, he may still exercise his right of lien on the remainder, provided such part delivery has not been made under circumstances showing an intent to waive the lien or right of retention.

When Lien Is Lost.—An unpaid seller loses his lien as soon as he parts with the goods, or as soon as the buyer tenders the purchase price. Section 56 of the Uniform Sales Act specifically provides that the unpaid seller of goods loses his lien thereon (1) when he delivers them to a carrier or other bailee for transmission to the buyer, without reserving to himself the title to the goods, or the right to the possession thereof; (2) when the buyer or his agent lawfully obtains possession of the goods; or (3) when the seller waives the lien. In this connection it should be observed that the unpaid seller does not lose his right of lien by reason of a judgment or decree obtained by him for the purchase price of the goods, for there may be little or nothing on which to levy and the judgment would, therefore, prove worthless. Consequently, it would be bad policy to compel the seller to surrender his merchandise in return for a judgment which may prove worthless.

STOPPAGE IN TRANSIT

When Right May Be Exercised.—The unpaid seller's lien continues in effect only during the time the goods are in his possession. Notwithstanding the fact that he has voluntarily parted with the actual possession of the merchandise, the seller is nevertheless still in a position to avail himself of his right of lien indirectly by way of exercising his legal right to stop the goods in transit. This may be done only in case of the buyer's insolvency. It frequently happens that a seller who has dispatched goods to a buyer at a distance learns in the meantime of the insolvency of the buyer.

As already indicated, the right of stoppage in transit rests solely upon the apparent insolvency of the buyer at time of sale or after the sale was made. It is but just and equitable that the goods of the seller shall not be applied to the payment of the debts of the buyer. It is not necessary that the buyer become actually or technically insolvent; so long as the purchaser by the manner in which he conducts his business furnishes usual apparent evidences of insolvency, it is deemed sufficient ground for such action. Thus, failure to meet his bills at maturity, or inability to pay his notes when due, thereby causing them to be protested, constitutes evidence of insolvency as required by the act.

When Goods Are in Transit.—According to Section 58 of the Uniform Sales Act, goods are deemed to be in transit from the moment the seller

or his agent delivers them to a carrier or other bailee for transmission to the buyer until the time of delivery to the buyer or his agent by such carrier or other middleman. The right of stoppage continues not only when the goods are in actual transit, but until they are delivered into the actual or constructive possession of the buyer or his agent. The unloading of the merchandise or placing it in the warehouse of the carrier or other bailee does not necessarily terminate the period of transit. As long as the goods remain in the hands of the carrier as such, the right of stoppage continues. This observation applies as well to possession of goods by a carrier after rejection on the part of the buyer, even when the seller has refused to receive them back.

The right of stoppage ceases if the buyer, or his agent, obtains possession of the goods before their arrival at the point of destination. The same condition obtains if, on arrival of the goods at destination, the carrier or other bailee notifies the buyer or his agent that it is in possession of the goods as bailee for the buyer or his agent. The goods are no longer considered in transit after such acknowledgment, even though a further destination has been indicated by the buyer and they still remain in the possession of the carrier or other bailee. Similarly, the goods are no longer in transit after the carrier or other bailee wrongfully refuses to deliver them to the buyer or his agent.

Provisions 3 and 4 of Section 58 are the other conditions under which goods are to be construed as being in transit. They are as follows:

3. If goods are delivered to a ship chartered by the buyer, it is a question depending on the circumstances of the particular case, whether they are in possession of the master as a carrier or as agent of the buyer.

4. If part delivery of the goods has been made to the buyer or his agent, the remainder of the goods may be stopped in transit, unless such part delivery has been made under such circumstances as to show an agreement with the buyer to give up possession of the whole of the goods.

In the event the goods, while subject to the unpaid seller's right of lien or stoppage in transit, are sold or otherwise disposed of to a third party, the seller is not affected by such action, unless he has assented thereto, or unless the transaction has been consummated by way of transfer by buyer of a negotiable document which was delivered to him by the unpaid seller. Thus, the right of stoppage is defeated if a bill of lading in negotiable form has been transferred by the first purchaser to a second *bona fide* purchaser for value. The principle underlying such law is that it is more equitable to limit the right of stoppage in transit of a seller who has entrusted the buyer with a perfect title than to deprive an innocent purchaser for value to whom such title has been negotiated.

Procedure in Exercising the Right.—It is not essential that a special form be used for the purpose. All that the seller need do is immediately

to notify the carrier of his decision to exercise the right of stoppage. Notice may be given to the person in actual possession of the goods, or to his principal. If given to the latter, sufficient time is required to enable the principal "by the exercise of reasonable diligence" to prevent delivery to the buyer. From the time the carrier receives the notice he is under obligation not to deliver the goods to the consignee. Instead, they are to be redelivered to the seller or otherwise disposed of according to his instructions. The seller, of course, bears all the expenses incident thereto. Section 59 of the Uniform Sales Act also provides that if a negotiable document of title to the goods has been issued by the carrier, the seller must first surrender it for cancellation before the goods are redelivered to him. If the carrier surrenders the goods to the buyer after being properly notified to stop them, he renders himself liable to the seller in action in tort for conversion of the goods, or for breach of contract, notwithstanding the fact that the right of stoppage is not an expressed but implied condition of the contract with the carrier to deliver.

Effect of Stoppage in Transit.—The mere fact that the seller chose to exercise the right does not necessarily involve a rescission of the original sale. The buyer may still claim and exercise his right of possession by paying or tendering the purchase price of the goods. Otherwise, the effect is merely to restore the goods to the possession of the seller, who may then choose to sue for damages sustained through the buyer's non-performance of the contract. On the other hand, if the goods were stopped in transit when the seller had no reasonable grounds for doubting the buyer's solvency, the buyer may not only compel delivery but may also sue the seller for any damage caused by the delay in delivery and failure to comply with the terms of the contract.

RIGHT OF RESALE

Significance.—It should be remembered at this point that title to the goods is still vested in the buyer even after the goods have been recovered and reduced to possession through the exercise of the right to stop them in transit. If the buyer does not tender the purchase price and claim the goods within a reasonable time, however, the seller may resell them to a third party, who thereby obtains a valid title thereto. Technically, the seller acts in the capacity of agent for the buyer, and makes the resale merely for the purchase price. In spite of this, the original buyer never receives a profit, if such is made, on the resale, to which he should be technically entitled.

Time and Manner of Resale.—Section 60 of the Uniform Sales Act provides that an unpaid seller who has a right of lien, or who has stopped the goods in transit, may resell the goods under any of the following conditions:

1. If the goods are of a perishable nature.
2. If a right of resale has been expressly reserved upon default of the buyer.
3. Where default in payment of the purchase price has existed for an unreasonable length of time.

RIGHT OF RESCISSION

Time and Manner.—A seller who has not parted with his goods or who has recovered his lien through the exercise of his right of stoppage in transit is permitted to rescind the transfer of title and resume ownership of the goods, when:

1. The right of rescission has been expressly reserved in the contract to the seller.
2. The buyer has been in default an unreasonable length of time.
3. The buyer has repudiated the sale.

Upon rescission, the seller revests himself with the title to the goods, and, in case of a resale, he need not account for any profits gained, but is entitled to damages sustained as a result of the default of the buyer.

REPLEVIN

Nature and Purpose.—In certain cases the seller of merchandise, in addition to his right of action for damages, is given the right to retake or recover his property. Technically speaking, he may exercise his "right of replevin or recaption." Where the purchaser has been guilty of fraud or misrepresentation, the prospects of collecting the purchase price are very remote. Consequently, the seller may exercise his right of replevin. Even though the seller voluntarily delivers the goods to the fraudulent buyer, directly or through an agent, the latter is guilty of wrongfully taking the property, and the seller is justified, under such circumstances, in rescinding or voiding the sale, and thereby insisting that no title or right of possession ever passed to the buyer. He may then recover the goods, provided he offers sufficient security against any injustice the buyer may suffer in consequence of such action. Although originally it was necessary to prove, in addition to the wrongful possession of the goods, that the buyer had come into possession unlawfully, it is no longer true in most states. Even where a buyer is not guilty of a wrongful taking or seizure, the seller will be allowed to exercise his right of replevin on goods wrongfully detained by a fraudulent purchaser. Other instances of replevin occur when a chattel mortgagee repossesses the property from the mortgagor when the debt is due and unpaid; also where the vendor in a conditional sales contract takes the goods from the buyer upon the latter's failure to keep up payments as agreed.

Procedure.—To exercise the right of replevin, the seller applies by affidavit or affidavit and petition in the proper court for a writ of replevin; if granted, the writ authorizes and directs the sheriff, or any other officer of the court, to summon the buyer to appear before the court to answer the action of the plaintiff for wrongfully detaining the goods and chattels described therein, and to seize the said property and keep it in his possession till further order of the court. The present possessor, namely, the person from whom the property has thus been taken, has the privilege of bonding back the goods. For this he is to furnish security so that the rightful owner, should it be decided that he is not rightfully in possession of the goods, will be protected against any loss pending a decision of the court.

As a prerequisite to the service of a writ of replevin, the seller is required to furnish a bond of indemnity, which is usually twice the value of the property involved, with sureties as security to the purchaser against any injustice that he may suffer as a result of wrongfully suing out of the writ.

When Right of Replevin Is Lost.—The owner of property wrongfully taken or acquired from his possession may exercise his right of replevin as long as the goods may be identified. He may follow them and reclaim them, even where their form has been changed, unless they have been annexed to another commodity in such manner as to become part of it. In like manner may the seller pursue any proceeds of the goods received by the defendant as long as they can be identified.

If the goods or the proceeds received from their sale cannot be identified because they have been intermingled with other goods of the same character and proceeds, the right to reclaim them is lost. Similarly, when the goods or proceeds fall into the hands of a third party who is a *bona fide* holder for full value, and without knowledge of the original purchaser's fraud, the first seller loses the right to reclaim the property in specie. Instead, he sues the defendant for the value of the property at the time replevin is attempted plus damages for the injury suffered. If the original purchaser or defendant obtained possession of the goods by fraudulently impersonating another or fraudulently pretending to be the agent of another, it is held that no sale took place, and, hence, no title was ever passed to the fraudulent buyer. He, therefore, could not pass any title to a third party, regardless of the latter's innocence or value paid for the property. Since the original owner of the goods never intended to sell to the defendant, the latter acquired no title, and any one who later purchased the goods from the defendant acquired no better title. The original owner is entitled, therefore, to pursue the goods and regain possession.

A seller may also lose his right of replevin by waiver. Thus, where a seller, having full knowledge of the fraud committed, accepts payment, a note, or security, or when he brings suit for the purchase price of the goods, he thereby loses his right to reclaim the goods in specie, for his action constitutes an affirmation of the contract of sale and a waiver of his right of replevin. The seller is not estopped from recovering his goods if any of these actions are taken without any knowledge of the fraud that has been committed. Neither is this right affected by subsequent bankruptcy of the defendant.

ATTACHMENT

Nature and Purpose.—Attachment is a provisional legal remedy whereby the defendant's property is seized and taken out of his control and held for the payment of a debt on which suit has been or is about to be brought by a creditor. If an attachment has been made prior to bringing suit, such action must be taken within a certain time, usually 30 days, after service of the writ of attachment; or else jurisdiction over the property attached ceases.

The purpose of this provisional remedy is to prevent a debtor from so disposing of his property during the pendency of a suit against him as to place it beyond the reach of his creditor in case he is successful in his action. It is a precautionary measure much appreciated by creditors who have learned from experience that debtors with ample assets cause them to disappear or make them execution proof after a judgment has been obtained.

Grounds for Attachment.—The right of attachment is purely statutory, the statutes usually specifying in great detail the classes of action in which the writ may be issued and the peculiar circumstances and relationships which must exist in these actions before the writ may be issued. Attachment proceedings are highly technical in most states, and if these technical requirements are not strictly complied with, the defendant may cause the attachment to be vacated.

Although the statutes differ widely in certain particulars, yet the principal grounds for resorting to this remedy are substantially the same in practically all states. They are as follows:

1. That the debtor is a nonresident of the state where the writ of attachment is sought against the debtor's property located within the state. This is one of the most usual grounds for granting an attachment. Thus, for example, in most jurisdictions it is sufficient if the defendant is a foreign corporation.

2. That the debtor has departed from the state with intent to defraud creditors or to avoid service of legal process.

3. That the debtor keeps himself concealed with intent to defraud creditors or to avoid service of legal process.

4. That the debtor has removed property or is about to dispose of property for the purpose of defrauding his creditors.

5. That the debtor has secured property from the creditor by fraudulent representations, such as the making of a false statement in writing regarding his financial condition.

Attachment Procedure.—Prior to the issuance of a writ of attachment, the plaintiff or creditor is required in most states to make an affidavit stating the amount of the indebtedness; that the claim is just; that no part of the debt claimed has been paid; the manner in which the debt accrued; that he is not indebted to the defendant; that the sum demanded is actually due; and the ground or grounds for attachment. The affidavit may be made by the creditor himself, his agent, or attorney. Another condition precedent to the issue of the writ of attachment in practically all states is the requirement that the plaintiff give a bond, or undertaking, with sufficient sureties, to protect the debtor against any injury which would result from a wrongful attachment, as where the debtor recovers judgment, or causes the attachment to be vacated. The attachment is not to be construed as wrongful, if the plaintiff had good cause to believe the grounds for attachment true, although cases to the contrary may be found in some states.

As soon as the writ of attachment is issued, the sheriff to whom it is directed immediately proceeds to execute it, by attaching enough property, which is not exempt from levy, to satisfy the creditor's claim, together with costs and expenses. If the original levy is insufficient, additional levies may be made from time to time until a sufficient amount of property has been attached. On the day specified in the writ, the sheriff returns a report of the procedure together with an exact and specific description of the property attached. The attachment then constitutes a lien on the debtor's property dating from the date of the actual execution of the writ. This lien is afterwards made absolute by judgment. In this connection it should be observed that in most states an attachment may be dissolved by the defendant tendering a bond for the payment of whatever judgment may be rendered against him.

SUPPLEMENTARY PROCEEDINGS

Nature and Purpose.—It frequently happens that, during the pendency of a suit against him, the debtor may transfer his assets so as to make them judgment proof. One of the provisional remedies is to obtain a writ of attachment. It may be difficult, however, to prove sufficient grounds for the issuance of such a writ. Where attachment is not resorted to, or where insufficient property has been attached, a judgment creditor

is given the right to examine the debtor under oath in proceedings supplementary to the judgment obtained with a view to determining the manner in which the assets were transferred to a third party and the disposition of the proceeds in case of sale. Any or all persons indebted to the judgment debtor may also be examined in supplementary proceedings. All assets so discovered may then be applied to the satisfaction of the judgment, subject to certain exemptions specified in the statute under consideration. Obviously, a condition precedent to supplementary proceedings is the securing of a judgment which has been returned unsatisfied after execution. Such right may be exercised any time within the period provided by the statute in question.

GARNISHMENT

Nature and Purpose.—Garnishment, sometimes termed "trustee process" or "third-party proceedings," is a process resembling that of attachment; it is a species of seizure by notice. Under these proceedings the creditor acquires a lien or right to hold the garnishee, in whose possession the goods, money, or credits of the debtor are found, liable for his debt to the defendant.

A garnishee is supposedly an innocent third party owing money to the defendant or in whose possession property of the defendant is found without his fault or blame. When such property or debt is attached, the garnishee is regarded in the eyes of the law as a trustee or custodian of the property or debt and is restrained from paying the debt or returning the property to the defendant. Instead, he is notified or warned to the effect that he is not to settle with the defendant but to answer to the suit of the creditor.

In practically every state the right of garnishment exists in one form or another, although in some few states it exists under a different name. In all instances the remedy is statutory, hence there are wide differences in its application. In many states it is limited to actions on contract but not permitted in actions in tort. In some states it is permitted only after an execution against the debtor has been returned unsatisfied, while in other states it is used in connection with a writ of attachment. The statutes differ also in other respects.

Procedure.—Despite these differences in the various states, it is believed that a brief explanation of the procedure followed in the State of Ohio, which is typical in many respects, will serve to elucidate the matter somewhat.

A person bringing an action for labor or necessaries must first make a demand in writing for the excess over and above 80 per cent of the personal earnings of the debtor and his minor children for the preceding 30 days, assuming that the third party is the debtor's employer and that

the debtor has dependents, 3 days and not more than 30 days before such action is actually commenced. In case the indebtedness was incurred through the purchase of other goods, the demand can be made only for the excess over and above 90 per cent. The amount exempted from garnishment is $75 per month if it can be shown that it is necessary for the support of the debtor and his family. If the defendant debtor tenders payment for the amount demanded, no additional charges are made, otherwise there is a charge of $2.50 to cover costs of the action. The law prohibits the making of such demand by the same creditor at closer periods than 30 days.

Failing to secure payment as demanded, the creditor files an affidavit for attachment and garnishment setting forth the facts and conditions of the case and praying for a judgment against the garnishee. An order is then issued by the court requiring the garnishee to appear and answer to the liability to the defendant debtor. This document, sometimes referred to as a "Notice of Garnishment" or an "Aid in Execution," serves as a notice to withhold all property, moneys, or credits in his possession until further orders from the court.

Failure of the garnishee to appear or to answer to the notice entitles the plaintiff to proceed against him in his own name. If the debt is admitted by the garnishee, an order is issued for its payment into court. It should be borne in mind that garnishment proceedings as well as all other rights given to creditors in enforcing payment are subject to the exemption provisions of the various states.[1]

THE BULK SALES LAW

Purpose and Value.—Prior to the enactment of bulk sales laws in the various states, it was not uncommon for dishonest debtors to sell their entire stock in bulk quickly and at a ridiculously low valuation, with intent to defraud their creditors. A practice somewhat similar to selling out to a third and *bona fide* purchaser for value would be one where the goods in bulk are transferred by a single proprietor or partnership to a corporation, into which the business was previously incorporated, in exchange for capital stock. To prevent such sales and transfers being consummated to the detriment of creditors, bulk sales statutes in substantially similar form have been enacted by every state and the District of Columbia, resulting largely from the sponsorship of the National Association of Credit Men and its affiliated local associations.

The purpose of the law is to suppress the widespread evil and practice of dishonest debtors' selling their goods in bulk secretly for the purpose of

[1] For a classified list of exemptions by states, see "Credit Manual of Commercial Laws," published annually by the National Association of Credit Men.

defrauding their creditors; for the most important uniform requirement of these laws is that the purchaser of goods in bulk must notify the creditors of the seller that the sale is to be made, otherwise the sale becomes void in some states, and fraudulent and void in most of the others. The word "void" in these statutes is frequently interpreted to mean merely "voidable," *i.e.*, the sale, to be voided, must be attacked by creditors. In no case does the mere giving of notice sanction the sale; it merely places creditors on guard so that when fraud is contemplated by the sale, it can be attacked even after it is made.

Classification of Statutes.—In general, the states may be divided into four groups in regard to their laws regulating the sales of a stock of merchandise and fixtures in bulk other than in the regular course of business, depending upon the effect which nonconformity with the statutory requirements has upon the validity of the sale. In the first group are included the following 33 states:

Alabama	Minnesota	Oklahoma
Arkansas	Mississippi	Rhode Island
Colorado	Missouri	South Carolina
Delaware	Nebraska	South Dakota
Illinois	New Hampshire	Tennessee
Indiana	New Jersey	Texas
Iowa	New Mexico	Vermont
Kansas	New York	Virginia
Maine	North Carolina	West Virginia
Massachusetts	North Dakota	Wisconsin
Michigan	Ohio	Wyoming

In these states which have adopted the New York form of statute, the law provides that the effect of noncompliance with the statutory requirements renders the sale absolutely void, and the goods are subject to attachment in the hands of the purchaser. To make the sale valid, the law requires that, prior to the sale, the seller shall prepare a full and detailed inventory of each article included in the sale, that the purchaser shall demand and receive from the seller a written list of the latter's creditors showing the amount of indebtedness due each, and that the purchaser shall, within a specified number of days prior to taking possession of the goods, notify every creditor of the vendor, personally or by registered mail, of the proposed sale and of the price, terms, and conditions pertaining to it.

In the second group are 11 states and the District of Columbia, which follow the Pennsylvania form of statute. This type of law affords greater protection to the creditors and, in case of noncompliance with the law, a sale in bulk is fraudulent and void, rather than just void. In this group are:

District of Columbia	Kentucky	Nevada
Florida	Louisiana	Oregon
Georgia	Maryland	Pennsylvania
Idaho	Montana	Utah

The Connecticut form of statute has also been adopted by Arizona, California, and Washington. Noncompliance with the law, makes the sale void, but the law is more limited in its application, and notice of the proposed sale must be *recorded*, but no personal notice is required. Finally, there is the Montana law which requires no notice to creditors, but which comprises most of the features of the Pennsylvania law.

In a number of the states, no proceeding to set aside a sale in bulk can be commenced after the expiration of a certain period of time. In Ohio, for example, this period is 90 days after the sale, whereas in North Carolina it is 12 months from date of maturity of creditors' claims.

Selected References

BREWSTER, S. F.: "Legal Aspects of Credit," Part V, Chaps. 25–29.
BRISCO, N. A.: "Retail Credit Procedure," Chap. 14.
"Credit Manual of Commercial Laws," 1937, pp. 82–97 and Chap. 6.
ETTINGER, R. P., and GOLIEB, D. E.: "Credits and Collections," Chap. 26.
MARKS, M.: "How to Correct Credit Abuses," Chap. 10.
PRENDERGAST, W. A., and STEINER, W. H.: "Credit and Its Uses," Chap. 24.
Uniform Sales Act.
YOUNG, R.: "Industrial Credits," Chap. 16.

Questions and Problems

1. When is a seller of merchandise deemed unpaid?

2. Brown sold a bill of goods to Smith, amounting to $1,500. Smith paid part of the purchase price of the goods immediately, with the promise to pay the remainder within 10 days. At the end of that period Smith defaulted. The goods were still in the possession of the seller. Can Brown resume title to the goods? How?

3. In which of the following cases can an unpaid seller exercise his lien, provided, of course, that the buyer has become insolvent in the meantime and that the seller wishes to retain the goods:

a. Seller has delivered the goods to the buyer's place of business.
b. Goods were sold for cash and were still in possession of the seller.
c. Part of the goods have been delivered and remainder is in the seller's hands.
d. Goods were sold on a 30-day credit basis, but were in the seller's hands for over 30 days from date of sale.
e. Judgment has been obtained by the seller for the purchase price of the goods held by seller for the buyer.

4. Goods have been delivered to a common carrier for delivery to the purchaser. The buyer secures the goods before they reach point of destination. Soon after, the seller learns of the buyer's financial weakness and that several of the buyer's checks have been recently dishonored. Can the seller recover possession of the goods? How?

5. A sells goods to B, and ships them. B's agent reroutes them to another destination. Are the goods still in transit? Explain.

6. A, of the state of Washington, sold to B, of Ohio, a carload of apples. A delivered the apples to the Northern Pacific Railway and received a negotiable document of title, which was mailed to B. Later A heard that B was insolvent and attempted to stop the goods in transit. In the meantime, B had sold the document to an innocent purchaser for value. Can A obtain possession of the goods? Who has title?

7. Mr. Jones, an unpaid seller, exercised the right of rescission. He later resold the goods at a price higher than that at which the goods were sold to the first purchaser. Must Jones share this profit with the first buyer? Suppose that the goods were sold at a loss, could Jones sue the first buyer for the difference?

8. Mr. Blank, operating a garage and service station, fraudulently obtained a bill of goods from a local wholesaler of automotive equipment. Most of the goods thus purchased were used up in repair work shortly after they were secured. Can the wholesaler exercise the right of replevin? Why or why not?

9. Under what conditions would one bring action to replevin rather than action to rescind the contract?

10. A retail grocer in Indianapolis, Ind., purchased a large bill of goods from a local wholesale house. Being in some difficulties with his bank and other creditors, the retailer left the state for parts unknown. Can the wholesaler in question obtain possession of the goods? If yes, by what proceedings can this be done and under what conditions?

11. Mr. X, who is engaged in the capacity of salesman for a clothing store, bought a diamond ring for his wife. He promised to pay the purchase price at the end of 90 days, but he defaulted. How much can the seller recover by means of garnishment proceedings? Would your answer be the same if the bill were owed to a grocery store for the purchase of various items of food? Give reasons for your answer.

12. A sells his business to B, including the entire stock in trade. C is one of the creditors of A and was unaware of the transaction until shortly after it was completed. What can C do to protect his interest in the matter?

13. A hardware merchant, seeing financial difficulties ahead, stocks up with large quantities of goods purchased on credit terms. He then sells his store and stock and conceals the cash received from the sale. Is such a sale legal? What makes it legal or illegal?

14. Why was the Bulk Sales Law necessary in states which operate under the Uniform Sales Act? What are the advantages of the former?

CHAPTER XXXI

FRIENDLY ADJUSTMENTS

In the preceding four chapters the collection problem has been handled from the standpoint of the individual creditor. It was also assumed that the debtor could pay or could be made to pay the full amount of the indebtedness. It is the purpose of this chapter to deal with the collection problem from the point of view of a group of creditors interested in the same account and under conditions which make full payment well-nigh impossible. Furthermore, the discussion will center on the various methods of adjusting the debt in a friendly manner, *i.e.*, out of court. The legal treatment of insolvent debtors through the bankruptcy road has been reserved for the chapter immediately following.

Types of Insolvency.—The term insolvency can be used in at least three ways. First there is what may be called the commercial insolvency as illustrated by the Uniform Sales Act. Under it a debtor is deemed insolvent if he "either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due," even though his assets may exceed his liabilities and he may ultimately be able to pay all his obligations. A second type of insolvency exists when a debtor becomes financially embarrassed. If it is of a temporary character, he may be able to pay the full amount of his indebtedness, but if the embarrassment is serious only a portion of the obligation may be ultimately repaid, yet the debtor's assets at a fair valuation, on a going-concern basis, may be in excess of his liabilities; such a concern may have a substantial equity in the business but may be "land poor," inasmuch as its equity may consist in fixed properties which cannot be readily converted into cash for the payment of debts as they mature or which at a forced sale will not return their true worth. This type of concern may be insolvent because of financial embarrassment, continue in business indefinitely while in such condition, and yet remain immune from bankruptcy proceedings. Finally, there is the permanent insolvency contemplated under the bankruptcy law whereby the liabilities of the debtor exceed the assets at a fair valuation.

General Causes of Insolvency.—Among the causes of insolvency most frequently cited are incompetence, lack of working capital, and fraud. In general, all failures may be classified, according to the causes which produced them, into two major divisions, the first division comprising failures the causes of which lie within the business itself, and the second

division containing insolvencies which are considered not to be due to the faults of those failing. Insolvency of the latter type may be caused by certain specific conditions beyond the control of the failing concerns, such as wars, floods, and disasters, or by failures of others; whereas insolvencies falling in the first classification arise out of incompetence, such as overbuying or careless selection of a stock of goods, unwise credit granting, carelessness in following up collections of outstanding accounts, inaccurate accounting system, poor business location, or any one of numerous other causes generally lumped under "bad management," or lack of adequate working capital ordinarily caused by more fundamental or real factors, such as failure to keep a sufficient amount in liquid form or an injudicious disbursement of capital in interest and dividend payments.

Treatment of Insolvent Debtors.—Once a debtor becomes insolvent, there are several possibilities whereby he may either be extricated from his financial embarrassment and a readjustment worked out, or his property seized, liquidated, and distributed among his creditors. Thus the insolvent debtor may make but part payment and arrange to pay the balance in instalments; he may ask for an extension; he may request a composition settlement; he may make an assignment of all his property for the benefit of his creditors; or a receiver may be applied for by the debtor or his creditors. Finally, there is a possibility, if insolvency occurs in the sense that his assets at a fair valuation fall short of satisfying his liabilities, of going into bankruptcy voluntarily, or of waiting until forced into bankruptcy by his creditors.

From the foregoing it is apparent that there is a certain degree of risk in all business and that it is inevitable that some debtors should become financially embarrassed either because of conditions inherent in the business itself or because of external factors absolutely beyond the debtor's control. As soon as an account assumes a serious aspect and it is discovered that the debtor is unable to meet his obligations, creditors should act with the utmost care and with great hesitancy before resorting to any drastic measures which may cause the bankruptcy of an honest merchant. Instead, they, or an adjuster representing them, should come to the insolvent debtor with a view not only to obtaining an immediate settlement but also to serving in a more constructive way by making an adequate diagnosis of the causes responsible for the particular situation of the debtor and applying proper remedies, in order to save the assets and rehabilitate and preserve the business. Such a policy of friendly interest in the readjustment of the debtor's business affairs is not only the most human, but also proves itself the most profitable in the long run, inasmuch as it practically always results in the acquisition of a loyal customer for the future.

EXTENSIONS

When to Grant an Extension.—An insolvent debtor frequently finds it to his advantage to consult with his largest creditors or with the adjuster representing them with a view to obtaining an extension of time in which to meet his obligations. If his financial responsibility is not seriously impaired and the causes of the insolvency are but temporary and remediable, an extension of time may be all that is needed in order to rehabilitate the impaired condition. Recognizing this fact, creditors should, from selfish as well as humanitarian motives, act with great hesitancy before refusing a request for an extension and resorting instead to drastic measures which may result in irreparable injury to the honest debtor and his dependents by placing the stigma of bankruptcy upon them. At the same time, these drastic steps, by precipitating the debtor's bankruptcy, preclude the possibility of continuing profitable business relations with the debtor.

Prior to granting of an extension, however, creditors should satisfy themselves that the debtor is honest. Dishonest debtors are not entitled to any consideration on the part of their creditors. If the debtor lacks the all-important quality of honesty and integrity, an extension of time will simply afford him an excellent opportunity to perpetrate a fraud upon the innocent creditors. As a means of protection, therefore, it is of utmost importance to ascertain whether or not the debtor possesses the necessary qualities of character and good moral fiber before any favorable decision is to be reached in acting upon his request for an extension.

Another consideration for creditors to ponder before granting an extension is the seriousness of the debtor's embarrassment and the causes therefor. If the weakness is but temporary, and there is reason to believe him sufficiently capable of continuing in business and extricating himself from his difficulties, there is no reason why creditors should not lend their assistance and cooperation in order to effect a quick recovery. Where the causes are temporary and curable, the prospects for improvement are very bright. Thus it frequently happens that a merchant has too much capital tied up in salable merchandise inventories, or in accounts receivable which are good and collectible, but slow paying. In either of the cases cited an improvement in collection methods aided by a lapse of time will usually remedy the weaknesses they produced.

Third, if the debtor is likely to require large quantities of additional merchandise in order to continue in business and meet the demands of his trade, it behooves the present creditors, if an extension is granted, not only to pledge their moral support but also to supply the debtor with fresh merchandise to replenish his stock. When a debtor exposes his

financial responsibility by requesting an extension, his credit standing in all markets is at once impaired, thereby automatically shutting off his credit in new markets. To the extent to which he finds it impossible to secure new credits, to that extent he must rely upon his old creditors, whose failure to supply the necessary stocks precludes any possibility of paying the original indebtedness for which an extension is requested. If, however, the additional amount of credit required is large in proportion to the existing claim, it would be bad policy to agree to an extension; it amounts to sending too many good dollars after those already impaired.

Method in Granting Extensions.—One of several methods may be followed in arranging for an extension. If an adjuster represents and acts as agent for all or a majority of the creditors, the commonest method is to execute and enter into a trust agreement between the debtor and the adjuster. In all cases where an adjuster is sought to represent them, creditors should assign their claims to him, thereby enabling the debtor to deal with one instead of a large number of creditors located at a distance from him. Unless claims are thus assigned it would be difficult to work out and consummate the proposed settlement, by reason of the possibility of one or two creditors retarding settlement by neglecting to give their assent or by insisting upon a prompt settlement or else threatening to take drastic action. From the creditors' standpoint it is equally desirable to seek an adjuster to represent and act for them, because of the pressure which such action brings to bear upon the debtor. The debtor is thereby made to feel that all creditors are cemented by a common interest, acting in unison as an individual through the medium of the adjuster, and should he compel legal action by his refusal to submit to terms, such action is greatly simplified.

The trust agreement provides for a continuation of the business by the debtor himself under the supervision of the adjuster, who is usually a representative or the manager of an adjustment bureau, or places the business under the direct control of the latter until the original indebtedness is fully paid for.

Another common method is for the debtor to give a series of instalment notes payable at stated intervals. If an extension is arranged with but a single creditor, usually the largest, he may be given instalment notes or a single promissory note.

Legal Aspects of Extensions.—An agreement by one creditor to give a debtor an extension of time, without any consideration therefor, is not binding on the creditor. This is on the ground that every contract or agreement must be supported by some consideration in order to be binding. Where, however, two or more creditors agree among themselves and with the debtor, that in consideration of each creditor's forbearance each of the other creditors will agree to an extension, there is deemed to

be adequate consideration to support the promise of each creditor. Once such an agreement is entered into, no one creditor, at least without the consent of all others, would have the right to demand payment before the expiration of the extended time. The agreement is binding only on the creditors who signed it, nor can any creditor be compelled to sign it. For this reason small creditors may be paid in full to prevent bankruptcy proceedings by nonassenting creditors.

If the debtor gives the creditor a note or other security, including guarantees, in consideration for an extension of time granted, the agreement is binding and the creditor would have to wait until the expiration of the extended period before he would have the legal right to bring action against the debtor. The principle underlying this is that the giving and the acceptance of the note or other security in place of the old account constitute a substitution of a new contract for an old one and are, therefore, equally binding on both parties.

COMPOSITIONS

Nature of Composition Settlements.—At common law a composition is a contract entered into by an insolvent debtor and two or more of his creditors (not necessarily all) whereby, in consideration of the mutual promises of the creditors to release the debtor from the balance of his indebtedness, the debtor settles the claims against him at an agreed percentage of their face value. This type of agreement is binding only upon those who accept it by signing. Such a composition constitutes in effect a discharge or release from further obligation to all agreeing creditors, not by the operation of law, as in the case of bankruptcy compositions, but through the mutual consent and valuable consideration.

It is sometimes possible to force a proposed composition settlement upon clamorous creditors. If a large number of creditors agree to the proposition, in order to force the remainder to become parties to the agreement, suit is filed by three or more creditors in the Federal district court, to have the debtor adjudged a bankrupt. Before the adjudication, however, the debtor asks for a creditors' meeting for the purpose of submitting terms of compromise, and effecting an adjustment. Bankruptcy proceedings are stayed and a meeting of creditors is called. At the meeting the debtor is examined and then submits his terms. A majority of the creditors in number and amount agree to the proposed settlement. An application is made to the court for the confirmation of the adjustment. If the composition is confirmed by the court, the debtor obtains the desired relief, without being adjudged a bankrupt. Recent amendments to the Bankruptcy Act have given some impetus to this kind of composition, as will be shown in the following chapter. In fact, under these amendments a noncorporate debtor may apply to the Federal court

for an extension or composition without initiating bankruptcy proceedings.

A composition settlement is usually the result of the debtor's initiative. He submits the terms of compromise offering to pay a certain percentage of the claims held against him. The proposal may be submitted to the creditors individually, or at a creditors' meeting called for the purpose. The latter is preferable, particularly when the creditors are numerous and widely scattered.

When to Agree to a Composition.—This form of settlement, not unlike that of extensions, should be agreed to by creditors from selfish and also humanitarian motives and only when the debtor's financial embarrassment is serious; otherwise an extension may suffice. Let us assume that the insolvent debtor's balance sheet shows a deficit of 20 per cent, *i.e.*, the liabilities exceed the assets 20 cents on the dollar. If the valuation is conservative the business is worth 80 per cent of the liabilities as long as it remains a going concern. A forced liquidation, however, would result in the realization of much less than the book value of the properties. Furthermore, if the business went through bankruptcy proceedings, much of the proceeds from a forced sale would be dissipated by expenses incident to such proceedings, until a settlement of 25 per cent would begin to look generous. Obviously, it is much more business-like for creditors to accept a settlement of 45 per cent and leave the debtor the remaining 35 per cent with which to continue and rehabilitate his business and start anew and unencumbered. Even the losses actually sustained may, under such circumstances, be ultimately recouped in profits arising from continued business relations with the debtor. Such possibility would be completely precluded were the debtor forced through bankruptcy. In addition, there is the opportunity of dispensing with the time, trouble, and worry attending all bankruptcy cases.

Then, too, humanitarian motives should prompt creditors to agree to a composition settlement. Honest debtors are entitled to such consideration. In modern times, as a result of the spirit and widespread recognition of commercial interdependence, the idea prevails that the credit grantor is in a measure a partner in the debtor's business. Because of the risk in any business enterprise, losses must be expected, and the creditor should stand ready to bear his proportionate share. For these reasons, offers made by honest merchants should be accepted and even encouraged, so that they may retain their business and save themselves and their dependents from disaster and the stigma of bankruptcy.

Offers for such settlement should never be considered when any suspicion of fraud attaches to the insolvency. Creditors should assure themselves beyond the shadow of a doubt that fraud is entirely absent. Moreover, they should relentlessly prosecute such a debtor to the fullest

extent, immediate selfish motives to the contrary notwithstanding. Creditors owe it not only to themselves but to their fellow merchants to prevent the perpetration of fraud on the part of dishonest debtors wherever possible. It is the greatest protection against future attempts to secure merchandise fraudulently, that a creditor can buy, for unscrupulous debtors stay shy of those who are willing to sacrifice large dividends in order to prosecute frauds.

FRIENDLY LIQUIDATIONS THROUGH ASSIGNMENTS

When the debtor's affairs are so badly involved as not to warrant the granting of an extension and no terms of composition can be agreed upon, there is still another course to follow, *viz.*, to wind up the estate and distribute the proceeds among the creditors pro rata. This may be accomplished through an assignment executed by the debtor or through bankruptcy proceedings. The former is regarded as a friendly liquidation, not because the debtor voluntarily and without pressure relinquishes control of his property (for bankruptcy or other court action by creditors may be the alternative) but because the liquidation takes place out of court and is not subject to strict legal supervision. Instead, the work is often done by a creditor's committee or by an adjuster representing creditors.

Nature and Kinds of Assignments.—An assignment for the benefit of creditors is a voluntary transfer in trust by a debtor, generally an insolvent, of some or all of his property, to an assignee for the purpose of applying such assets or the proceeds thereof to the payment of some or all of his debts and returning the surplus, if any is available, to the assignor. Such an assignment may be made at common law or under state law, for every state has some form of law whereby property may be turned over by a debtor to an assignee for the purpose of sale and division among the assignor's creditors pro rata. Common law assignments are used throughout the country as the legal basis for friendly adjustments. They differ from statutory assignments principally in the following respects: (*a*) they are usually not filed, and (*b*) the administration of the estate is under the supervision of a committee of creditors or other representatives rather than under control of a court. Both types of assignments have certain things in common. In both instances the conveyance is presumed to be voluntary, both are recognized and regulated by law in most jurisdictions, and both types constitute an act of bankruptcy and may be set aside and invalidated by the filing of a petition in bankruptcy within 4 months after the execution of the assignment.

Advantages and Disadvantages of Assignments.—The principal advantages of a friendly liquidation through an assignment over the liquidation of an insolvent estate in court are the speed with which the

task can be completed, the superior opportunity for marketing the assets in a way to secure a larger fund for distribution among creditors, the elimination of or reduction in court costs and fees of a multitude of officials provided for in the Bankruptcy Act, the elimination of or reduction in attorney's fees, freedom from restraint by the court, and the privacy with which the work can be done. Obviously, if the assignment is statutory, these advantages are not realized in full.

One of the most important limitations is that an assignment constitutes an act of bankruptcy, making it possible for nonassenting creditors to take the administration of the estate out of the jurisdiction of creditors or the state insolvency court, since bankruptcy supersedes all other forms of liquidation of insolvents. Second, there is no power under friendly assignments to subject the debtor to an examination under oath. Third, there is no machinery for the recovery of preferential payments. Fourth, from the debtor's point of view, the chief objection is that he cannot secure a discharge from his obligations except by the consent of all creditors. Fifth, there is the territorial limitation, since assignments are governed by different laws under varying jurisdictions. Especially is this true of statutory assignments. Sixth, there is lack of uniformity in the laws and requirements of the various states. Finally, there is no direct effective supervision over the assignee in the administration of the estate. Debtors have the power to appoint their own assignees and in some states they are not compelled even to consult the creditors or to obtain their consent to the appointment. This objection, however, is largely theoretical, since the assignment, while presumably voluntary, is made under the pressure of creditors who are in a position to dictate terms.

Assignment Procedure.—In handling common law assignments the procedure is much simpler and less formal than in the case of statutory assignments, but it is believed that a brief description of the latter procedure which is definitely codified may be helpful to an understanding of the subject. The first requirement is to make the assignment in writing, to serve as protection against fraud and collusion and to give effect to the instrument itself. Under common law the powers of the assignee are usually limited by the express terms of the instrument, otherwise they are limited both by the instrument and by statute. The written instrument lists and describes on one schedule the property transferred and the disposition to be made of it as per another schedule on which are listed all of the debtor's creditors for whose benefit the assets are appropriated.

The second step in the proceeding is to execute the assignment by the assignor and in some states also by the assignee. Next, the instrument must be recorded in a specified public office in order to make it

valid. Fourth, the assignment must be delivered to the assignee. Failure to do so may render the act void and fraudulent against judgment creditors. Fifth, possession of property must be delivered next and should follow immediately the deed making the transfer. To give the assignment validity, the assent of creditors must be secured, unless it is made to a trustee for the benefit of creditors who are not parties to the agreement. In most jurisdictions the consent of creditors is not essential to the validity of an assignment.

Notice of the Assignment.—Upon receiving the assignment from the debtor, the assignee executes a bond guaranteeing faithful performance of the trust, takes possession of the property specified in the schedule, and gives public notice of the assignment to the creditors if required by the state law. Creditors are also requested to file their claims with the assignee, and debtors of the estate to account and pay their obligations.

The New York statute also provides that, if the judge so orders, 10 days' notice must be given, to all parties interested in the estate, of:

1. All proposed sales of property.
2. Declaration and time of payment of dividends.
3. The filing of the final account of the assignee and of the hearing thereon.
4. The proposed compromise of any controversy.

Liquidation of Estate.—Proper steps are then taken by the assignee to collect the debts assigned and to dispose of the property at the earliest time possible, consistent with the best interests of the creditors. Provision may be made in the assignment that the business be continued for a limited time. The obvious purpose of this provision is to secure a more advantageous execution of the trust. Sometimes the assignee may continue the business even though no special authority is contained in the assignment. Thus he may continue the business of the debtor, if a manufacturing concern, in order to convert the raw material on hand and complete the goods in process into finished products. But if he continues the business beyond this point, he does it at his own risk and is held accountable for all losses incident to such unauthorized operations. In some states, the court is given power to authorize the assignee to continue the debtor's business for a limited period.

One of the most important functions of the assignee is to dispose of the property assigned by sale. He is forbidden to appropriate it for his own use even when he pays the full price. In making a sale, the assignee must act in good faith and exercise a certain degree of prudence and diligence. Otherwise, he becomes personally liable to the party suffering from his alleged misconduct to the extent of the loss incurred. No time is stipulated in which he is bound to sell the property, for to do so might result in lower prices and hence smaller dividends to the creditors in

whose behalf the trust is executed. On the other hand, if the assignee delays unreasonably in disposing of the property, the delay may be considered evidence of fraud and the court may grant an order directing him to show good cause why a sale should not be had. Sales may be private or public, in the discretion of the assignee, unless definitely provided in the assignment.

Deductions.—Out of the proceeds of the sale all expenses incident to the execution of the trust are deducted. These deductions are usually provided for in the assignment and are made out of the first sums obtained from the sale. They should cover the cost of advertising, insurance, interest, taxes, salaries, wages of employees, rent, the cost of suits concerning the property assigned, and commissions of the assignee.

Assignees are allowed compensation for their own time and services, in addition to reimbursement of their expenses. The amount of compensation is either stipulated in the assignment or fixed by agreement, independently of the assignment. In the absence of express stipulation or agreement, the assignee is in most states entitled to a reasonable compensation similar to that allowed by law to trustees, guardians, and executors.

Distribution of Dividends.—After all the necessary deductions are made out of the proceeds of sales and collections, it devolves upon the assignee to distribute, without unreasonable delay, the sums remaining in his hands among the creditors who are entitled to the benefits of the trust. Such sums may be distributed in one payment, or in the form of several successive dividend payments.

Not unlike bankruptcy proceedings creditors must be paid in case of assignments according to priority. Any surplus remaining in the hands of the assignee after all creditors who are entitled to participate are satisfied must be turned over to the assignor. Amounts paid to the assignor before the debts, for the payment of which the trust was created, have been satisfied are subject to appropriation for the benefit of all creditors whose debts were provided for by the assignment and remain unpaid.

Final Accounting.—The next step in the proceeding is for the assignee to render his accounts of all transactions, receipts, and disbursements to the assignor and the creditors. In a majority of states the assignee is required by law to present his accounts to the court for examination and approval before obtaining a discharge from the trust. In any event an accounting must be made to the creditors, else they may compel it by filing a bill in equity forcing the assignee to render a full and accurate account or to be liable for the value of the property sold by him.

Close of the Trust and Discharge of Assignor.—The last step in assignment proceedings is to close the trust and to secure a release from further

liability on the debts covered by the assignment. The time for closing the trust is fixed either by the assignment itself, or by the lapse of a reasonable period of time. Where assignors may be discharged from further liability under the insolvency laws, such a discharge is usually granted on petition of the assignor and upon consent of creditors owning a certain percentage of the debts, usually two thirds, of all creditors residing in the United States.

RECEIVERSHIPS

Equity Receiverships.—From the standpoint of the purpose for which a receiver may be appointed, all receiverships may be divided into those of equity and bankruptcy. The former are used mostly in connection with friendly adjustments.

A receiver in equity may be appointed by a Federal court in an action brought by one or more creditors as plaintiffs against the debtor as defendant, provided that at least one of the petitioning creditors is a resident of another state from that of the debtor and the amount of the petitioners' claims is in excess of $3,000. A state court may appoint an equity receiver for a solvent or insolvent debtor in proceedings of various kinds including dissolution and for temporary purposes pending the outcome of litigation. Such a receivership may be requested either by the debtor or by creditors, but when a state court appoints him, the receiver can take possession of only the property in the jurisdiction of the court.

An equity receivership is usually sought when the debtor is solvent in the bankruptcy sense but is unable to meet his obligations as they mature. The object is to preserve the estate for the creditors during the readjustment, reorganization, or litigation which is to decide the rights of the litigants, and to establish a so-called moratorium on behalf of the debtor. To warrant the appointment of such a receiver, the court must be shown by the plaintiff that such action is necessary to prevent loss or injury to those financially interested. A mere default in payment of an obligation is not sufficient ground, for under such circumstances the ordinary processes of the law can be resorted to as a remedy.

An equity receiver is an officer of the appointing court. It is his duty to take possession of the property of the debtor and to operate the business, often with the cooperation of creditors, for the benefit of all persons interested, until it is liquidated or the receivership is terminated and the property returned to the debtor. Sometimes the business is thoroughly reorganized under the receivership, which is terminated upon completion of the process of reorganization which is really one form of liquidation. Pending receivership, all persons are enjoined from inter-

fering with the assets in the hands of the receiver, who is not even amenable to suit except by express permission of the court.

On all matters of policy and on questions outside of ordinary management and operation, the receiver must apply to the court for authority and instructions. He is held responsible for all debts incurred with third parties and for any fraud or negligence resulting in injury to the property under his management. For this reason, the receiver is usually required to execute a bond, the amount of which is fixed by the court.

In the matter of compensation of equity receivers, some states regulate the amount to be paid, but in most of them it is left to the discretion of the court and is determined by the circumstances of the particular case. The amount allowed is usually in excess of the corresponding fees allowed in bankruptcy proceedings, partly because of lack of regulations and partly on account of the difference in scope of activity.

An equity receivership is terminated by the appointing court when the necessity for the office ceases to exist and a formal order is issued to that effect, either upon the receiver's own application or upon petition of other interested parties. The court itself, of course, has authority to terminate that which it has created. Before the receiver is discharged from his trust, he must render a final accounting at which time creditors and others interested may appear and raise objections. In no case can a debtor, however, receive a discharge from his unpaid debts under an equity receivership.

Receiverships in Bankruptcy.—Under Section 2 of the Bankruptcy Act, a Federal court may appoint a receiver, upon application of interested parties, for the preservation of an estate, to take charge of the property of a bankrupt after the filing of a petition in bankruptcy. A petition for such a receiver is filed in practically all involuntary cases. His principal duty is that of custodian of the insolvent estate, unless the court allows him to continue the business for a limited period of time. Thus it is his duty to take an immediate inventory of the estate of the alleged bankrupt, seize all his books and records, close the place of business, and take all necessary steps to collect and appropriate the property and effects belonging to the debtor, for the benefit of creditors. He remains in control until the petition in bankruptcy is dismissed, or, in event of adjudication, until the first meeting of creditors which must be called by the referee within 30, but not less than 10, days after the debtor has been declared a bankrupt. At this meeting a trustee is elected to whom all assets belonging to the insolvent estate are transferred immediately by the receiver.

Before the receivership is terminated, a special meeting of creditors is called for the purpose of approving the receiver's final report and application for allowances to him and his attorney. If he has conducted the

business, the receiver may be allowed by the court compensation not exceeding 6 per cent on the first $500 disbursed to creditors directly or through a trustee to whom such moneys have been turned over, 4 per cent on an amount in excess of $500 and under $1,500, 2 per cent on sums of $1,500 to $10,000, and 1 per cent on amounts exceeding $10,000. In the event of a composition settlement, his compensation is limited to 0.5 per cent of the amount paid creditors. When acting as mere custodian and not carrying on the business, his commission or fee is limited to 2 per cent of all disbursements to creditors up to $1,000 and 0.5 per cent on amounts in excess of $1,000.

DEALING WITH INSOLVENT DEBTORS THROUGH ADJUSTMENT BUREAUS

Origin of Adjustment Bureaus.—The conditions prevailing prior to the establishment of the bureaus are responsible for their origin and tremendous development. Concerted action on the part of creditors, prior to the organization of adjustment bureaus, in dealing with a failing debtor was practically unknown. The insolvent estate was frequently dissipated, leaving nothing for creditors. Receivers, trustees, and appraisers appointed in the course of bankruptcy proceedings were often incompetent or friendly to the debtor. Fraudulent debtors frequently escaped punishment and honest debtors were made to suffer on account of action taken against them by overzealous creditors. Waste and maladministration were common in the handling of all cases involving credit breakdowns. In a word, the methods of procedure in winding up an estate were clumsy, haphazard, and expensive.

To secure more effective cooperation of creditors in dealing with embarrassed merchants, many of the various lines of trade have organized within their respective industries and have established local representatives or secretaries in the larger market centers for the purpose. The National Association of Credit Men, in particular, has been instrumental in the development and widespread use of such mediums by establishing local adjustment bureaus within their own organization.

Aims of Adjustment Bureaus.—Adjustment bureaus of the National Association of Credit Men operate at present in 72 market centers, located in key cities where they serve additional markets. They are departments of local associations of credit men or are affiliated with them. If the bureaus are independent organizations, the local association of credit men is given representation on the Board of Directors. The bureaus are under the close and constant supervision of the manager of the National Adjustment Bureau Department of the Association, as well as under close scrutiny by committees of local credit men. They are organized for altruistic purposes—for service and not for profit. Their aims and objects have been set forth by the first committee

appointed by the National Association of Credit Men in its report submitted in 1906 as follows:

1. To investigate, upon request, the affairs of a debtor reported to be insolvent and to adjust the estate, when possible, without court proceedings.
2. To secure capable and efficient receivers, appraisers, or trustees when court proceedings are found to be necessary.
3. To secure quick adjustment of all honest failures at the minimum cost and with the maximum dividend to creditors.
4. To facilitate and economically to secure extensions or liquidations when, upon investigation, it is found to be to the best interests of all.
5. To influence concerted action by the creditors for the benefit of all.
6. To assist creditors to acquire for their own use the estate of failing or insolvent debtors, when mutually agreed upon.
7. To prosecute or assist in the prosecution of the guilty party or parties where investigation discloses fraud or the intent to defraud.[1]

Functions of Adjustment Bureaus.—All activities of these bureaus may be divided into four parts. The first function consists in personal investigations made by representatives of the bureau upon request of a member of the National Association of Credit Men. These representatives investigate the debtor's condition and adjust the account. A second function is that of effecting friendly adjustments, including service in a fiduciary capacity in any action of any character except bankruptcies. These adjustments are made in behalf of two or more creditors and for the common good of all. Bureaus are also equipped to serve in a fiduciary capacity during bankruptcy proceedings. Bureau representatives attend all hearings and otherwise investigate all bankruptcy cases, irrespective of whether or not a representative of the bureau is elected receiver or trustee. Finally, 65 of the bureaus are equipped to handle collections in their respective zones or to forward them for collection to other bureaus and attorneys.

The main purpose of all bureaus, and the sole activity in some of them, is to handle in behalf of all creditors the affairs of insolvent and embarrassed debtors, whether in friendly adjustment or in bankruptcy.

Selected References

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[1] *Bulletin*, National Association of Credit Men, July, 1906.

Questions and Problems

1. You have been asked to address a group of credit men representing wholesalers and manufacturers on the subject of "Friendly Adjustments." Some of the members of the group to be addressed believe in the use of harsh methods in making settlement of overdue accounts, while some of the others do not quite appreciate the value of friendly settlements. It is your task to enlighten them all on the subject assigned. What special reasons would you advance in your address in favor of friendly adjustments, wherever possible, in preference to forcible method?

2. What is an extension? Under what circumstances would you, as a creditor, agree to it?

3. Why is it essential that a debtor be honest in all cases of friendly adjustments?

4. Mr. Blank, who is operating a dry goods store, owes the X Wholesale Dry Goods Company $1,200 on open account. The account is now 40 days past due, but Mr. Blank is still unable to meet his obligation. He requests that the X Company grant him an extension of 90 days, believing that at the end of that time the larger seasonal sales will enable him to pay his bills. The X Company, believing its customer to be honest and deserving, agreed to the extension. Ten days later it obtained information through a mercantile agency showing an impaired condition in Mr. Blank's character and other facts contained in the report pointed to the advisability of enforcing payment at once. Can the X Wholesale Dry Goods Company enforce payment immediately, despite its previous agreement to extend the time 90 days, or must the creditor wait until the expiration of 90 days?

5. Would your answer be different if the agreement to grant Mr. Blank an extension were reached jointly with two additional creditors at a meeting held for the purpose?

6. Suppose the X company had accepted a 90-day promissory note before it agreed to extend the time of payment for Mr. Blank, could the X Company set the extension aside and enforce payment before the expiration of the 90-day period?

7. If a debtor is seriously embarrassed but is honest and deserving of fair treatment by his creditors, which of the methods of amicable adjustment would you recommend?

8. What is a composition settlement? How does a common law composition differ from a composition in bankruptcy?

9. Under what circumstances should creditors agree to a common law composition settlement?

10. Suppose 15 out of 20 creditors agree to a common law composition, what is the status of the remaining five creditors? Must they accept the terms agreed to by the majority of creditors or can they proceed to enforce full payment of their claims?

11. Describe the steps involved in a friendly liquidation.

12. Why should a debtor ever agree to a friendly liquidation?

13. What is an assignment? When can it be set aside?

14. What advantages can be claimed for assignments, from the standpoint of both debtor and creditor, over bankruptcy proceedings?

15. Suppose an assignment has been made in favor of creditors, but a few recalcitrant creditors fail to approve of it, what action can they take in the case?

16. Outline the various steps taken in the making and execution of an assignment in favor of creditors.

17. An assignment has been made to a trustee for the benefit of creditors. In the meantime one of the creditors obtained a judgment. Can such judgment be executed or is the assignment valid even though this creditor did not agree to it?

18. In the case of assignments, what deductions are first made before any dividends are distributed? Do all creditors share alike?

19. What are the two types of receivership and how do they differ?

20. If you were appointed an equity receiver for a business establishment, what would be your duties? As receiver in bankruptcy?

21. When do equity receiverships terminate and how? Does the same answer apply to receiverships in bankruptcy?

22. Outline the functions of adjustment bureaus operated under the auspices of the National Association of Credit Men, in the order of their importance.

23. How do creditors benefit from the use of adjustment bureaus in the handling of overdue accounts and various types of adjustments?

24. John Doe operated a very popular and well-patronized cafeteria in the center of the retail district of Wichita, Kan. Domestic trouble, followed by a separation of debtor from his wife, together with some other unwise activities on his part, caused the debtor to lose heavily in his business. When a creditors' meeting was finally called, it was ascertained that the debtor owed approximately $20,000, and that the only assets of the debtor and his wife consisted of the cafeteria fixtures, which debtor later sold for $1,000, the half interest in a restaurant which the debtor's wife later sold for $3,000, and the lease on the cafeteria (in the wife's name) which had five years to run, together with various items of personal assets which were exempt.

At the creditors' meeting, the manager of the local association of credit men proposed to let the debtor keep his cafeteria fixtures, and that the wife be given the undivided half interest in the restaurant herein before referred to. This was to be done on condition that the debtor would execute a note for his indebtedness, payable three years after date, to the said manager of the association, with interest at the rate of 7 per cent from date until paid, and providing further that the said note be secured by an assignment of the lease on the premises where the cafeteria was located. This was agreed to by all parties concerned, and the upstairs of the lease was subleased for $292.50 per month, and the downstairs was subleased for $650 per month, which made a gross profit of $507.50 per month on said lease, for a period of five years.

Was this case properly handled? What were the alternatives?

CHAPTER XXXII

BANKRUPTCY

Conception of the Term.—The etymology of the word "bankruptcy" is somewhat in dispute. Among the various explanations offered is the following, which seems both plausible and authoritative. During the existence of the temple in Jerusalem, Hebraic custom required the deposit in the temple on certain occasions of sums of money. This money had to be in Hebraic currency, but, since Roman coins were generally used at the time, money changers established places of business consisting of tables or benches (banks) on which they displayed their supply of Hebraic coins which were to be exchanged for Roman money. Money lending was another function which was later added to the practice of money changing. Some of these ventures proved unsuccessful and creditors, therefore, drove the failing money lender from his table or bench. Thus he found himself "bench-broken" ("bancus ruptus" in Latin) or "bench-rupted," bankrupted.[1]

Bankruptcy today, not unlike the days described in the preceding paragraph, consists of a condition coupled with an outward act. The condition is insolvency of the debtor and is not synonymous with bankruptcy, while the outward action to indicate the existence of that condition is a decree of bankruptcy handed down by a Federal court instead of a physical act of destroying the bench. Thus bankruptcy may be defined as a legal process whereby an insolvent debtor is declared a bankrupt, and his assets are seized and equitably distributed among his creditors, after which he is discharged from further liability.

Early Legislation.—There was a time in the history of mankind when individuals or businesses could not go into bankruptcy. Under the ancient laws of the Twelve Tables, enacted in Rome in 459 B.C., exceedingly harsh methods could be used by creditors against their debtors. In fact, a creditor had the right either to kill the debtor or to sell him and his family into slavery. When several creditors were involved, they were permitted by law to cut the debtor's body to pieces and get their proportionate share in satisfaction of their claims. While it is doubtful whether any use was made of this provision of the law, the very existence of such a law is indicative of the brutal treatment of insolvent debtors. A law enacted in Rome in 239 B.C. finally prohibited corporal punishment for indebtedness but still permitted imprisonment. As part of the

[1] ETTINGER and GOLIEB, "Credits and Collections," p. 405.

Lex Julia, enacted by Julius Caesar, the first bankruptcy statute of the more modern type was put into effect.[1]

Until comparatively recent times, the English laws permitted the imprisonment of those who could not or would not pay their debts. The earliest English bankruptcy law dates back only to 1542 and was designed primarily for the protection of creditors against fraudulent debtors.

During the early days of the American republic no crime brought so many to the jails and prisons as the crime of debt. Persons likely to get into debt were for the most part defenseless and dependent, and consisted of the great body of artisans, laborers, and servants. As one historian put it, "one hundred years ago the laborer who fell from a scaffold or lay sick of a fever was sure to be seized by the sheriff the moment he recovered and be carried to jail for the bill of a few dollars, which had been running up, during his illness, at the huckster's or the tavern." The early state insolvency laws were of a drastic nature, designed primarily for the protection of creditors. Because of the dependency of most debtors on their daily wages for their daily subsistence, a creditor's right of action against a debtor's property bore little significance. Hence, the surrender of the person of the debtor for his imprisonment was considered necessary to protect the interests of the creditors. Many of the early laws were extremely drastic in the punishment which they provided for debtors. No debtor had the right to petition himself into bankruptcy and be discharged from his obligations. The laws merely provided that creditors could under certain circumstances throw the debtor into bankruptcy, seize his property, and divide it among themselves. The balance had to be paid thereafter in the best way possible, else the debtor went to jail or prison.

Nineteenth Century Legislation.—Beginning with the nineteenth century, the views respecting the relationship between debtors and creditors underwent a decided change. The spirit of commercial interdependence had given rise to the idea that the creditor is in a sense a partner of the debtor. In accordance with this development and with the improvement in business ethics, a more humanitarian feeling toward insolvent debtors was implanted in the hearts of the public at large, and new laws were consequently passed, abolishing imprisonment for debt or any other corporal punishment for such offenses. These laws merely held the debtor responsible to the extent of the amount of the property he possessed at time of failure.

Today, the commercial world has progressed even much farther than the law. Creditors have established organizations, called "adjustment bureaus" and described elsewhere, for the assistance of failing but honest

[1] MARKS, M., "How to Correct Credit Abuses," pp. 61–64.

debtors, as well as creditors. These quasi-public organizations not only secure the best results expeditiously, but also aid the debtor, in that they obviate the necessity of placing upon him the stigma of bankruptcy.

Article 1, Section 8, of the United States Constitution, provides that "Congress shall have power to establish . . . uniform laws on the subject of bankruptcy throughout the United States." This has been interpreted to mean that a Federal Bankruptcy Act supersedes any act of the states, although the right to make a general assignment for the benefit of creditors is not precluded by the passage of the Federal Bankruptcy Act.

Under the power granted by the aforementioned clause of the United States Constitution, Congress has passed four different bankruptcy acts, in 1800, 1841, 1876, and 1898, respectively. The National Bankruptcy Law under which we essentially operate at present was adopted in 1898. It has since been amended in 1903, 1906, 1910, 1917, 1922, 1926, 1932, 1933, 1934, and 1935. It was further amended and most thoroughly revised in 1938 by the Chandler Act, most commonly referred to as the Bankruptcy Law of 1938. While this law contains some new chapters representing modern concepts of bankruptcy legislation, it has retained the essentials of the older act in modified form. It became effective September 22, 1938. But even today, a debtor can be imprisoned in this enlightened country for non-payment of alimony, because such a debt is not affected by a discharge in bankruptcy.

Purposes of Bankruptcy Legislation.—Obviously, the necessity for bankruptcy legislation arises from the nature of present-day trade and is based on the principle that much of our commerce is built on credit and that credit implies risk. The most honorable merchant may be ruined without actually committing any crime. It is partly to relieve such an honest debtor from the load of his debt and to save him from going to an almshouse, as well as to distinguish between fraudulent bankruptcies and honest misfortunes, that bankruptcy legislation has been enacted. The second, and probably in many respects the more important purpose of bankruptcy legislation, is to provide a just treatment of creditors. It aims to prevent preferences, and to secure a fair and equitable division of the estate among all creditors, regardless of how far or near they are to the debtor's location or whether they are large or small, strict or lenient in their collection follow-up. More specifically, the purposes of present-day bankruptcy proceedings may be summarized as follows:

1. To establish judicially the insolvency of debtors.
2. To provide facilities for locating and collecting the debtor's assets.
3. To provide for the uniform administration of insolvent estates by taking such administration out of the hands of state courts.

4. To provide remedies and punishments to insure the orderly administration of the properties in accordance with the intention of the law.

5. To provide means whereby the debtor may, upon agreement of his creditors, retain his assets on payment of a certain agreed percentage of his indebtedness and otherwise to rehabilitate a distressed business enterprise.

6. To effect a distribution of the bankrupt's assets equitably among the creditors.

7. To discharge debtors, if not guilty of fraud, from further legal obligations to their creditors, and thereby relieve them from the unbearable pressure of creditors.

Kinds of Bankruptcy.—Bankruptcy is divided into two main types: voluntary and involuntary. The fundamental distinction is that in the former instance the debtor himself requests the court to be adjudged a bankrupt, whereas in the latter case he is forced into bankruptcy by his creditors, presumably against his will.

In voluntary bankruptcy the debtor himself files a petition admitting his inability to meet his obligations by reason of his assets, at a fair valuation, being less than his liabilities, and expressing his willingness to be adjudged a bankrupt on that ground. The purposes of voluntarily going into bankruptcy are: first, to secure relief from further obligations, so as to be able to begin business anew and unencumbered; and, second, to have the assets equitably distributed among all creditors. Normally, there are about 15 voluntary cases for every involuntary bankruptcy (see Table VI).

Who May Become Bankrupts?—Any one, regardless of the amount owing, may voluntarily file a petition in bankruptcy, except municipal, railroad, insurance, and banking corporations or building and loan associations. Similarly, any one, except these five types of organizations, wage earners, and farmers, may be forced into bankruptcy. However, under an amendment enacted on March 3, 1933, reorganizations of interstate railroads can be effected under the Bankruptcy Act, as will be shown later in the chapter. Another amendment passed on May 24, 1934, and reenacted in 1937 to overcome constitutional objections, provides also for the readjustment of debts of insolvent municipalities. This is, however, a temporary measure, expiring in 1940.

Conditions for Bankruptcy Proceedings.—All bankruptcy cases come under the jurisdiction of the district courts of the United States. In all such cases the law requires that the debtor have his principal place of business or residence in the judicial district in which the petition is filed, the preceding six months or the greater portion thereof.

To force a person or firm into bankruptcy, a petition must be filed by three or more creditors with provable claims amounting in the aggre-

gate, in excess of collateral or securities held by them, to at least $500. If the creditors are less than 12 in number, one creditor with a net provable claim of $500 or over may file the petition. In determining the number of creditors for this purpose, all creditors are excluded who were employed by the bankrupt at time the petition was filed, relatives, stockholders and officers of the bankrupt corporation, and creditors whose claims are fully secured, who have received voidable preferences, or who have participated in the act of bankruptcy charged in the petition. Furthermore, the debtor must owe $1,000 or more at time of filing of petition and must also be insolvent in the sense that the entire mass of his resources at a fair valuation falls short of satisfying his existing indebtedness. Finally, the debtor must have committed one or more of the six acts of bankruptcy within 4 months of filing of petition.

In cases of voluntary bankruptcy, insolvency must be proved but no restrictions are placed on the amount that must be owed by the person who petitions himself into bankruptcy. The practice is confined nevertheless to debtors who wish to secure a discharge from substantial obligations because of the expense of the proceedings and the stigma it places on the bankrupt.

Acts of Bankruptcy.—The six acts of bankruptcy as set forth in Chapter III, Section 3, of the law consist of having:

1. Conveyed, transferred, concealed, removed, or permitted to be concealed or removed any part of his property, with intent to hinder, delay, or defraud his creditors or any of them; or
2. Transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors; or
3. Suffered or permitted, while insolvent, any creditor to obtain a lien upon any of his property through legal proceedings and not having vacated or discharged such lien within 30 days from the date thereof or at least 5 days before the date set for any sale or other disposition of such property; or
4. Made a general assignment for the benefit of his creditors; or
5. While insolvent or unable to pay his debts as they mature, procured, permitted, or suffered voluntarily or involuntarily the appointment of a receiver or trustee to take charge of his property; or
6. Admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt.

Payment, while insolvent, of a preexisting debt constitutes sufficient evidence of the commission of the second act of bankruptcy. But payment of a debt which arises simultaneously with or after the payment does not constitute a preference. Thus, payment made for the purchase of merchandise on C. O. D. or "cash" terms does not result in a preference, since the effect of such transaction is not to diminish the insolvent's

estate, but merely to substitute one asset for another, namely, merchandise for cash.

Not until the debtor commits one of these acts may the court adjudicate him bankrupt. It is possible, however, to create one of these acts of bankruptcy or to cause the insolvent debtor to commit it. Thus, one creditor, with the approval of others who are desirous of placing the debtor in bankruptcy, brings suit for a claim, obtains a judgment, and levies execution against the debtor's property. In this manner, the third act of bankruptcy is committed, thereby allowing other creditors to file their petition, for the result of suit and execution of judgment is to secure a preference whose effect is to deplete the insolvent's estate for the benefit of one creditor and to the detriment of all others.

Ordinary Bankruptcy Proceedings.—The various steps in the administration of a bankrupt's estate for the satisfaction of his creditors may be summarized in the following manner:

1. Petition is filed in the Federal district court.
2. A receiver is appointed on application, to preserve the insolvent estate.
3. A trial is held, the court adjudges the debtor a bankrupt, and refers the case to a referee in bankruptcy for administration.
4. Referee notifies creditors of the adjudication.
5. Creditors file proofs of claims with the referee.
6. The first meeting of creditors is called by the referee.
7. Claims are proved and allowed.
8. Creditors elect a trustee for the purpose of handling the estate under the supervision of the referee, liquidating the assets and distributing the proceeds.
9. Bankrupt is examined by the creditors.
10. Trustee liquidates the estate and prorates the proceeds among the creditors by means of dividend payments as declared by the referee.
11. Trustee files the final accounts with the referee for his approval.
12. If approved by the referee after the final meeting of creditors is held, the final report is submitted to the court.
13. A petition for discharge is filed, on which a hearing is held, and, if not successfully opposed, the discharge is granted.

Filing the Petition.—Irrespective of the kind of bankruptcy, proceedings are always begun by filing a petition in the Federal district court of the state or territory in which the debtor is residing.

The petition is a written document, alleging the essential facts necessary to warrant the court in adjudicating the insolvent debtor a bankrupt. For involuntary proceedings, no special forms have been provided, the petition being prepared in each case by the creditors' attorney. For voluntary cases, the petition is prepared on a prescribed

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DEBTOR'S PETITION

To the Honorable.. .....

Judge of the District Court of the United States

For the ....District of .....

.....Division.

The Petition of ..... (Full name, no initials)

of..... , in the County of.....

.....District, State of ...., (State occupation)

..... (Employer's name and address)

Respectfully Represents: That. .....has had..... ...principal place of business

..... [or has resided, or has had his domicile]

for the greater portion of six months next immediately preceding the filing of this petition at

.....

within said judicial District; that .....owes debts which .....is unable to pay in full; that .....is willing to surrender all .....property for the benefit of .....creditors except such as is exempt by law, and desires to obtain the benefit of the Acts of Congress relating to Bankruptcy.

That the schedule hereto annexed, marked A [1, 2, 3, 4, 5], and verified by your petitioner's oath, contains a full and true statement of all..... debts, and (so far as it is possible to ascertain) the names and places of residence of.....creditors and such further statements concerning said debts as are required by the provisions of said acts.

That the schedule hereto annexed, marked B [1, 2, 3, 4, 5, 6], and verified by your petitioner's oath, contains an accurate inventory of all his property, both real and personal, and such further statements concerning said property as are required by the provisions of said acts.

That petitioner has not been granted a discharge in bankruptcy within six years.

Wherefore Your Petitioner Prays, That.....may be adjudged by the Court to be a bankrupt within the purview of said acts.

.....
ATTORNEY FOR PETITIONER.

.....
PETITIONER.

United States of America,

.....District of..... } ss.

County of.....

I,.....

the petitioning debtor mentioned and described in the foregoing petition, do hereby make solemn oath that the statements contained therein are true according to the best of my knowledge, information and belief.

.....
PETITIONER.

Subscribed and sworn to before me, this..... .....day of.....A. D. 19.....

.....

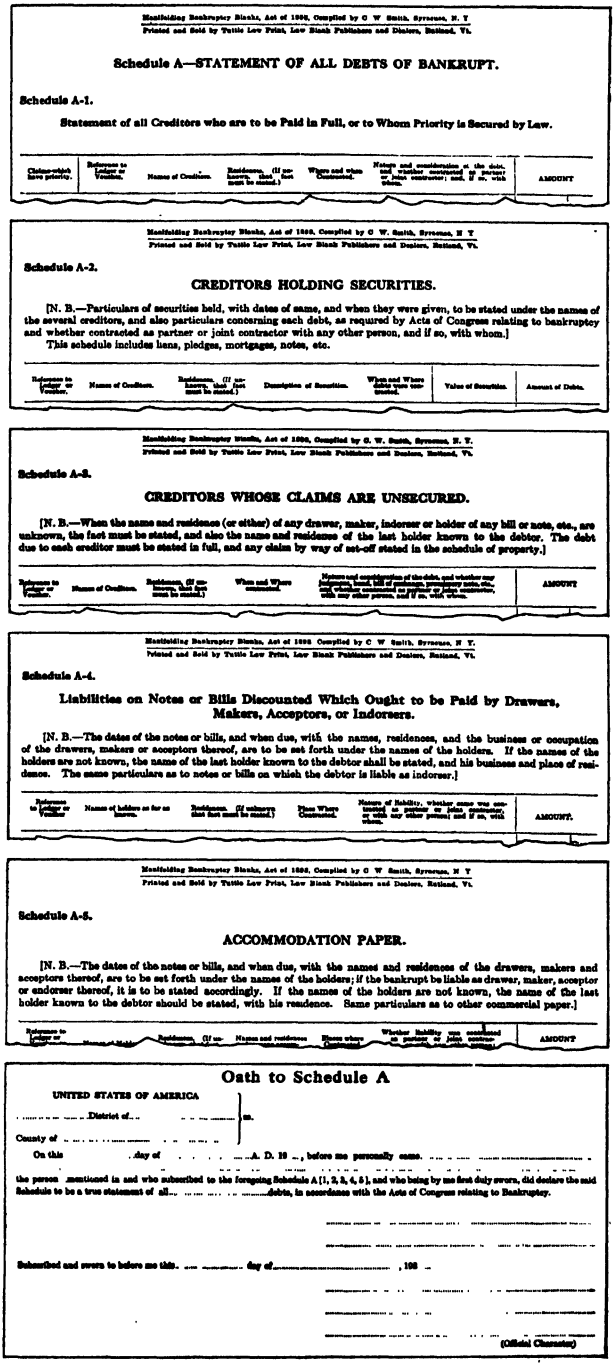
.....
[OFFICIAL CHARACTER]

All the Schedules must be filed in triplicate with this Petition. If Schedules are not filed with Petition use form 501A. (Act of May 27, 1926.)

Oaths required by this act, except upon hearings in Court, may be administered by (1) referees; (2) officers authorized to administer oaths in proceedings before the courts of the United States, or under the laws of the State where the same are to be taken; and (3) diplomatic or consular officers of the United States in any foreign country (Bankruptcy Act of 1898, c. 4, Sec. 30).

No petition will be accepted for filing unless full name of petitioner, correct residence address, nature of employment and name of employer is given (Circular 2838, October 6, 1923).

FIG. 72.—Petition in voluntary bankruptcy. No special form has been designed for involuntary bankruptcy cases.



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Schedule A—STATEMENT OF ALL DEBTS OF BANKRUPT.

Schedule A-1.

Statement of all Creditors who are to be Paid in Full, or to Whom Priority is Secured by Law.

Claims which have priority.	Reference to Ledger or Voucher.	Name of Creditors.	Residence. (If unknown, that fact must be stated.)	Where and when Contracted.	Nature and consideration of the debt, and whether contracted as partner or joint contractor; and, if so, with whom.	AMOUNT

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Schedule A-2.

CREDITORS HOLDING SECURITIES.

[N. B.—Particulars of securities held, with dates of same, and when they were given, to be stated under the names of the several creditors, and also particulars concerning each debt, as required by Acts of Congress relating to bankruptcy and whether contracted as partner or joint contractor with any other person, and if so, with whom.]

This schedule includes liens, pledges, mortgages, notes, etc.

Reference to Ledger or Voucher.	Names of Creditors.	Residence. (If unknown, that fact must be stated.)	Description of Securities.	When and Where dated upon face thereof.	Value of Securities.	Amount of Debts.

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Schedule A-3.

CREDITORS WHOSE CLAIMS ARE UNSECURED.

[N. B.—When the name and residence (or either) of any drawer, maker, indorser or holder of any bill or note, etc., are unknown, the fact must be stated, and also the name and residence of the last holder known to the debtor. The debt due to each creditor must be stated in full, and any claim by way of set-off stated in the schedule of property.]

Reference to Ledger or Voucher.	Names of Creditors.	Residence. (If unknown, that fact must be stated.)	When and Where contracted.	Nature and consideration of the debt, and whether any judgment, bond, bill of exchange, promissory note, etc., and when and where executed; and if on account, or as partner or joint contractor, with any other person, and if so, with whom.	AMOUNT

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Schedule A-4.

Liabilities on Notes or Bills Discounted Which Ought to be Paid by Drawers, Makers, Acceptors, or Indorsers.

[N. B.—The dates of the notes or bills, and when due, with the names, residence, and the business or occupation of the drawers, makers or acceptors thereof, are to be set forth under the names of the holders. If the names of the holders are not known, the name of the last holder known to the debtor shall be stated, and his business and place of residence. The same particulars as to notes or bills on which the debtor is liable as indorser.]

Reference to Ledger or Voucher.	Names of holders as far as known.	Residence. (If unknown, that fact must be stated.)	When Where Contracted.	Nature of liability, whether same was contracted as partner or joint contractor, or with any other person; and if so, with whom.	AMOUNT.

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Schedule A-5.

ACCOMMODATION PAPER.

[N. B.—The dates of the notes or bills, and when due, with the names and residences of the drawers, makers and acceptors thereof, are to be set forth under the names of the holders; if the bankrupt be liable as drawer, maker, acceptor or endorser thereof, it is to be stated accordingly. If the names of the holders are not known, the name of the last holder known to the debtor should be stated, with his residence. Same particulars as to other commercial paper.]

Reference to Ledger or Voucher.	Names of Holders.	Residence. (If unknown, that fact must be stated.)	Names and residences of Sureties.	Where Contracted.	Whether liability was contracted as partner or joint contractor.	AMOUNT

Oath to Schedule A

UNITED STATES OF AMERICA
.....District of.....
} ss.
County of .....

On this .....day of .....A. D. 19 .., before me personally came .....

the person mentioned in and who subscribed to the foregoing Schedule A [1, 2, 3, 4, 5], and who being by me first duly sworn, did declare the said Schedule to be a true statement of all.....debts, in accordance with the Acts of Congress relating to Bankruptcy.

.....

.....

Subscribed and sworn to before me this..... day of....., 19..

.....

.....

.....
(Official Character)

FIG. 73.—Schedule *A* in bankruptcy, listing the bankrupt's creditors and liabilities.

legal form (see Fig. 72), uniform throughout the United States, to which are annexed five schedules showing (see Fig. 73):

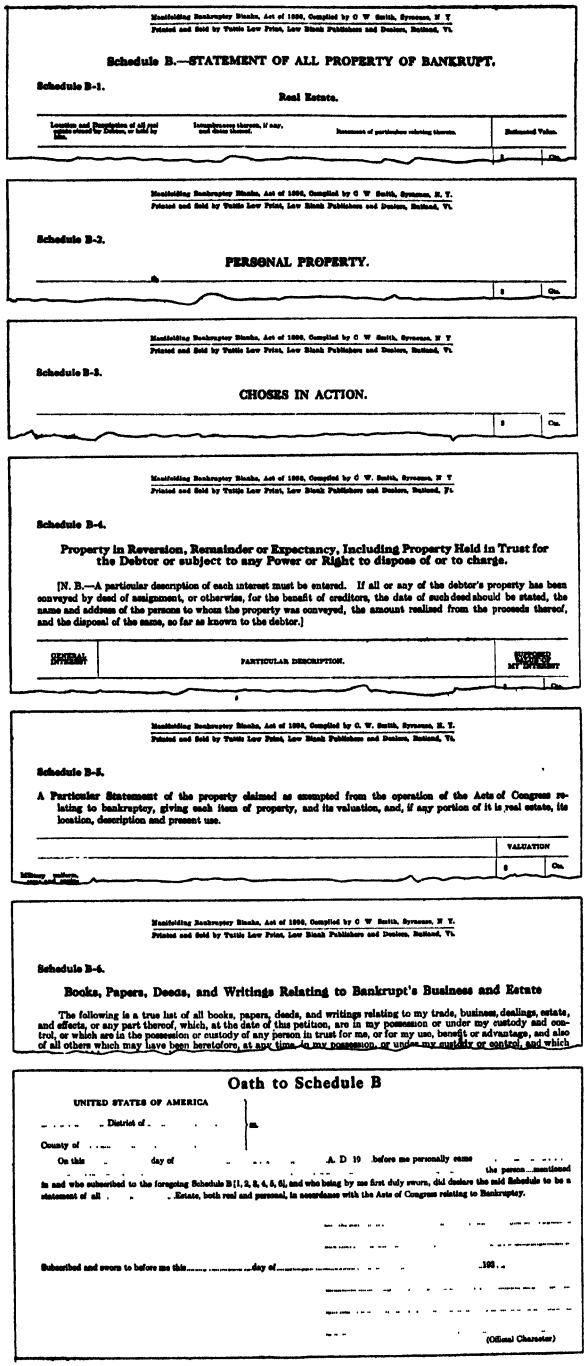
1. A statement of all creditors who are to be paid in full, or to whom priority is secured by law.
2. Creditors holding securities.
3. Creditors whose claims are unsecured.
4. Liabilities on notes or bills discounted which ought to be paid by drawers, makers, acceptors, or indorsers.
5. Accommodation paper.

Another list of six schedules (see Fig. 74) is made out and annexed to the petition showing a statement of all property of bankrupt, including real estate, personal property, choses in action, property held in trust for the debtor, property claimed as exempted from the operation of bankruptcy laws, and books, papers, deeds, and writings relating to bankrupt's business and estate. All schedules must be filed with the petition in voluntary cases and within 5 days after adjudication in involuntary bankruptcies.

The truthfulness of the statements contained in all of these schedules is verified by oath. A summary of debts and assets is then drawn up (see Fig. 75), the petition is filed with the clerk of the district court, and a fee of $30 is paid, except when a fee is not required from a voluntary bankrupt who takes the pauper oath. Of the fee deposited with the petition, $15 goes to the referee, $10 to the clerk, and $5 to the trustee. The petition is prepared in quadruplicate, three copies being filed with the clerk of the court, one copy for the clerk, one for the referee, and one for service on the bankrupt.

Appointment of Receiver.—At any time after the filing of either a voluntary or involuntary petition a receiver in bankruptcy may be appointed, on application of interested parties, for the preservation of the estate. A receiver may be appointed merely as a custodian which is the usual way, or with full powers, or to conduct the business, or in an ancillary capacity. The various duties, responsibilities, and compensation of receivers in bankruptcy as custodians have already been discussed in the preceding chapter. This kind of receivership ends when the petition is dismissed or, if the debtor is adjudged bankrupt, upon the election of a trustee at the first meeting of creditors, and after the hearing on the receiver's final report.

Trial.—As soon as the clerk makes the necessary entries, he submits the petition to the court. In voluntary cases adjudication or dismissal of petition can usually take place at once. If the petition is filed by creditors, the alleged bankrupt is given a reasonable opportunity to deny the charges. Thus he may contend that he is not insolvent, that he has not committed any act in bankruptcy, that the allegations regarding the



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Schedule B.—STATEMENT OF ALL PROPERTY OF BANKRUPT.

Schedule B-1.

Real Estate.

Location and description of all real estate owned by Debtor, or held by him.	Incumbrances thereon, if any, and claims thereof.	Statement of particulars relating thereto.	Estimated Value.
			$ Cts.

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Schedule B-2.

PERSONAL PROPERTY.

	$	Cts.

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Schedule B-3.

CHOSES IN ACTION.

	$	Cts.

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Schedule B-4.

Property in Reversion, Remainder or Expectancy, Including Property Held in Trust for the Debtor or subject to any Power or Right to dispose of or to charge.

[N. B.—A particular description of each interest must be entered. If all or any of the debtor's property has been conveyed by deed of assignment, or otherwise, for the benefit of creditors, the date of such deed should be stated, the name and address of the persons to whom the property was conveyed, the amount realized from the proceeds thereof, and the disposal of the same, so far as known to the debtor.]

GENERAL INTEREST	PARTICULAR DESCRIPTION.	ESTIMATED VALUE OF MY INTEREST
		$ Cts.

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Schedule B-5.

A Particular Statement of the property claimed as exempted from the operation of the Acts of Congress relating to bankruptcy, giving each item of property, and its valuation, and, if any portion of it is real estate, its location, description and present use.

	VALUATION
	$ Cts.

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Schedule B-6.

Books, Papers, Deeds, and Writings Relating to Bankrupt's Business and Estate

The following is a true list of all books, papers, deeds, and writings relating to my trade, business, dealings, estate, and effects, or any part thereof, which, at the date of this petition, are in my possession or under my custody and control, or which are in the possession or custody of any person in trust for me, or for my use, benefit or advantage, and also of all others which may have been heretofore, at any time, in my possession, or under my custody or control, and which

Oath to Schedule B

UNITED STATES OF AMERICA
.. District of .. ss.
County of ..

On this .. day of .. A. D 19 before me personally came .. the person mentioned in and who subscribed to the foregoing Schedule B [1, 2, 3, 4, 5, 6], and who being by me first duly sworn, did declare the said Schedule to be a statement of all .. Estate, both real and personal, in accordance with the Acts of Congress relating to Bankruptcy.

Subscribed and sworn to before me this ..day of .. 190..

(Official Character)

FIG. 74.—Schedule *B* in bankruptcy, listing all property of the bankrupt.

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531-533-535 West Larned St. Randolph 8670
Detroit, Mich.

SUMMARY OF DEBTS AND ASSETS.

[From the Statement of the Bankrupt in Schedules A and B.]

Schedule A—	1	(1)	Taxes and debts due United States	
Schedule A—	1	(2)	Taxes due States, Counties, Districts and Municipalities	
Schedule A—	1	(3)	Wages	
Schedule A—	1	(4)	Other debts preferred by law	
Schedule A—	2		Secured Claims	
Schedule A—	3		Unsecured Claims	
Schedule A—	4		Notes and Bills which ought to be paid by other parties thereto	
Schedule A—	5		Accommodation Paper	
			Schedule A, Total	
Schedule B—	1		Real Estate	
Schedule B—	2-a		Cash on hand	
Schedule B—	2-b		Bills, Promissory Notes, and Securities	
Schedule B—	2-c		Stock in Trade	
Schedule B—	2-d		Household Goods, etc	
Schedule B—	2-e		Books, Prints and Pictures	
Schedule B—	2-f		Horses, Cows and other Animals	
Schedule B—	2-g		Carriages and other Vehicles	
Schedule B—	2-h		Farming Stock and Implements	
Schedule B—	2-i		Shipping and Shares in Vessels	
Schedule B—	2-k		Machinery, Tools, etc	
Schedule B—	2-l		Patents, Copyrights, and Trade-Marks	
Schedule B—	2-m		Other Personal Property	
Schedule B—	2-n		Debts due on Open Accounts	
Schedule B—	2-o		Stocks, Negotiable Bonds, etc	
Schedule B—	2-p		Policies of Insurance	
Schedule B—	2-q		Unliquidated Claims	
Schedule B—	2-r		Deposits of Money in banks and elsewhere	
Schedule B—	4		Property in Reversion, Remainder, Trust, etc	
Schedule B—	5		Property claimed to be exempted	
Schedule B—	6		Books, Deeds and Papers	
			Schedule B, Total	

Petitioner.

FIG. 75.—Summary of debts and assets filed by the bankrupt.

provable claims of petitioning creditors are untrue, or that the court has no jurisdiction, and so on. The court hears the evidence on both sides and on that basis either dismisses the petition or adjudges the debtor a bankrupt.

If the bankrupt elects to contest the proceedings, a jury trial is necessary before the court can sign the decree adjudicating him a bankrupt. Usually, however, such suits are not contested, and at the expiration of about 15 days, which the bankrupt is given in which to appear and plead to the petition and after which he is deemed to have waived jury trial, the court either dismisses the petition or enters a decree adjudging him a bankrupt. Section 18, Chapter IV, of the Federal Bankruptcy Act provides that in case of involuntary proceedings the writ of subpoena served on the defendant must be returnable within 10 days, unless the court shall for cause fix for a longer time, and that the bankrupt or any creditor may appear and plead to the petition within 5 days after the return day, making a total of 15 days under normal conditions. In both kinds of bankruptcy, certain creditors may controvert the facts alleged in the petition.

Referee in Bankruptcy.—If the petition is sustained by proof, the decree is signed adjudicating the insolvent debtor a bankrupt, and the case is turned over to a referee who is directed to proceed with the administration of the estate. The referee is an officer of the Federal court, appointed by the district judge for a term of two years. His duties are to supervise the administration of all bankrupt estates within his assigned territory, beginning as soon as the insolvent is adjudged a bankrupt and continuing until a discharge is granted. He must have such intimate relations with all the proceedings that the law provides for as many referees as may be necessary to expedite the bankruptcy business pending in the courts. A large state may have from 30 to 50 referees.

Powers of Referee.—According to Chapter V, Section 38, of the Federal Bankruptcy Act, referees are invested, subject to a review by the district judge, with the jurisdiction to:

1. Consider all petitions referred to them by the clerk of the Federal district court in the absence of the judge from the district, and either dismiss them after a hearing or make the adjudications.

2. Exercise the power vested in courts of bankruptcy for the administering of oaths to and examination of witnesses and to require the production of documents in proceedings before them. They cannot, however, exercise the power of commitment.

3. In the absence of a judge from the judicial district or in case of his sickness or inability to act, as evidenced by a certificate issued by the clerk, to take possession and release the property of the bankrupt, whenever required.

4. Grant, deny, or revoke discharges.

5. Confirm or refuse to confirm arrangements or wage-earner plans.

6. Perform such part of the duties as are conferred by the act on courts of bankruptcy or prescribed by rules or orders of such courts in their respective districts.

7. During the proceedings, upon application of the trustee, to authorize the employment of stenographic help, at the expense of the estate, for reporting and transcribing the proceedings.

Duties and Compensation of Referee.—The referee's principal duties as prescribed in Chapter V, Section 39, are as follows:

1. To give notice to creditors of the adjudication and of meetings.

2. To prepare and file schedules in bankruptcy, if bankrupt neglects them. This, of course, applies only to involuntary proceedings, for in voluntary cases schedules must be ready to file when petition is filed.

3. To examine all schedules of property and lists of creditors filed by bankrupts. These schedules show all the assets of the estate and arrange all liabilities in the order of priority of claim, and constitute an index to the entire proceedings.

4. To declare dividends and prepare and deliver to trustees dividend sheets showing the amounts declared and to whom payable.

The other duties deal with the preservation and handling of all records of the proceedings, and the furnishing of information to all interested parties.

Compensation for his effort is regulated by the law and consists of $15 deposited with the clerk when petition is filed, 25 cents for each proof of claim that is filed, to be paid from the estate as a part of the cost of administration, and 1 per cent on all sums disbursed to creditors by the trustee, or 0.5 per cent of such disbursements in case of a composition settlement or an extension arrangement.

Filing Proof of Claims.—Creditors should file their claims promptly upon receipt of notice of the adjudication and the first creditors' meeting, since only those creditors whose claims have been allowed may participate in the election of a trustee. Claims may be filed with the referee at or before the first meeting of creditors or thereafter within 6 months from adjudication.

Claims are filed on certain forms which were adopted and prescribed by the Supreme Court of the United States in accordance with the provision in Chapter IV, Section 30, of the Bankruptcy Act (see Fig. 76). On these forms, a creditor sets forth his claim and the consideration therefor, payments made on the claim, and the amount justly owing from the bankrupt. If any securities are held for the claim under consideration, that fact must be stated on the "proof of debt" form. It is advisable to attach itemized bills setting forth the nature of the claim. If a claim

U. S. A. C. OFFICIAL FORM No. 33 — UNIFORM BANKRUPTCY BLANKS
7-23-1-3 4825 — THE COLUMBUS BLANK BOOK MFG. CO., COL., O.

PROOF OF DEBT DUE CORPORATION

In the District Court of the United States.

For the ..... District of .....

IN THE MATTER OF } No. ..... In Bankruptcy.
..... Bankrupt. }

At ....., in said District of ....., on the ..... day of ....., A. D. 19....., came ....., of ....., in the County of ....., and State of ....., and made oath, and says that he is ..... of the ....., a corporation incorporated by and under the laws of the State of ....., and carrying on business at ....., in the County of ....., and State of ....., and that he is duly authorized to make this proof, and says that the said ....., the person by [*or* against] whom a petition for Adjudication of Bankruptcy has been filed, was at and before the filing of the said petition, and still is, justly and truly indebted to said corporation in the sum of ..... Dollars; that the consideration of said debt is as follows: .....

that no part of said debt has been paid [except .....];

that there are no set offs or counterclaims to the same [except .....];

and that said corporation has not, nor has any person by its order, or to the knowledge or belief of said deponent, for its use had or received any manner of security for said debt whatever, and that no note has been received for said debt and no judgment rendered thereon.

.....
.....of said Corporation.

Subscribed and sworn to before me this .....day of .....A. D. 19.....

.....
by the said .....
who is personally known to me, whose identity is established by satisfactory proof.

.....
(Official Character)

FIG. 76.—Proof of claim filed by creditors.

is based on a written instrument, such instrument must be filed with the claim. In event the instrument is lost or destroyed, a statement to that effect must be filed under oath with the claim.

If a creditor is unable to attend the creditors' meeting personally, he may be represented by an attorney, if he fills out the blank power of attorney incorporated in the "proof of debt" form and found on the reverse side. No special advantage, save that of convenience, can ordinarily be gained from such representation. On the other hand, there is a possibility of placing such claims in the hands of unscrupulous attorneys who are overanxious to secure a large number of claims in order to obtain control of the estate through the appointment of a trustee who is to represent *them* rather than the creditors. If not in a position to control the insolvent's estate, such attorneys may hold out in a composition settlement in order secretly to secure additional compensation for themselves from the debtor. For these reasons, some attorneys make it a practice to solicit claims against insolvent estates and offer to represent creditors without any fee. It is against such attorneys as these that creditors must be cautioned in the exercise of their power to authorize an attorney to represent them at creditors' meetings. It is unjust, however, for credit men to maintain a contemptuous attitude toward the commercial attorneys, as such, for relatively few of them are in the class of dishonest bankruptcy practitioners.

A much better practice in vogue at the present time is to file the claim with the referee and to give a representative committee of creditors or an adjustment bureau, where one is available, a proxy to vote at the meetings, or else assign the claim to the bureau, which will itself file it and take whatever action it deems advisable. In either case, the creditor may be certain that a more competent trustee will be elected and that the estate will be administered in a more business-like fashion.

All debts owing at the time the petition is filed, though not payable until a later date, may be proved. Other provable debts consist in claims for torts reduced to judgment before the adjudication; claims of persons contingently liable for the bankrupt; and all liquidated claims of a contractual nature, such as breach of contract.

Meetings of Creditors.—The first duty of the referee is to notify every creditor of the adjudication and to call a creditors' meeting, which must be held not less than 10 or more than 30 days after the decree of bankruptcy has been signed. According to Section 58, Chapter VI, creditors or a committee appointed by them are entitled to 10 days' notice by mail, unless they waive notice in writing. Such notice must be published at least once, not later than one week prior to the meeting. Not only must notice be sent of all meetings of creditors, for the same applies to all examinations of the bankrupt, all hearings for the confirma-

tion of a composition, all proposed sales of property or compromises of any controversy, declaration and time of payment of dividends, the filing and examining of the final accounts of the trustee, and the proposed dismissal of the proceedings; creditors are also entitled to 30 days' notice of applications for the discharge of bankrupts.

The purpose of the first meeting of creditors, at which the judge or referee presides, is to allow or disallow the claims of creditors, to elect a trustee, to place the debtor on the witness stand for an examination by creditors or their representatives, and to appoint a committee of three or more creditors to consult and advise with the trustee.

Subsequent meetings may be called from time to time whenever the referee deems it necessary or, within 30 days, whenever one fourth or more in number of creditors who have proved their claims file a written request to that effect. When the affairs of the estate are ready to be closed, except in no-asset cases, a final meeting must be ordered.

Allowance of Claims.—Ordinarily, before the first meeting of creditors, many claims will have been filed; others are filed at this meeting. If filed in proper form and in the class of provable claims, the next thing is to determine whether they shall be allowed. Generally, all provable claims are allowable. To this there are two important exceptions. Secured claims, for example, are allowable only to the extent of the difference between the amount of the claim and the value of the property securing the claim. Again, claims with voidable preferences will not be allowed till such preferences are surrendered.

A preference is voidable if, (1) given for a preexisting debt, (2) within four months before the filing of the petition, or after filing the petition and before the adjudication, and (3) if the person receiving it or benefiting thereby had reasonable cause to believe that the debtor was insolvent at the time and therefore apparently intended to give the recipient a preference. The purpose in making such preferences voidable is to enable the trustee to recover every payment made to creditors within four months prior to filing the petition or before adjudication, in order to provide for an equitable distribution of the insolvent estate.

The Trustee.—Just as the referee represents the court, so the trustee represents the creditors. The trustee (the trusteeship may consist of one or three persons) is elected at the first meeting by those creditors whose claims have been proved and allowed. A majority vote, in both number and amount of claims, is necessary to effect such election.[1] The

[1] Claims of $50 or less are counted only in computing the amount but not the number of voting creditors, thereby minimizing the influence of collection agencies and others who corral many small claims for control purposes. Relatives of the bankrupt or stockholders and officers of the bankrupt corporations are precluded from voting for the election of a trustee or for a creditors' committee.

election of the trustee is subject to the approval of the referee, and in event the creditors cannot agree on a trustee, as where the vote on the per dollar of claim basis conflicts with the per capita basis, the referee appoints one. Where there is a conflict in the results of the two votes, the choice of the majority of creditors is usually appointed by the referee.

Before entering upon his official duties, a trustee, in order to qualify for the position, must file a bond, the amount of which is determined by the court, which may increase or decrease the amount of such bond at any time if there is ample cause for such a change. This in a measure indicates the importance of his position, for creditors may administer the insolvent estate only through the medium of their trustee. Hence, to insure the largest possible dividends it is essential that a competent trustee be elected in order that the estate may be handled in an honest and business-like manner. It is urged, therefore, that all creditors be present or else properly represented at the first meeting, when such election takes place.

Following his appointment and qualification, the trustee takes title to all of the bankrupt's property as of date the debtor was adjudged a bankrupt, except in so far as exemption to the property is claimed and allowed. He is vested with the title of all documents relating to the bankrupt's assets; interests in all sorts of intangible assets, including patents, patent rights, copyrights, and trade-marks; property fraudulently transferred by the bankrupt to his creditors; and rights of action arising from contracts, etc. In a word, the trustee practically stands "in the shoes" of the bankrupt as far as title to the property is concerned. He holds the property and may convey title to the purchaser thereof subject to all legal and equitable liens. Naturally, he acquires no better title to the property than the bankrupt had.

Duties of the Trustee.—The duties of a trustee are outlined in paragraph (*a*), Section 47, Chapter V, of the Bankruptcy Act. He is required to examine proofs of claim and object to their allowance if deemed improper, to examine the bankrupt, to reduce all property to possession, liquidate it under the direction of the court as expeditiously as compatible with the best interests of all parties concerned, place the proceeds received in one of the designated depositories, distribute the moneys among the creditors as required by law and, at the expense of the estate, to oppose the discharge of the bankrupt if deemed advisable. Real and personal property belonging to the bankrupt estate, after being properly appraised by three disinterested appraisers appointed by the court, is usually sold subject to the approval of the court, and the sale must receive approval if the property realizes less than 75 per cent of its appraised value. He must account for all receipts and disbursements, furnish information concerning the estate to all parties in interest, lay before the final meeting

of the creditors detailed statements of the administration of the estate, make final reports and file final accounts with the court 15 days before the day fixed for the final meetings of the creditors, and pay dividends within 10 days after declared by the referee. If three trustees are placed in charge of an estate, at least two must concur to make their acts valid.

Compensation of Trustee.—Compensation for his efforts is regulated by Section 48, Chapter V, of the law itself on a percentage basis, with the exception of the $5 which he receives out of the $30 fee deposited with the clerk when the petition is filed. In addition to this $5 his compensation must not exceed 6 per cent of the first $500 disbursed to creditors on claims allowed by the court, 4 per cent on amounts from $500 to $1,500, 2 per cent on sums from $1,500 to $10,000, and 1 per cent on all sums in excess of $10,000. If the trustee is allowed to conduct the business, his compensation may be fixed by the court but must not exceed twice the ordinary maximum allowance.

Examination of the Bankrupt.—One of the most important phases of the proceedings is to place the bankrupt on the witness stand, where he may be questioned personally by any *bona fide* creditor or through an attorney or other representative of creditors, with a view to ascertaining and establishing the fraud or preference of which the creditors may be suspicious. To make such an examination possible, Section 7, Chapter III, of the Bankruptcy Act, provides that the bankrupt shall submit to an examination concerning the conduct of his business and all matters directly relating to the cause of his bankruptcy, his dealings with his creditors and other persons, the whereabouts of his property, as well as all matters which may affect the administration and settlement of his estate. This testimony, however, may not be used against him in any criminal proceeding.

The other well-defined duties which devolve upon the bankrupt are: to attend the first meeting of his creditors, the hearing upon his petition for a discharge, if objections are filed, and such other meetings as the court may direct; to comply with all lawful orders of the court; to examine the correctness of proofs of claims against his estate; to cooperate with the trustee in collecting and protecting the assets; to prepare and file schedules of assets and liabilities; and to file at least 5 days before the first meeting of creditors a statement of his affairs.

Should the bankrupt, upon examination, prove hostile or otherwise unsatisfactory, because of his evasive replies; or should he refuse to answer questions or to produce records; or should he otherwise manifest a desire to withhold necessary and helpful information, the court may confine him for contempt of court. He is also subject to arrest if he refuses to appear for examination when so ordered or when satisfactory proof by affidavits is given that the bankrupt intends to leave the district

in order to avoid examination or otherwise defeat the proceedings in bankruptcy. Under such circumstances the judge is given power to issue a warrant to the marshal directing him to bring the bankrupt before the court for examination. When so confined, the bankrupt may be kept in custody not exceeding 10 days.

Declaration and Payment of Dividends.—Before any dividends may be declared and paid on the allowed claims of general creditors, certain debts having priority must be paid in full out of the bankrupt estate. The following debts are given priority by Section 64, Chapter VII, of the Bankruptcy Act, in the order in which they are listed herewith:

1. The actual and necessary cost of preserving the estate subsequent to filing the petition.

2. The filing fees paid by creditors in involuntary proceedings, and the reasonable expenses of recovering transferred and concealed property.

3. The cost of administration, including fees and mileage payable to witnesses, and reasonable fees to one attorney for services actually rendered to the petitioning creditors in involuntary cases, and to the bankrupt in voluntary cases, as the court may allow.

4. Wages due to workmen or other employees which have been earned within 3 months prior to the date of the commencement of proceedings, not exceeding $600 to each claimant.

5. Reasonable expenses incurred by creditors in opposing the confirmation of an arrangement or wage-earner plan.

6. All taxes due to the United States, the state, county, district, or municipality.

7. Debts owing to any person who by the laws of the states or the United States is entitled to priority.

After the above claims have been paid in full, the remainder is distributed pro rata among all other creditors. In this connection it should be observed that a judgment creditor has no priority over other unsecured creditors unless an execution has been levied on specific property at least four months prior to the filing of the petition.

As already indicated in a previous connection, the referee must declare dividends and prepare dividend sheets showing dividends declared and to whom payable. It then devolves upon the trustee to pay the dividends thus declared within 10 days after the declaration by the referee. Section 65, Chapter VII, of the act provides that the first dividend must be declared within 30 days after the first date set for the first meeting of creditors, if the money of the estate in excess of the amount necessary to pay in full all prior claims amounts to 5 per cent or more of the allowable claims. Not more than 50 per cent of the funds on hand in excess of the amount needed to satisfy prior and lien claims may be paid out on the first dividend. Subsequent dividends must be declared

whenever the amount to be distributed equals 10 per cent or more, as well as upon closing of the estate. Dividends may be declared oftener and in smaller proportions upon the order of the judge. The final dividend, however, is not to be declared within 3 months after the first dividend has been declared. All dividends which remain unclaimed for 6 months after the declaration of the final dividend are to be paid by the trustee into the court. If unclaimed for a period of 1 year, the judge may direct that such dividends be distributed among creditors whose claims have been allowed but not paid in full, the balance, if any, going to the bankrupt. Unclaimed dividends belonging to minors must remain intact until 1 year after such minors arrive at majority.

Discharge of Bankrupt.—One of the main purposes of the Bankruptcy Law is to enable creditors to take possession of an insolvent debtor's assets and equitably to distribute the proceeds among themselves. The second chief object of the law is to release the bankrupt debtor, through a discharge, from his unpaid liabilities, thereby allowing him to start anew and unencumbered. In accordance with this object, Section 14, Chapter III, of the act provides that the adjudication of a bankrupt other than a corporation automatically acts as a discharge application. If the bankrupt is a corporation, it must file an application for a discharge within 6 months following adjudication (see Fig. 77*A*).

After the bankrupt has been examined, the court fixes a time for the filing of objections to the discharge. Notice must be sent to creditors, trustees, and the U.S. District Attorney at least 30 days in advance. Then 30 days' notice is given to the bankrupt, his attorney, and objecting parties of a hearing to be held on the objections filed (see Fig. 77*B*).

After hearing the application for a discharge and proofs and pleas in opposition thereto, the court will grant the discharge unless the bankrupt has committed one of the acts expressly prohibited by Section 14, Chapter III, of the Bankruptcy Act. According to this section a discharge shall not be granted if the bankrupt has:

1. Committed an offense punishable by imprisonment, as provided by the act, such as concealing property from the trustee, making a false oath or account in bankruptcy proceedings, or presenting under oath a false claim against his estate.

2. Destroyed, mutilated, falsified, concealed, or failed to keep books of account or records from which his financial condition might be ascertained, except where the court feels that such acts might have been justified by all the conditions in the case.

3. Obtained a new credit or an extension or renewal thereof through a false statement issued in writing concerning his financial condition.

4. Transferred, removed, destroyed, or concealed any of his property, or permitted others to do so, with intent to hinder, delay or defraud his

Form 857—Special—Petition for Discharge and Verification. Order by above description.

Tuttle Law Print, Publishers, Rutland, Vt. TUTTLANN, REGISTERED U. S. PAT. OFFICE

In the District Court of the United States

For the.....District of.....

In the matter of

.....
Bankrupt.

In Bankruptcy

No......

To the Honorable.....
Judge of the District Court of the United States for the

.....District of.....

The petition of.....
.....(individually and as copartners comprising the firm of.....) (a corporation incorporated under the laws of the State of.....) having its principal office in the.....) of.....
.....in the county of....., District of .....respectfully represents:

That on the.....day of.....19....., a petition in bankruptcy was duly filed in this Court by (or against) petitioner(s) praying that he (they) (it) be adjudged bankrupt under the Acts of Congress relating to bankruptcy, upon which said petition petitioner(s) was (were) duly adjudged bankrupt(s) on the..... day of.....19.....; that petitioner(s) duly filed schedules, of all debts and assets, duly verified, all in accordance with the Acts of Congress relating to bankruptcy and the rules and practice of this court; that on the..... day of.....19....., ...of.....was appointed Trustee and thereafter duly qualified; that petitioner(s) has (have) been duly examined concerning his (their) (its) acts, conduct and property and such examination has been concluded; that your petitioner(s) has (have) duly surrendered all of his (their) (its) property and rights of property and has (have) fully complied with all the requirements of the Acts of Congress relating to bankruptcy and of the orders of the Court and Referee touching his (their) (its) bankruptcy; that petitioner(s) has (have) not been granted a discharge in bankruptcy within six years nor has (have) your petitioner(s) committed any of the acts or offenses specified in subdivision (b) of Section 14 of the Bankruptcy Act, as amended, constituting grounds for the refusal of a discharge.

WHEREFORE, your petitioner(s) pray(s) that he (they) (it) may be declared by this Court to have a full discharge from all debts provable against his (their) (its) estate under the Acts of Congress relating to bankruptcy, except such debts as are excepted by law from such discharge.

Dated....., 19.....

.....

.....

.....
Petitioner(s)

UNITED STATES OF AMERICA
....District of..... } ss.
County of.....

.....
being (severally) duly sworn, depose and say: that he is (the.....of.....) (they are) the petitioner named in the foregoing petition; that he has (they have) read the same and know the contents thereof; that the same is true to the knowledge of deponent except as to those matters therein stated to be alleged upon information and belief, and as to those matters he (they) believe it to be true.

Sworn to before me this..... } .....
day of.....19..... } .....

....
[SEAL] (OVER)

FIG. 77*A*.—Petition for discharge and order of notice when bearing on it will be had.

ORDER OF NOTICE THEREON

.....District of.....ss.:

On this.....day of.....A. D. 19....., on reading the foregoing petition, it is

ORDERED BY THE COURT, that a hearing be had upon the same on the..... day of.....A. D. 19.....before said court, at..... in said District, at.....o'clock in the..... .....noon; and that notice thereof be published in.....a newspaper printed in said District, and that all known creditors and other persons in interest may appear at the same time and place and show cause, if any they have, why the prayer of said petitioner should not be granted.

AND IT IS FURTHER ORDERED BY THE COURT, that the Referee shall send by mail to all known creditors copies of said petition and this order, addressed to them at their places of residence as stated.

WITNESS the Honorable..... Judge of said Court, and the seal thereof, at

.....

[Seal of the Court.] in said District, on the .....day of

.....A. D. 19.....

.....
CLERK.

....hereby depose , on oath, that the foregoing order was published in the..... .....

on the following.....days, viz.:

On the.....day of....., and on the..... day of....., in the year 19.....

.....

District of.....

.....19.....

Personally appeared..... .....and made oath that the foregoing statement by him subscribed is true.

Before me,

.....

.....
(Official Character)

I HEREBY CERTIFY that I have, on this.....day of..... A. D. 19....., sent by mail copies of the above order, as therein described.

.....
REFEREE.

IN BANKRUPTCY

IN CASE NO.

In the District Court of the United States

District of

In the matter of

Bankrupt.

Bankrupt's Petition for Discharge

With Verification

Filed.....o'clock.....M.,

this.....day of.....19.....

Attorney.

Printed and Sold by Public Law Print, Rutland, Vt.

FIG. 77*B*.—Reverse side of petition for discharge on Fig. 77*A*, serving notice of a hearing on the petition.

creditors, within 12 months immediately preceding the filing of the petition.

5. Has been granted a discharge in bankruptcy within 6 years, or had a composition or arrangement confirmed within 6 years.

6. Refused to obey any lawful order of, or to answer any material question approved by, the court, in the course of the proceedings.

7. Failed to explain satisfactorily any losses or deficiency of assets to meet his obligations.

If there has been any fraud in bringing about the proceedings, or in concealing property which should have been surrendered for the benefit of creditors, any of the defrauded creditors may apply to the court within a year after the discharge has been granted and have it revoked. It must be proved that knowledge of the fraud has been acquired by the petitioners since the granting of the discharge, and had such facts been known in time, the discharge would not have been granted. It, therefore, behooves insolvent debtors to be honest in their dealings with creditors, particularly in bankruptcy proceedings.

Debts Not Affected by Discharge.—Section 17, Chapter III, of the Bankruptcy Act provides that a discharge in bankruptcy releases the bankrupt from all his provable debts incurred before the petition was filed, except the following debts, which remain a claim against him even after a discharge in bankruptcy has been granted:

1. Taxes levied by the United States, the state, county, district, or municipality.

2. Liabilities for obtaining property by false pretenses or false representations, or malicious injuries to the person or property of another, or alimony due or to become due, or for maintenance or support of wife or child, or for the seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversation.

3. Unscheduled claims unless creditor had notice or actual knowledge of the proceedings in bankruptcy.

4. Debts created by the bankrupt's fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity.

5. Wages earned by employees within 3 months prior to date of commencement of proceedings in bankruptcy.

6. Moneys received from an employee to secure the faithful performance of such employee in accordance with the terms of the contract.

To the above may be added all debts incurred after the petition has been filed. All creditors whose claims fall in any of the above groups may proceed with the enforcement of collection as if no bankruptcy proceedings had taken place.

Settlement by Arrangements.—It has already been brought out in Chap. XXXI that a composition at common law is a contract entered into by an insolvent debtor and his creditors, whereby the debtor settles the claims against him at an agreed percentage of their face value, provided the creditors mutually promise to release him from the balance of his indebtedness. Such a settlement is binding, however, only upon those creditors who consent to it. To effect similar adjustments and make them binding upon all creditors is the purpose of two of the new chapters of the Chandler Bankruptcy Act of 1938 dealing with "arrangements," Chapter XI having to do with compositions and extensions of unsecured debts and Chapter XII covering real property arrangements by persons other than corporations.

Under Chapter XI a debtor may file a petition, stating that he is insolvent or unable to pay his debts as they mature and setting forth the terms of his arrangement, which is a plan for the settlement or extension of time for the payment of his unsecured debts. The petition must be accompanied by a statement of the debtor's executory contracts, his schedules, a statement of his affairs, and the filing fee. If proceedings in bankruptcy are already pending, no new filing fee need be paid nor is it necessary to file new schedules or a new statement of affairs. Furthermore, such proceedings may be stayed by the court pending action on the petition for an arrangement.

The judge may refer the proceeding to a referee and upon application of interested parties appoints a receiver unless the estate is already in the hands of a trustee in bankruptcy. Appraisers may then be appointed to prepare an inventory and appraisal of the debtor's property. Upon 10 days' notice, a meeting of creditors is called, the notice being accompanied by a copy of the proposed arrangement and a summary of assets and liabilities as shown by the schedules. In this notice may also be named the time for filing of the application to confirm the arrangement as well as the time for hearing the confirmation and objections thereto. Either the judge or the referee may preside at this meeting, where proofs of claim are received and allowed or disallowed, the debtor is examined, and written acceptances of creditors on the proposition are received and passed upon. At this meeting or thereafter a receiver or trustee is appointed whose task it is to receive and distribute the consideration to be deposited by the debtor. Creditors may also appoint a committee and nominate a trustee who is later appointed by the court if it should become necessary to administer the estate in bankruptcy.

If at the meeting of creditors an arrangement has been accepted in writing by all creditors affected thereby, the court confirms it. Otherwise, it must be accepted by a majority in number of all creditors and amount of all claims allowed before an application for confirmation of

the arrangement may be filed with the court. If creditors are divided into classes, such as small versus large creditors, or borrowed-money versus merchandise creditors, it is necessary to obtain a majority both in number of creditors and in amount of claims in each class. The judge thereupon confirms the arrangement, if he is satisfied that (1) it is for the best interests of the creditors, (2) it is fair, equitable, and feasible, (3) the debtor has not been guilty of any act or failed to perform any duty which would prevent the discharge of a bankrupt, and (4) the proposal has been offered and accepted in good faith.

Upon confirmation, the terms of the arrangement are binding upon the debtor and all creditors. The court retains jurisdiction of the case until all claims subject to the arrangement have been allowed or disallowed. But the debtor is discharged from all his unsecured debts immediately after the confirmation and the fulfillment of his obligations thereunder, except for debts that are not dischargeable in bankruptcy. When the proceeding is consummated, the court enters a final decree discharging the receiver or trustee and closing the estate.

If an arrangement is withdrawn or abandoned prior to its acceptance, or is not accepted, or its terms are violated by the debtor, the court either dismisses the proceeding or, upon hearing after due notice to all interested parties, enters an order adjudging the debtor a bankrupt. If the case is already in bankruptcy, proceedings, if stayed, are resumed upon failure of the arrangement to materialize. But even here no adjudication can be entered against a wage earner or farmer without his consent in writing.

Arrangement proceedings dealing with unsecured creditors are superior to the procedure under the old law in several respects, even including the amendment of 1934. Settlement may now be made on any terms, on a composition or extension basis, and for any consideration. Creditors may now accept in liquidation of their claims bonds, stocks, and similar securities which were formerly not recognized as proper consideration for a composition settlement. It is not necessary to go into bankruptcy in order to effect an arrangement. Nor is it necessary to treat all unsecured creditors on a parity. Small creditors may be treated more favorably and so may banks or so-called money-borrowed creditors. The proceeding applies to corporations as well as to individuals, thus perhaps obviating the necessity in certain cases for corporations to resort to the corporate reorganization section of the Bankruptcy Act. Finally, the procedure in arrangement is relatively simple, clear, and speedy.

Chapter XII of the new law deals with the adjustment of debts which are secured by the real property of an individual or partnership, that relating to corporations being covered in Chapter X under cor-

porate reorganizations. In the main the treatment of secured debts is similar to that used for such indebtedness by corporations, while the treatment of the unsecured debt of such debtors is similar to that described immediately above. The right to file the petition is limited to the debtor, but creditors may later submit a counter proposal which must be first accepted by the debtor before action for confirmation can be taken. Filing of a petition under this chapter usually operates to stay any act to enforce a lien against the property, thus controlling pending foreclosure proceedings. While this relief is available to individuals, no wage earner or farmer can be adjudicated a bankrupt under its provisions without his consent.

Agricultural Compositions and Extensions.—Under Section 75 of the Bankruptcy Act, which expires in 1940, a farmer who is insolvent or unable to meet his obligations as they mature may file a petition for a composition settlement or for an extension of time to pay his debts. This applies to secured or unsecured debts, or both, just as with individuals other than farmers. In the case of farmers, however, provision is made for the appointment of so-called "conciliation commissioners" who act as referees and receivers combined, one such commissioner appointed by the Federal district judge for each county having an agricultural population of 500 or more farmers. An elaborate organization has been provided and detailed instructions have been laid down in Section 75, but practically no use has been made of them, because the relief afforded is more apparent than real and much of it can be obtained through ordinary bankruptcy proceedings, and largely owing to the fact that the farmer has been able to secure so much more relief through various governmental measures taken since the enactment of the amendments covered by Section 75 as to make the latter obsolete.

Corporate Reorganizations.—Chapter X, which provides for corporate reorganizations (except banks, insurance companies, municipalities, railroads, and building and loan associations), is a recent adjunct to the Bankruptcy Act intended for true reorganizations involving a readjustment of the rights of secured creditors or holders of securities and not for the purpose of effecting ordinary compositions with unsecured creditors. It places under the jurisdiction of the bankruptcy courts proceedings formerly handled under Federal equity receiverships, combining for the most part the procedure used in equity cases with that used in bankruptcy. A petition for reorganization may be filed voluntarily by the corporation itself, by three or more creditors with total claims of $5,000 or more, or by an indenture trustee of outstanding securities. The corporation must be insolvent in the bankruptcy sense or unable to meet current obligations as they mature and to have committed an act of bankruptcy within 4 months, or one of the conditions specified

in Section 131 must exist. Approval of the petition is usually based on the allegations contained therein, although the debtor and the creditors are given a chance to file a controverting answer and to be heard. If the petition is approved no order of adjudication is entered. Creditors, stockholders, indenture trustees, and the Securities and Exchange Commission are then notified 30 or 60 days in advance of a hearing to determine whether the debtor shall remain in possession of the property or a trustee shall be appointed. In the meantime, the judge may appoint a temporary trustee to take over the business and if the debt involved is $250,000 or over the appointment of a trustee becomes mandatory. A reorganization plan is worked out and filed with the court on which a hearing is held, upon due notice to creditors, for the consideration of and, perhaps, definite action on the plan. No definite time limit for the filing of reorganization plans is fixed by law. Plans may be proposed by creditors, stockholders, the debtor, the trustee, or the examiner.

Prior to confirming a reorganization plan, the judge must be sure that the plan approved by the judge has been accepted in writing, filed in court, in the case of insolvency of the corporation, by at least two-thirds of each class of creditors affected by the plan, *in amount*, and if solvent, by a majority of each class of stock. The number of creditors, unlike ordinary bankruptcy proceedings and compositions, is irrelevant, the amount of claims consenting to the plan being the main consideration. Moreover, creditors have no voice in the choice of a trustee and can only vote upon acceptance or rejection of a reorganization plan, although they may be heard on other questions. When the plan is confirmed, its provisions are binding upon the debtor and all creditors and stockholders, including a dissenting minority which in an equity court is able to block all plans of reorganization. The judge then enters a decree discharging the debtor and the trustee and closing the estate. Failure to consummate a plan may result in a dismissal of the proceeding or in an adjudication.

Wage Earners' Plans.—Prior to the enactment of the bankruptcy law revision in 1938, there was no way in which a wage earner could adjust his debts out of future earnings. There were only two general possibilities: to go through bankruptcy or leave the wages subject to attachment and garnishment under the various state laws. The latter would often result in loss of employment, for an employer would not wish to be harassed by court orders at frequent intervals.

Under Chapter XIII of the present Bankruptcy Act a wage earner, *i.e.*, an individual who works for wages, salary, or hire and whose total income does not exceed $3,600, if insolvent or unable to pay his debts as they mature, may file a petition with the Federal court in his jurisdic-

tion stating his desire to effect a composition settlement or an extension, or both, out of his future earnings or wages. With this petition he submits his schedules of assets and liabilities and a statement of affairs, and pays a fee of $15. The proceeding may be referred by the judge to the referee, who promptly calls a meeting of creditors, giving them 10 days' notice thereof. At this meeting proofs of claims are received and allowed, the debtor is examined, witnesses may be heard, and the debtor submits his plan and deposits with the referee not more than $15 to cover expenses of the proceeding. If any other costs are involved, they are to be paid out of the fund as it accumulates from future earnings of the debtor. From this point on, the proceeding is no different from that followed in effecting an arrangement.

Under this plan the wage earner subjects his future earnings to the supervision and control of the court, thereby removing the possibility of garnishment by creditors. The portion agreed upon is paid over to the court at regular intervals, and out of this fund an equitable distribution is made among the creditors. Usually, a wage earner's plan includes only unsecured creditors, although it may contain provisions dealing with secured creditors provided all of the latter affected by the plan agree to it.

This chapter of the new law is apparently intended for those individuals who are unable to pay their debts but may not be insolvent in the bankruptcy sense or for those who do not wish to have the stigma of bankruptcy placed upon them and yet fear the results of garnishment proceedings. Over 50 per cent of the bankruptcy cases have to date been instituted by wage earners, most of them resulting from the pressure of wage attachments. Whether the necessary relief will be afforded under the new law is still problematical. If a wage earner has to rely solely upon his future earnings for the payment of a load of debt, bankruptcy may be the best way out, provided that he is honest and that his precarious condition has been brought about by extenuating circumstances. There is no reason why a person should under such circumstances remain burdened indefinitely. It further depends upon the reasonableness of creditors and their willingness to make important concessions. For the real mild cases of overindebtedness, the law should certainly prove a boon to the debtor who shuns wage attachments on the one hand and possible bankruptcy on the other.

Weaknesses of Our Bankruptcy Law and Its Administration.—Despite its numerous good features and laudable purposes, the bankruptcy law of the United States has had many defects. One of the weaknesses of the law lay in the definition of insolvency. To come within the provisions of the act, except under arrangements and reorganizations, a person, to be insolvent, must have property which at a fair valuation is

insufficient in amount to meet his debts. Thus one may be ordinarily insolvent in the sense that he is unable to meet his obligations and yet he may not petition himself, or be petitioned without his consent, into bankruptcy. If solvency as defined by the act is proved by the alleged bankrupt, in the case of involuntary proceedings, the case is dismissed and the petitioning creditors must bear all the expense, including fees of the defendant's attorney.

A second defect has been in the procedure which is unusually cumbersome, particularly for the handling of "no-asset cases" or cases of bankrupts with very small estates. According to the reports of the Attorney General of the United States, which are submitted annually to the President and to Congress on bankruptcy cases handled during the fiscal year, as shown in Table VI, the vast majority of cases are of the type mentioned. In 1935, for example, 37,027 of the 67,158 cases concluded during the year involved no assets whatsoever, and many more were too small to justify the complicated procedure provided by the law.

A third weakness in our bankruptcy law and its administration is the inordinate expense incurred in carrying out its provisions. Each bankruptcy case is administered separately and must carry the expense of a separate and independent management by receivers, trustees, appraisers, and attorneys. Anywhere from 22 to 25 per cent of all amounts realized from the liquidation of bankrupt estates are eaten up by administration fees and expenses. Thus the machinery is not only complicated and cumbersome but is also very expensive to operate.

Probably one of the greatest weaknesses is the gross inefficiency with which bankrupt estates are generally administered, except when closely guarded by creditor interests. In 1935, for example, the cases concluded by the bankruptcy courts involved over a billion and a half dollars of liabilities. Various authorities have estimated that the assets of the bankrupt estates, at least in the case of commercial failures, approximate 40 or 50 per cent of the debts owed. Yet in the year in question less than 5 per cent of the liabilities was realized through the sale of bankrupts' assets, and the situation during that year is quite typical and was duplicated in the several years preceding. Even in 1929 when assets were disposed of at abnormally high prices, only 10 per cent of the liabilities was represented by the gross amount realized. One of the reasons for such small returns is the fact that many trustees who are elected to take over the bankrupt estates and liquidate them for the benefit of creditors know next to nothing about the business and take too much time to perform their duties.

Perhaps an even more important explanation for the small amounts realized from the liquidation of bankrupt estates is to be found in the

TABLE VI.—BANKRUPTCY CASES IN THE UNITED STATES, FOR SELECTED YEARS. SHOWING ASSETS REALIZED AND PAYMENTS MADE
(Amounts expressed in thousands of dollars)

Statistical Summary for the United States	Year (ending June 30)			
	1926	1929	1932	1935
Cases pending, concluded, etc.:				
Pending at close of previous fiscal year	59,850	58,556	66,423	63,352
Filed during fiscal year	46,374	57,280	70,049	69,153
Concluded during fiscal year, including petitions dismissed and compositions confirmed	47,307	57,039	63,502	67,158[a]
Pending at close of fiscal year	58,917	58,797	72,970	65,347
Petitions dismissed	1,211	1,752	2,746	3,550
Compositions confirmed	736	814	718	806[b]
Cases concluded after declaration of bankruptcy:				
Basis of proceedings:				
Voluntary	41,108	50,975	57,645	52,906
Involuntary	6,193	6,064	5,857	3,577
Total	47,301	57,039	63,502	56,483
Status of bankrupt as to assets:				
Filed as pauper claims	2,649	3,620	5,510	5,834
Other "no asset" cases	26,913	35,572	38,760	31,193
Total "no asset" cases	29,562	39,192	44,270	37,027
Asset cases	17,739	17,847	19,232	19,456
Grand total of cases declared bankrupt	47,301	57,039	63,502	56,483
Amount of liabilities, by nature:				
Represented by priority, secured and lien claims	$197,395	$237,048	$ 482,249	$ 575,079
Represented by unsecured claims allowed	339,515	343,118	379,808	459,754
Represented by unsecured claims, not proved	269,403	303,440	398,173	484,099
Total	$806,313	$883,606	$1,260,230	$1,518,932
Gross assets realized in asset cases, less expense of conducting business	$ 93,018	$ 88,964	$ 85,604	$ 63,073
Distribution of assets as shown above:				
Fees and expenses of administration	$ 19,842	$ 19,050	$ 18,683	$ 15,721
Paid on account exemptions	812	728	877	391
Paid to secured creditors	32,274	30,570	26,374	15,315
Paid to priority creditors				6,175
Paid to unsecured creditors	38,491	35,753	36,681	22,803
Other payments	1,360	1,514	2,454	2,668
Undistributed balance, if any	239	449	535	
Total	$ 93,018	$ 88,964	$ 85,604	$ 63,073

Source: Annual Report of the U.S. Attorney General, Summary of the Bankruptcy Proceedings, for the respective years.

[a] Includes compositions and extensions under Section 74.

[b] Includes 189 extensions made under Section 74 of the act.

dishonesty which has pervaded the administration of our bankruptcy laws; not dishonesty in the courts or on the part of referees, but dishonesty on the part of many of the attorneys, trustees, and others involved in such cases. There has hardly been a city of any size in the United States which has not had one or more bankruptcy rings. The common method of operating a bankruptcy ring is for an attorney, or a group of attorneys, to solicit claims against a bankrupt from the different creditors. With these claims in their possession they are then in a position to elect as a trustee one of their colleagues who, in turn, sells the property of the bankrupt at ridiculously low figures to another member of the ring, and, when the case is finally closed, the property is disposed of at its real value and the difference is split among all the parties in the ring. Many attempts have been made by associations of credit men, bar associations, and the Federal judges to break up these rings. These attempts have not always been successful. The scandal in New York brought this fact forcibly to the attention of the public in 1931. It has disclosed unbelievably discreditable conditions which resulted in the removals, resignations, disbarments, and convictions of scores of attorneys.

All this tends to result in exceedingly small dividends to unsecured creditors, so that an average dividend of 4 cents on the dollar begins to look about as high as can be expected. Is there any wonder that creditors show so little interest in bankruptcy cases? This obviously is another defect, for much of the administration of our bankruptcy law is predicated on creditors' active interest and participation.

Finally, many dishonest debtors have frequently escaped by the door of bankruptcy. In many instances all the assets are not collected and discharges are not fought by creditors, except in extraordinary cases. Bankruptcy has thus become a means of enrichment to persons with fraudulent designs and so far has failed to accomplish fully the fundamental purposes for which it was designed.

Conclusion.—At last a real revision of our bankruptcy laws has been effected. The Chandler Act, better known as the Bankruptcy Act of 1938, is the result of 6 years of labor on the part of bankruptcy committees representing such organizations as the National Association of Credit Men, the American Bar Association, the Commercial Law League of America, the National Association of Bankruptcy Referees, the American Bankers Association, law-school professors, and others, comprising the National Bankruptcy Conference.[1] It has aimed to overcome

[1] For a clear-cut yet comprehensive discussion of this law and how it compares with the law as amended from time to time, see J. I. Weinstein, "The Bankruptcy Law of 1938," published by the National Association of Credit Men; see also "The Chandler Bankruptcy Act" by Paul H. King, in the Proceedings of the First Institute on Credit held at The Ohio State University in October, 1938, Ohio State Universty Publications, College of Commerce Conference Series-Number 4.

many of the defects discovered, through wide experience, in the law which it supersedes and especially in its administration. Whether and to what extent these defects will be remedied depends upon how the new provisions will work out in actual practice.

Probably still more could have been accomplished if bankruptcy were treated primarily as an administrative rather than as a judicial function, as is done in England. There, bankruptcy is treated chiefly as a commercial matter and its administration is under the Board of Trade, which is analogous to our Department of Commerce. Official receivers are assigned to districts to handle such cases, the system is self-supporting, the results are quick, and fraud has been reduced to a minimum.

Another possible improvement yet to come is in the handling of no-asset cases or small estates in bankruptcy. The procedure, even under the new law, is still cumbersome and expensive in such cases. For such cases it might be well for the United States district judges, sitting as a board, to appoint official receivers in large cities and official custodians to serve in jurisdictions where there are no official receivers. These officials are to devote all their time to the duties of their respective offices. They should be paid a salary and all authorized commissions and fees collected by them to be turned over to the U.S. Treasury. They would also become trustees in all cases whose probable realized assets would be less than $10,000. They would make careful investigations so that all assets may be collected and irregularities or fraud discovered and brought to the attention of the U.S. Attorney's office.

It is believed, however, that most of the flagrant abuses of our bankruptcy laws in the past as well as the principal defects discovered can be remedied by an intelligent application of the revised law, provided that creditors make an earnest attempt to put its provisions into effect. While the new law is superior to anything we have had, it is no guaranty against fraud, maladministration, bankruptcy rings, inefficiency, and small dividends. The framework for improved conditions has been provided, but it remains for creditors to make proper use of it. To make the law effective, creditors must exercise their prerogatives, attend creditors' meetings, insist upon a thorough examination of the bankrupt before accepting an offer for an arrangement, and, above all, must cooperate with other creditors instead of acting alone or through the medium of dishonest bankruptcy practitioners. Creditors must realize that the bankrupt estates are their property and that larger dividends will be forthcoming if they would protect that property as if it were in their own possession. If bankruptcy abuses continue, no longer would it be possible for creditors to blame faulty legislation to the same extent as in the past. A larger share of such responsibility must be assumed directly

by the creditors themselves and it is now mainly in their hands that the remedy lies.

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Questions and Problems

1. A called B a bankrupt because B could not pay his bills to A. Can A have any recourse against B?

2. How do you explain the development of bankruptcy legislation?

3. What are the two major purposes of bankruptcy legislation? Which, in your opinion, is the more important of the two?

4. Mr. X, a wage earner, has had considerable sickness in his family. As a result, his indebtedness ran up to about $2,000. Would you recommend that he secure a discharge from his obligations through bankruptcy proceedings? Why or why not? How else can the situation be handled under the present bankruptcy law?

5. If you decide that Mr. X obtain a discharge in bankruptcy, what kind of proceedings would have to be instituted? Why?

6. Mr. A, an operator of a drug store, is in financial difficulties and finds it impossible to meet his obligations with promptness. In fact, there are a number of creditors with claims against him which are 6 months overdue. Assuming that the creditors wish to throw Mr. A into bankruptcy, what kind of proceedings would have to be instituted? In order to have the debtor declared a bankrupt, what conditions must be fulfilled?

7. Outline the procedure in bankruptcy, and indicate which of the steps in the proceedings are of greatest importance to the creditors, and why.

8. Whom or what interests do the following officials represent: The receiver? The referee? The trustee?

9. What are the possibilities of establishing the following as prior claims in bankruptcy:

a. A check given by a customer in payment of an account just before the customer goes into the hands of a receiver in bankruptcy?

b. Salaries and wages owed to the officers and employees of a bankrupt corporation?

10. X has been discharged in bankruptcy. Some time later he promised one of his creditors that he would pay him the difference within 1 year. At the end of the year, X refused to pay his creditor, claiming immunity because of his previous discharge of that obligation in bankruptcy. Can the creditor enforce payment or has his claim been discharged once for all?

11. What debts can never be discharged in bankruptcy? Can you give reasons for such provision in the law?

12. In what ways can a debtor secure relief under Chapters XI, XII, and XIII of the act not available to him prior to the revision of 1938? Why have so few individuals taken advantage of it?

13. Explain the lack of interest on the part of farmers in Section 75 of the law which was designed to afford them relief.

14. What have been the principal weaknesses of the bankruptcy law and its administration? Have these weaknesses been remedied by recent amendments?

15. Suggest a plan, in the form of amendments to the present law, which would remove the remaining objectionable features, without sacrificing any of the fundamental aims of such laws.

PART V

CREDIT AND COLLECTION CONTROL

CHAPTER XXXIII

CREDIT INSURANCE

One of the methods of controlling bad-debt losses is by shifting them, at least in part, to an agency that stands ready to assume some of the risks, as is done in the case of credit insurance. Another, and probably a superior, method is to adopt all the necessary measures which make for effective administration of the credit and collection functions by each creditor, as will be outlined in the subsequent two chapters.

Nature of Credit Insurance.—The basic principle underlying this particular phase of insurance is identical with that upon which all kinds of insurance are founded. It merely involves an application of the law of averages to losses incurred in the form of bad debts. The contract entered into by the insured with the company constitutes the credit insurance policy, variously styled the bond of indemnity, or the contract of guarantee on insolvent debtors' accounts. A credit insurance policy of the general coverage type[1] is a guaranty that the policyholder shall not suffer those losses, occurring because of uncollectible accounts coming within the coverage of the policy, which exceed the normal loss incident to the particular business of the insured. It protects the insured only against extraordinary losses, the normal loss, or, as it is frequently styled, the initial loss, being borne by the insured, probably on the theory that the insurance company could not undertake insurance against such annual loss for a premium smaller than the yearly *expected* loss. Hence, only payment of the net excess over the normal, initial, or "own" loss may be guaranteed by the insurance company. For this reason, credit insurance may be defined as an application of the principle of indemnification for *excessive* or unanticipated losses arising from bad debts.

Development.—The principal companies writing practically all of the domestic credit insurance are the American Credit Indemnity Company of New York and the London Guarantee and Accident Company, Ltd. The first of these organizations was incorporated as early as 1893 and is the only company writing credit insurance exclusively. In 1936 this company was acquired by the Commercial Credit Company, one of the large finance companies. The second organization established a credit insurance department in the United States in 1905.

[1] Three specific coverage policies are also issued, the ID policy covering one debtor, the ACR policy covering specifically named debtors, and the XS policy providing insurance over and above a stated deductible amount.

Prior to the passage of the national Bankruptcy Act in 1898, credit insurance business was in the experimental stage and only restricted policies were written, at relatively low premium rates. Beginning with that year, however, policies were liberalized from time to time so as to include all sorts of insolvency.

In insuring against a given contingency, the degree of risk must be determined by past experience with respect to the average outcome of numerous similar cases handled over an extended period of time. Obviously, the accuracy with which the risk may be determined varies directly with the amount of data available regarding similar contingencies in the past, and the more accurate and scientific the computation of the risk the less, within certain limits, the cost of insurance. To determine scientifically the degree of risk in a proposed extension of credit, it would be necessary to resort to a compilation of records covering failures of commercial houses, the causes therefor, and the financial condition of such concerns sometime prior to failure. Only from such records carefully kept over a period of years is it possible for credit insurance companies to determine with reasonable accuracy the extent of the risk in a given credit transaction. Since such statistics were not available in the past, the cost of credit insurance was based largely on mere guesswork. Consequently, premiums were made sufficiently high to cover the insurance company's loss in case it guessed wrong.

Statistical Basis of Credit Insurance.—Credit insurance underwriting is no longer entirely a matter of judgment of the individual underwriter, for one of the most outstanding developments in the field has been the adoption of a mortality table by the credit insurance companies. This table, known as the "Manual of Credit Insurance Rates," was first compiled in 1919 and was subsequently revised to meet new legal requirements and conditions.

The manual consists of the results of a long succession of mathematical calculations based on the experience of the insurance companies as revealed by their records, covering a period of more than 30 years, including two wars and different phases of the business cycle. These records show the precise experience of a large number of manufacturers and wholesalers or jobbers in various lines of trade, giving their sales to concerns with various ratings and the losses incurred because of insolvency of the debtors.

Present Status.—Credit insurance policies are not issued to retailers; they are limited to firms granting credit to other mercantile establishments. Policies are carried by concerns of all sizes, varying from those with a volume of sales amounting to $50,000 a year to companies with an annual sales volume of $75,000,000. Medium-sized houses, however, constitute the majority of policyholders.

All but a few lines of business are solicited by credit insurance companies. Certain lines of trade are considered too hazardous because of the nature of the goods handled, the flexibility of terms of sale, or the type of persons engaged in them. In the jewelry trade, for example, an average retailer may purchase diamonds on terms of about 8 months, and, if he has not succeeded in disposing of them by that time, the credit period may be considerably extended. Rules as to what business to cover are naturally changing from time to time.

As a result of the semiscientific method of approach that has been marked by the adoption of the Manual of Credit Insurance Rates, the various businesses have been grouped into five general classes according to the nature of the credit risk. Class I includes the best group of risks and the general conditions of the policy issued to companies belonging in this class are therefore most favorable. Classes II, III, and IV are regarded as good risks, but are somewhat inferior to Class I. Risks in Class V are generally not insured. The classification of business lines for purposes of credit insurance are constantly changing and the Manual is corrected accordingly. This may signify that credit insurance is still in the experimental stage and as experience is acquired adjustments in classifications are effected. Or it may mean that the condition and soundness of certain lines of business are undergoing constant change which make reclassification necessary.

Term of Policy.—Credit insurance policies are generally issued for a period of 1 year. Some policies are written for a longer period when it is desired that they expire on the date which marks the expiration of the fiscal year of the insured. Since in most concerns the fiscal year coincides with the calendar year, a vast number of policies are written to expire on Dec. 31. It is definitely stipulated that all losses to be covered by the policy shall occur during its term, or (under some policies) such losses must result from shipments of goods made during the term of the policy even though they do not occur until months later.

Policies are renewable annually and may be so arranged as to cover losses occurring during the life of the renewal arising from sales made during the term of the preceding policy, or only the losses occurring during its term on shipments made thereunder. If the insured becomes insolvent during the term of the policy, ceases to continue business as previously carried on, or goes into liquidation, the policy terminates immediately and adjustments are then made in the same manner as if the policy had by its terms been made originally to expire at the date of such termination.

Types of Policies.—While policies in the credit insurance field vary widely, they are subject nevertheless to some classification. Until recent years both unlimited and limited policies have been issued. The

unlimited policy has finally been discontinued and only limited policies are now issued. The limited policy is one having a face value which constitutes the total maximum liability of the insurer above the normal loss of the insured. This amount may, however, be increased up to $200,000 by payment of an additional rate per $1,000 for the additions to the face amount.

Credit insurance policies are also differentiated on whether or not they contain a provision for the collection of past-due accounts by the insurance company. Thus, we have the noncollection form, the optional collection form, and the compulsory collection type of policy. Under the first form of policy losses are payable only for insolvency. The optional collection form of policy provides that if the insured will file with the company any account for collection before it is more than a specified number of days past due, the company will admit the account as a loss. If, however, the insured fails to submit the account for collection and loss is later incurred because of the debtor's insolvency, the loss is admitted provided the insolvency occurred during the term of the policy. Under the compulsory collection policy all past-due accounts to be covered by the policy *must* be filed for collection before they are so many days overdue, otherwise the amount recoverable is subject to a reduction for each day thereafter.

Under both the optional and compulsory collection types of policies the company proceeds to collect the accounts as they are filed, and remits promptly the amounts collected less the agreed collection charges. The uncollected parts of the accounts thus filed are provable as claims for losses under the policy and the policyholder is relieved of the burden of further proving such claims.

Finally, there are general coverage policies, which are the type discussed in this chapter, and special coverage policies, which insure a single account, or a limited number of accounts so long as they are approved by the insurer, or an amount over and above a stated deductible sum.

Insolvency for Purposes of Policy.—Credit insurance policies guarantee indemnity against losses occurring because of insolvency of debtors. All policies are alike in what they stipulate to be the earmarks of insolvency, with the exception of the first definition. This varies with the nature of the policy. Optional policies stipulate that when the indemnified elects to file with the company, for collection, an account which is not over so many days past due under the original terms of sale, the debtor whose account is thus filed is deemed insolvent. Where the filing of an account with the insurance company is not optional, in order to come within the first definition of insolvency, it must be filed before it is over a stipulated number of days past due under the original terms of sale.

The other conditions of insolvency are fairly standardized, and appear in practically all general coverage credit insurance policies. They are as follows:

1. A debtor shall have absconded;
2. A sole debtor shall have died;
3. A sole debtor shall have been adjudged insane;
4. A receiver shall have been appointed for a debtor;
5. A debtor shall have transferred or sold his stock in trade in bulk;
6. A writ of attachment or execution shall have been levied on a debtor's stock in trade and said stock sold thereunder, or the writ returned unsatisfied;
7. A debtor shall have made a general offer of compromise to his creditors for less than his indebtedness;
8. There shall have been a recording of or taking possession under a chattel mortgage given by a debtor on his stock in trade;
9. A debtor's business shall have been assigned to or taken over by a committee, appointed by a majority in number and amount of his creditors;
10. There shall have been a recording of or taking possession under an assignment or a deed of trust made by a debtor for the benefit of his creditors;
11. A voluntary or involuntary proceeding shall have been instituted to adjudge a debtor bankrupt;
12. A proceeding for the relief of a debtor shall have been instituted in a Court of Bankruptcy.

The Normal Loss.—In all underwriting of general coverage policies there are three basic factors, *viz.*, (1) normal loss; (2) coverage; and (3) the premium. All of them are necessarily interdependent. The premium, for example, cannot be determined until coverage on each of the ratings specified in the table of ratings under the "coverage" clause of the policy is first ascertained, or until the normal loss is finally agreed upon.

The normal loss ratio is largely determined by the policy of a concern in dealing with its past-due accounts; also upon the number or volume of such accounts. This, in turn, varies according to the usual terms of sale. As a rule, the longer the period involved in credit extensions the larger the amount of outstandings carried on the books; consequently, the larger the sum tied up in past-due accounts. Given two houses of substantial similarity with respect to size, line of business, conditions of operation, and terms of sale, the one which adopts a stricter and more effective policy toward its past-due accounts will invariably have a smaller normal loss ratio.

The normal loss is that amount which is *normally* lost in a particular line of trade because of bad debts. The amount normally lost is calculable and is considered an expense item similar to other items of manufacturing and selling cost. When the policyholder bears his

normal loss himself, his insurance premium is reduced not only by that amount but also by a sum to cover the insurer's overhead. That is why normal losses, which are certain, are not insured. For each of the five classes of business lines there are tables in the Manual giving the percentages of the normal loss on varying amounts of sales, the percentage decreasing with increases in sales volume. For example, regular policies which include coverage only of preferred accounts may stipulate that on sales of $100,000 per annum the normal loss be calculated at 0.5 per cent of sales if the insured is in the first business line classification, 0.6 per cent if in the second classification, 0.75 per cent if in the third, 0.8 per cent if in the fourth, and 1 per cent if in the fifth classification. Combination policies covering inferior accounts are

The gross amount to be covered under this Bond on any one such insolvent debtor shall not exceed the amount set opposite the corresponding rating of the debtor in the subjoined table of ratings.

TABLE OF RATINGS.

	Gross Amount		Gross Amount		Gross Amount		Gross Amount		Gross Amount		Gross Amount
Aa A1	$ 1500.	Aa 1	$ 1000.	Aa 1½	$ 500.	Aa 2	$ 400.	G 3	$ 750.	H 4	$ 200.
A+ A1	$ 1500.	A+ 1	$ 1000.	A+ 1½	$ 500.	A+ 2	$ 400.	H 3	$ 450.	J 4	$ 150.
A A1	$ 1500.	A 1	$ 1000.	A 1½	$ 500.	A 2	$ 400.	J 3	$ 300.	K 4	$ 100.
B+ 1	$ 1500.	B+ 1½	$ 1000.	B+ 2	$ 500.	B+ 2½	$ 400.	K 3	$ 200.	L 4	$ 100.
B 1	$ 1500.	B 1½	$ 1000.	B 2	$ 500.	B 2½	$ 400.	G 3½	$ 500.	M 4	$ 100.
C+ 1	$ 1500.	C+ 1½	$ 1000.	C+ 2	$ 500.	C+ 2½	$ 400.	H 3½	$ 500.	K —	$ 100.
C 1½	$ 1500.	C 2	$ 1000.	C 2½	$ 500.	C 3	$ 400.	J 3½	$ 200.	L —	$ 100.
D+ 1½	$ 1500.	D+ 2	$ 1000.	D+ 2½	$ 500.	D+ 3	$ 400.	K 3½	$ 150.	M —	$ 100.
D 1½	$ 1500.	D 2	$ 1000.	D 2½	$ 500.	D 3	$ 400.	L 3½	$ 125.	— —	$ 200.
E 2	$ 1500.	E 2½	$ 1000.	E 3	$ 500.	E 3½	$ 400.	M 3½	$ 100.	— 1	$ 500.
F 2½	$ 1500.	F 3	$ 1000.	F 3½	$ 500.	F 4	$ 400.	G 4	$ 300.	— 2	$ 250.
										— 3	$ 150.
										— 4	$ 100.

FIG. 78.—Table of ratings taken from an actual credit insurance policy issued to a specialty wholesale grocery firm.

similarly graduated as to normal loss, the percentages being somewhat higher all along the line.

The first step in computing the normal loss for an applicant is to determine in which of the five classes of business the firm belongs. On it the minimum normal loss percentage is taken from the appropriate table in the Manual. The firm's average loss for a period of from 3 to 5 years is next ascertained. Then begins a series of computations in the form of "merit ratings" and "extra charges" depending upon whether the applicant's loss experience is better than that shown in the Manual for that class of business or inferior to it, also on how long the applicant has been in business. It is therefore suggested that an applicant scrutinize the method of computation with care if he is to comprehend the technique, let alone the reasons for it. In general, the normal loss is intended to reflect the experience of the class of business of the applicant, modified by the latter's own experience.

Coverage.—All credit insurance policies definitely stipulate the maximum amount which the insured may recover for losses on any one account to which he sells. This term should not be confused with the

face value of the policy which represents the maximum aggregate loss for which the insurance company is responsible. The amount of coverage is definitely specified, in dollars, in the policy itself on the basis of the capital and credit ratings which the account has. A maximum amount designated for any one rating applies to each and every account of that rating to which the insured sells. Much freedom is allowed the insured in the choice of the mercantile agency whose ratings should govern the shipments under the policy. Although any well-known agency is acceptable, nevertheless those of Dun & Bradstreet's are most used for the purpose. The mercantile agency[1] whose ratings shall govern, as agreed upon by both parties when the policy is written, is then specified in the policy. Gross amounts to be covered on any one debtor are then limited to the amount specified opposite the corresponding rating of the debtor in the "table of ratings" of said policy (see Fig. 78).

The amount of coverage may usually be stipulated by the insured so long as it does not exceed the maximum set by the insurance company. For the so-called "regular ratings" by Dun & Bradstreet, the maximum coverage limits, though not absolute, are as shown on page 568.

It is thus apparent that the maximum coverage allowed varies not only with the pecuniary strength of the risk as evidenced by the capital rating but also with the credit grade. Furthermore, the premium, which is roughly from $4 to $30 per thousand, varies in the same fashion. While the limits of coverage, as shown on page 568, are relatively high and within those limits the coverage to be allowed can be set at the discretion of the insured, in practice the nature of the insured's business will determine the limits so that they will not exceed the amount of credit which the applicant is likely to extend in the normal course of his business.

If a debtor has more than one governing rating, the maximum indebtedness covered is limited to the largest amount set opposite any one of the debtor's governing ratings. It is to be construed that

[1] Other credit agencies of a specialized type whose use is permitted by credit insurance companies in determining coverage are:

1. Coal Dealer's Blue Book.
2. Manufacturing Jewelers Board of Trade.
3. Iron and Steel Board of Trade.
4. Graphic Arts Board of Trade.
5. Shoe and Leather Mercantile Agency, Inc.
6. Lyon Furniture Mercantile Agency.
7. Typo Mercantile Agency.
8. Lumberman's Credit Association, Inc.
9. National Lumber Manufacturers' Credit Corporation.
10. Packer Produce Mercantile Agency's Red Book.
11. Produce-Reporter Company's Blue Book.

ratings of the latest published book of the mercantile agency chosen govern, except where reduced in a special agency report. If the name of a debtor does not appear in the latest published rating book, the shipment to the debtor is governed by the rating appearing in the latest agency report if compiled within four months prior to date of shipment; otherwise the shipment is governed by the rating appearing in the first report of the agency compiled within four months after the shipment.

First credit ratings		Second credit ratings	
Rating	Coverage maximum	Rating	Coverage maximum
Aa A1	$200,000	Aa 1	$50,000
A + A1	150,000	A + 1	40,000
A A1	100,000	A 1	30,000
B + 1	75,000	B + 1½	30,000
B 1	50,000	B 1½	25,000
C + 1	30,000	C + 1½	20,000
C 1½	25,000	C 2	15,000
D + 1½	20,000	D + 2	12,500
D 1½	15,000	D 2	10,000
E 2	10,000	E 2½	5,000
F 2½	5,000	F 3	3,000
G 3	2,500	G 3½	1,500
H 3	1,500	H 3½	750
J 3	1,000	J 3½	500
K 3	500		
Blank 1	50,000		
Blank 2	25,000		

Coinsurance.—One of the fundamental features contained in a credit insurance policy consists in the coinsurance requirements. Policyholders are required to coinsure or to bear part of the risk, even on the best risks. Thus the amount insured against losses from well-rated and preferred debtors may be limited under the coverage provision. Besides, the maximum provable loss on any one amount may be limited to some definite sum or to a definite percentage of the face amount of the policy. For instance, even on well-rated risks, the insurer is liable only to the extent of $900 on an actual loss of $1,000, although the full amount otherwise comes within the terms of the contract, the policyholder being required to bear part of the risk to the extent of the remaining $100. The purpose of the coinsurance is to reduce thereby the moral hazard of taking unreasonable risks in the extension of credit, the company guaranteeing only an amount approximating, on the average, the replacement

value of the goods, the aim being to cause the insured to lose his profit on the transactions, before any losses are paid by the insurance company.

Credit insurance does not normally protect the insured against losses sustained because of the insolvency of debtors who are "off-rated." "Rated" accounts consist of those having a capital rating followed by a first- or second-class credit rating; whereas "off-rated" accounts have a lower credit rating or possess no rating whatever. According to statistical evidence, the heaviest losses are sustained from accounts which are off-rated. Accordingly, such inferior credit risks, when covered by a special rider, require payment of a much larger premium.

The Insurance Premium.—There are two principal practices with respect to the determination of the premium to be paid by the insured for the risk underwritten by the insurer. On some policies the entire premium is determined and paid in advance, while others stipulate that the premium be a specified percentage of the total gross shipments and deliveries made by the insured during the term of the policy, but such sum can be no less than a stipulated minimum. The minimum is payable in advance, while the remainder, if any, is paid at the termination of the policy when the amount can be definitely ascertained. The theory on which such premium is apparently based is that losses usually vary directly, though not proportionally, with sales. Since it is frequently impossible to predetermine with a fair degree of accuracy the gross sales for a whole year, the premium is likely to be inexact, unless it is based on the actual experience of the insured during the time the policy is in force. The chief disadvantage, however, of leaving the determination of the premium to the end of the year is the inability of the policyholder to determine the cost of the contract in advance. On a regular policy, the premium, though subject to changing rates, is ordinarily kept below ½ of 1% of total sales.

Under all circumstances the size of the premium varies with the degree of hazard involved, and is determined after a careful consideration of a number of factors. The factors upon which the calculation is based are the following:

1. The statements made in the application for insurance on the reverse side of the policy. They generally include the line and nature of the business and how long in it; territory covered; customary and longest terms of sale, including discounts allowed; distribution of shipments among manufacturers, jobbers, and retailers; detrimental information possessed on any doubtful accounts sold or to be sold; contemplated changes in the manner of doing business, terms of sale, radii of operation; gross annual sales and bad-debt losses over the preceding five or six years; and condition of accounts outstanding at the time the policy is written.

2. The maximum coverage for individual debtors.

3. Whether there is a provision for the inclusion of inferior ratings.
4. Whether there is a provision for the adjustment of the premium on the basis of gross sales.
5. The amount of coinsurance.
6. The term of the policy and its face value.
7. Other special riders and indorsements.
8. The efficiency of the insured's credit and collection department.

As already pointed out in a previous connection, credit insurance companies have succeeded, after a long succession of painstaking mathematical calculations, in evolving a manual containing fixed schedules of rates for various lines of business. These tables correspond to the mortality tables of life insurance companies and are used in a similar manner. Premium rates are then determined only after a careful consideration of the factors hereinbefore enumerated, most of which are inserted in the application for insurance on the reverse side of the policy, followed by a consultation of the Manual of Credit Insurance Rates.

Notification of Claims.—All losses covered by credit insurance must be proved. This is accomplished by sending to the insurance company notification of past-due accounts in accordance with the "notification of claim" condition of the policy. For this purpose, the insured may elect, under the optional collection form, to have the debtor deemed insolvent for the purpose of the policy, by sending the account for collection within a specified number of days from the time it became due. Under another form of policy, past-due accounts *must* be turned over to the insurer for collection within so many days from date of maturity. In any event, the insured is expected to make every practicable effort to collect the account or as large a portion as possible. Amounts thus collected thereon are considered salvage and deducted from the allowed loss. If a loss occurs because of the debtor's insolvency under the other definitions of the term it is necessary to file a notification of claim within a specified time, usually 15 or 20 days, after knowledge of the insolvency has been acquired, and the account must be placed in the hands of the insurer for collection.

When claims are filed with the insurance company, they must be accompanied by an itemized statement of the account showing its true condition, and all papers and documents relating thereto. Further information and papers, such as invoices, proofs of debt, and affidavits, must also be furnished upon request. When the insurance company is charged with collecting bad accounts, a charge is made for the service in accordance with a schedule of fees contained in the policy and all amounts collected are immediately remitted to the insured.

Policies requiring the insured to turn over their past-due accounts to the insurance company for collection have been objected to on the

ground that in its collection efforts the company is likely to consider its own interests to the exclusion of the interests of the debtor and the insured. Creditors frequently consider it advantageous to accept a settlement which may net them immediately substantially less than what could be obtained through bankruptcy proceedings. If the debtor is honest and deserving, creditors would probably be satisfied with a smaller sum, in the anticipation of ultimately recovering even more than the losses incurred, through the continuance of friendly relations as soon as the embarrassed debtor is extricated from his difficulties and his business is soundly rehabilitated. The chief concern of the insurance company, it is alleged, is the immediate settlement of the account and the collection of the largest sum possible. It is probable that this reasoning about the attitude of insurance companies is faulty and can be disproved in fact.

The collection provision referred to in the preceding paragraph operates during the term of the policy. In the absence of such condition, it is provided that, where a claim is made for payment of losses in excess of the normal loss, a final statement of such claim be filed by the insured with the insurer not later than 30 days after the expiration of the policy. An adjuster is thereupon sent to the insured to effect an adjustment. By a special rider it is possible to provide for interim adjustments of claims, in which case loss payments are made to the insured during the life of the policy upon filing with the company interim statements when such losses occur. After the expiration of the policy, a final statement is filed, including any additional losses occurring under the policy when matters are finally adjusted.

Adjustments.—Adjustments are usually made within 30 or 60 days from the date the final statement of claim is received by the insurance company, and the amount due becomes payable at once. To ascertain the total net allowed loss, the following deductions must be made from the gross loss covered and proved:

1. All discounts to which the debtor would have been entitled had the debt been paid at the time of adjustment.

2. All amounts collected on the account.

3. Amount of goods returned or replevined, if in the undisputed possession of the insured.

4. All amounts mutually agreed upon as thereafter obtainable. If no satisfactory mutual agreement can be reached as to the amount thereafter obtainable, the insurance company must allow as much of the total unpaid sum as covered by the policy. All accounts admitted in adjustment must be assigned to the insurance company, except those upon which a mutual agreement has been reached as to the amount obtainable after the adjustment. If the company collects eventually

from the accounts thus assigned more than the aggregate sum paid the insured, the net excess must be refunded.

5. Any legally sustainable set-off that the debtor may have against the indemnified.

6. The amount of coinsurance agreed upon in the insuring clause of the policy. Under some policies it is not deducted until after the actual loss has been ascertained, whereas under other policies coinsurance is deducted from the gross loss covered and proved.

7. The normal loss.

To illustrate clearly the method of procedure in making adjustment of claims for payment of losses under a credit insurance policy, it may be assumed that the normal loss of the insured is $7,500, and that the face value of the policy is $10,000. It may be further assumed that the maximum loss on any single account covered by the policy is limited to the amounts stipulated by the insurance company (see page 568). The insurance company is to be liable only to the extent of 90 per cent of an actual loss covered, the remaining 10 per cent being borne by the insured in accordance with the coinsurance clause. No riders are included for inferior ratings. Having no provision for the collection of past-due accounts by the insurance company, and assuming that no rider is included calling for interim adjustment of claims, the insured submits at the expiration of the policy a statement of claims. An adjuster is sent to the insured, where claims are adjusted as shown below:

Name	Dun & Bradstreet's rating	Gross loss	Gross loss covered and proved	Coinsurance	Salvage	Share of salvage deducted	Net allowed loss
A	D 2	$ 2,500	$ 2,500	$ 250.00	$ 400	$ 400.00	$1,850.00
B	G 3½	1,875	1,500	150.00	500	400.00	950.00
C	K 3½	1,200	.....	.....	375	.....	.....
D	F 4	650	.....	.....	.....	.....	.....
E	C 2	2,850	2,850	285.00	1,275	1,275.00	1,290.00
F	D 1½	1,340	1,340	134.00	460	460.00	746.00
G	D 2½	985	.....	.....	320	.....	.....
H	F 4	1,000	.....	.....	250	.....	.....
J	G 3	3,000	2,500	250.00	300	250.00	2,000.00
K	H 4	435	.....	.....	.....	.....	.....
L	F 3½	1,460	.....	.....	500	.....	.....
M	E 2	3,125	3,125	312.50	930	930.00	1,882.50
		$20,420	$13,815	$1,381.50	$5,310	$3,715.00	$8,718.50
Less normal loss borne by insured							$7,500.00
Net amount paid by insurance company							$1,218.50

From the table it is apparent that, although the actual net loss sustained by the insured is $16,110 (gross loss less salvage), he is allowed to prove only $8,718.50. By "salvage" is meant the part of the debt collected or thereafter obtainable, if mutually agreed upon, and value of the goods returned or replevined. Discounts are totally disregarded for our purposes. The difference is accounted for by losses not allowed by coverage, by the coinsurance provision, and by deductions of salvage. Thus the gross loss in B was $1,875, the salvage $500, leaving an actual net loss of $1,375. From the gross loss proved and allowed, the 10 per cent coinsurance plus a share of the salvage equal to the ratio of the allowed loss to gross loss

$$\left(\frac{1{,}500}{1{,}875} \text{ of } 500\right)$$

are deducted, leaving a net allowed loss of $950.00. Similar calculations have been made in case of customer J, for it is provided in the policy that in case the indebtedness of the debtor to the insured at the time of insolvency is not covered in full by the policy, then all deductions of salvage are to be made pro rata, *i.e.*, "in the ratio which the amount covered bears to the whole of such indebtedness." On losses incurred from extensions of credit to C, D, G, H, K, and L nothing was allowed because of inferior ratings.

Arguments for Credit Insurance.—It is argued by advocates of credit insurance that by insuring against extraordinary and abnormal losses a merchant may know in advance just what the loss will be for the ensuing year. It gives him greater control over his costs of doing business. In order to enable him to compute his anticipated profits with a greater degree of accuracy, all he needs to do is to add to all other ascertainable costs the premium paid for his insurance protection, and his normal or initial loss. Obviously, this is based on the assumption that the policy covers all classes of risks irrespective of ratings.

It is also urged that credit insurance tends to make the credit manager more careful. He is forced to keep a closer watch on his customers in order to keep within the provisions of the policy. Since losses are adjusted on the basis of the latest data that were available at time shipments were made, the insured is forced to observe strictly changes in agency capital or credit ratings of his customers. In this manner, credit insurance serves as an inducement for the exercise of caution in granting credit accommodations.

A third argument used in its favor is that, by insuring against excessive loss from bad debts, the insured can afford to take larger chances in passing credits and thus increase his volume of business.

A fourth argument advanced is that, in case of a widespread depression, credit insurance makes possible the shifting of extraordinary losses onto the insurance companies, thereby averting the danger of a panic, which might otherwise result. When the peril of such losses is removed, credit becomes more stable. Then it is argued that it is just as logical to carry insurance against bad-debt losses as it is to insure against loss by fire.

Another very significant argument in favor of credit insurance is the collection service, generally furnished by credit insurance companies. In this phase of the work, it is reported that credit insurance companies have been very successful. In the personal investigations conducted by the author during the past several years it has been revealed that the collection service is an important factor, and in some cases it is the chief reason why credit insurance policies are carried. The companies are said to be more vitally concerned with the bad debts reported to them and, hence, make more strenuous attempts to recover than do ordinary collection agencies, although the charges are usually about the same in both cases.

Objections to Credit Insurance.—Some of the weaknesses of credit insurance are plainly revealed in the very presentation of its advantages. In the first place, it is not true that it is possible to predetermine exactly the cost arising from losses occurring because of insolvency of debtors during the term of the policy. The insured does not exercise greater control over his costs, for several reasons. To begin with, credit managers deserving of their positions would not under any circumstances follow blindly the ratings of mercantile agencies and disregard information from all other sources. No sane creditor would refuse accommodations to a merchant who has no rating, but whom other sources of information show to be worthy of a line of credit. To be sure, all losses occurring from sales to off-rated accounts may be covered by the policy by special riders, but the expense of such protection is high. To the extent to which certain classes of risks are not covered to that extent at least is it difficult to predetermine accurately the aggregate loss which will be suffered during the policy period. Even though it is assumed that the insured will follow the ratings in his credit extensions, what assurance is there that the total losses will not exceed the face of the policy?

It is doubtful whether credit insurance induces care and caution on the part of the insured in the handling of his accounts. The fact that the credit manager is dividing his responsibility by shifting all possible excessive loss onto the insurer is apt to make him more lenient. If inclined to take larger chances in passing credits or to shirk his responsibility for investigating his risks thoroughly because of the protection afforded by the policy, his actions will ultimately prove against the

best interests of his house. It is bad policy to rely mainly on an insurance policy to make good credits granted under its provisions in the event they develop into a loss. Furthermore, it militates against the best methods in credit granting if reference to the policy must be made each time an order from a customer is passed upon. It is not even necessary that the credit manager himself watch the accounts in order to keep them within the provisions of the policy. Any clerk or bookkeeper can effectively discharge such mechanical and routine duties. Some credit managers may even disregard the policies altogether, feeling that they can afford to take undue risks and, instead of serving as a curb on their caution, it may stimulate undue liberality and leniency, for as long as they can thereby increase the volume of business, their house will stamp its approval on their actions, even though losses are incurred which are covered by insurance. Accordingly, there is less incentive to make a good showing by a reduction of bad debts. Even the most ardent advocates of credit insurance are compelled to admit that the tendency is for the insured to exercise greater liberality in credit extensions in order to make a pecuniary gain off the policies.

The argument that, in case of widespread depression, a panic is averted by shifting the extraordinary losses onto an insurance company is equally unsound. Credit losses, as fully demonstrated hereinbefore, cannot be shifted in their entirety. To the extent to which such losses cannot be shifted, to that extent is this argument unsound. Moreover, instead of preventing a precipitation of failure of debtors who are unable to meet their obligations during such period of inactivity, credit managers may, by placing great confidence in the security of accounts covered by insurance, become careless in collecting their accounts, and thus invite losses. If it is provided that these past-due accounts shall be collected by the insurance company, it is not unlikely that, instead of averting the panic, it will only be hastened and accentuated because of the greater pressure that will be brought to bear upon the debtors by the insurance company which is interested primarily in an immediate settlement, irrespective of the consequences to the debtor or the insured. Furthermore, when the losses are so severe because of a general depression that individual creditors find themselves unable to carry them, it is doubtful whether credit companies could stand the strain. Besides, the insured would find their policies not large enough to cover all these losses.

It is hardly logical to compare credit insurance with fire insurance. A fire may destroy every dollar in property that a concern possesses, and within a short space of time. Such a risk is too heavy to be carried alone. On the other hand, it is hardly conceivable for a firm to lose all its accounts receivable in any one year as bad debts. If any comparison at all is attempted between credit and fire hazards, the insurance

against credit losses should be based on the principle underlying insurance against fire where the risks are sufficiently scattered. Thus a concern with several hundred buildings located in different parts of the country might and successfully does carry its own fire insurance. When accounts are large in number and well distributed, no credit insurance need be carried save a reserve on the creditor's own books. Even though in some one year a concern's losses may exceed a certain normal percentage as determined by its experience over a period of years in the past, the average of the next several years will probably be no higher. And if this average is higher, it cannot be insured against, but must be borne by the insured as a normal or initial loss, for in determining the terms covering renewals, the experience of the previous year is taken into consideration so that in the event the loss incurred during the term of the preceding policy is higher than the average loss of the past 5 or 6 years, the initial or normal loss is increased accordingly. Consequently, when averaged over a period of years, the insured will find that the premium will only be so much additional, to be charged to the loss account, over what would normally be charged off when not carrying any credit insurance.

Another criticism against credit insurance as practiced today is aimed at the method of computing the initial or normal loss. It will be observed that in determining the normal loss the insurance company computes all losses, including those which are not normally allowable under the policy because of inferior ratings and other stipulations of the agreement, notwithstanding the fact that the losses on these accounts constitute an important or even major part of the aggregate losses. If off-rated accounts are not allowable under the policy, they should not be considered in arriving at the initial loss to be borne by the insured. Thus, the normal loss of $7,500 undoubtedly includes losses of the character of C, D, G, H, K, and L, whose ratings are too poor for the purposes of the policy. Since these losses amount to $4,285 (gross loss less salvage), it is necessary that the insured sustain a total of $11,785 ($7,500 plus $4,285), disregarding other stipulations for the normal losses, before the insurance company would have any liability.

From the foregoing it is apparent that credit insurance, as at present conducted, protects the insured to a limited degree against certain unanticipated losses. It has already been fully demonstrated that over a period of years credit insurance necessarily adds to the cost of doing business an amount equal to the premiums paid out over and above the amounts received as indemnification for losses under the policies. Insurance companies, in order to remain in business, must receive premiums greatly in excess of the losses paid. From this excess all expenses incurred in soliciting and conducting business are covered, as

well as a profit secured. Should the losses in any one year exceed the premiums received, the difference will be more than made up during subsequent years, because the normal losses of the insured are automatically raised and the premium paid also becomes correspondingly larger, partly because of the increase in the face value of the renewal. It is, therefore, argued that because it is cheaper in the long run for a merchant to carry his own credit insurance, also because his risks are scattered over a large number of accounts, he should merely set up a reserve for bad debts sufficient in amount when accumulated from year to year to cover all possible unexpected losses. This may account for the relatively little progress credit insurance has made over the years judging by the premiuns received on such policies. The complexity of the whole subject and failure of business men to understand the intricate technique in making the necessary computations have no doubt contributed to the situation.

In the case of some concerns selling to relatively few accounts, however, and where the risk is, therefore, inadequately distributed, it may be advisable to have their risks underwritten. This may explain the development of specific coverage policies. Many credit managers feel, however, that accounts insurable at reasonably low rates represent a sufficiently high degree of credit responsibility to obviate the necessity for protection, and that where the insurable rates are high, the accounts represent inferior credit risks to whom credit could not be extended without protection. The cost of protection on these cases, however, is so high as to absorb nearly all profit, leaving little, if any, benefit to the insured from insuring against losses from such risks.

Foreign Credit Insurance.—During the first two years following the World War, many losses were sustained by exporters because of bad debts. These losses were undoubtedly due to the disturbance of economic equilibrium caused by the war, and the carelessness with which credit was extended during the period of general prosperity. Apparently, without a careful analysis of these factors, many exporters felt that exporting must cease on a credit basis, or else some form of protection should be devised whereby excessive losses could be eliminated or minimized. Instead of seeking the remedy within each concern, through more careful investigations of credit risks on the part of credit managers, a group of manufacturers attempted early in 1919 to organize an association for the purpose of providing some form of credit insurance on a mutual basis. An investigation disclosed the impracticability of attempting to insure against all contingencies because of the prohibitive cost of such protection. Since losses from actual insolvency of foreign buyers, death, disappearance, etc., were relatively low, it was decided that insurance be offered against such contingencies at a reasonable rate.

From contributions made by interested parties, a department was organized for the collection of data on which to base rates for insurance. Considerable information was secured from the credit files of numerous American and foreign banks, culminating in the issue of a rating book covering numerous buyers in Latin America. Actual insurance against insolvency of foreign buyers was finally begun in the early part of 1921.[1]

The membership grew, as a result, from 100 at the beginning of the year to about 500 at the end of the year. In the early part of 1922 the Associated Exporters Foreign Credit Guarantee Exchange was formed in New York City which offered to sell foreign insurance against all contingencies. After a few months it ceased operations. At present, foreign credit insurance is written in this country only by the American Manufacturers Foreign Credit Exchange through the American Foreign Credit Underwriters, Inc.[2] Because of its limited application in this country, no further discussion will be presented in this book.

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Questions and Problems

1. Does credit insurance really insure? If yes, what does it insure?

2. What is meant by normal loss and how is it determined?

3. What provisions in a credit insurance policy are of especial importance to the credit manager?

4. In what ways does the term "insolvency" differ in credit insurance from that used in connection with bankruptcy?

5. What factors are considered in arriving at the premium to be paid for any one insurance policy?

6. How is the net allowed loss determined at the expiration of the policy?

[1] POOLE, GORDON C., "Export Credits and Collections," p. 68.

[2] For a comprehensive study of foreign credit insurance in other countries, see "Export Credit Insurance in Europe Today," Senate Document No. 225, U.S. Government Printing Office, 1934.

7. "Credit insurance is analogous to fire insurance. If you believe in fire insurance, you certainly must believe in credit insurance." Criticize this argument that is so often advanced in favor of credit insurance.

8. Does credit insurance make a credit manager more careful in the performance of his credit-granting function or does it permit him to take longer chances and thus increase his volume of business? Explain. How do you explain the fact that both of these arguments are used in favor of credit insurance?

9. To what extent would insurance protect creditors in periods of crisis and depression?

10. What, in your opinion, are the weaknesses of credit insurance policies as written at present?

11. How do you explain the growing popularity of credit insurance?

12. What are the principal weaknesses in foreign credit insurance policies of the prevailing type?

13. Criticize the following statements:

a. "Credit insurance makes the losses for the year known in advance."

b. "The efficient credit manager is the strongest ally that a credit insurance company can have."

14. Under what circumstances would you recommend the use of credit insurance by mercantile institutions?

15. Is the complexity of credit insurance technique a help or a hindrance in the sale of policies? Explain. Is it necessary for the insured to know just how premiums are determined and other computations made?

CHAPTER XXXIV

CREDIT LIMITS

Meaning and Purpose.—Once the credit manager has decided that the customer is worthy of credit, the next step is to determine how much credit can be extended with safety. While a credit risk may be entirely satisfactory when kept within certain limits, it may prove extremely hazardous when those limits are greatly exceeded.

Purchasing or borrowing beyond reasonable limits usually means extravagant living on the part of the consumer or unwarranted expansion of business on the part of the merchant, as the case may be. Neither should be allowed by the credit grantor.

It is sound business practice to place a definite limit on every account at the time it is opened, above which it is considered unwise to approve purchases on credit. In some retail stores, such limits are used merely as dividing lines beyond which purchases must be approved by refer authorizers. In any event, a credit limit on a customer's account is but an approximate and sometimes arbitrary amount, not susceptible of accurate ascertainment. It is essential, nevertheless, for it serves a useful purpose by substituting estimates for mere guesswork. It affords a quick and effective warning of approaching danger in an account's activity and is often a danger signal which, when heeded, prevents many a catastrophe. The credit limit should never attain such rigidity, however, as not to permit of revisions warranted by additional knowledge gained from time to time or by changes in the condition of the risk.

Advantages of Credit Limits.—The use of credit limits saves the credit manager's time. Were it not for such a device it would be necessary for the credit manager himself to check all orders for credit. With the use of limits, it is possible for the credit expert carefully to examine and accurately to weigh the information only when a decision is to be reached on the more important phases of the customer's account. Thereafter, authority can be delegated to an assistant who can check all orders received from such a customer against the limit set previously by his superior. Such procedure releases a considerable amount of the credit manager's time which can and should be devoted to a consideration of the more important problems incident to the proper and effective management of his department.

The adoption of credit limits is a real economy in the operation of a credit department. It saves expense in that it obviates the necessity

for looking up bulky records each time an order is received from an account in order to determine whether or not the order should be approved. The economy in time is not inconsiderable. The alternative to this would be to rely upon memory of the condition of the account and the nature of information available concerning it. Memory is, however, a poor substitute for exact knowledge.

Not only does the use of credit limits save time of the credit manager and his force and effect economies, but it is also a distinct service to the purchaser. It generally acts as a check against reckless buying and extravagance.

Objections to Credit Limits.—One of the most common objections to the use of limits is that in order to reflect actual conditions accurately limits must be constantly revised, a procedure that is too costly and burdensome. When placing a credit limit on a customer's account, it is necessary to bring all information up to date. Facts and figures must be gathered from a variety of sources and carefully examined. In a short time after the limit has been established on the basis of a careful consideration of all the evidence in the case, conditions may arise which may make necessary a change in the limit. Furthermore, a given order from the customer might cause him to exceed the limit slightly. Of what value is the limit in such cases? Should the order be approved or rejected? Then it is charged that the practice of setting limits may prove embarrassing to the firm. Suppose a customer inquires as to the limit placed on his account, what reply can be made? If he is told what limit has been assigned and the amount seems to be smaller than other creditors have allowed him, the customer may harbor ill feeling toward the firm thenceforth, which will be reflected in his limited patronage. Finally, the delegation of authority which the use of credit limits makes possible may cause the credit manager to lose the necessary intimate contact with his accounts.

It should be pointed out that these objections are in reality of no special significance. Limits, after all, are but approximate amounts. For this reason alone it would not be necessary to revise them at short intervals, nor will it be necessary to reject an order when a limit is slightly exceeded. Credit limits are not intended to reflect actual conditions so accurately as to require constant adjustment. Instead, they are regarded as outposts and danger signals. Moreover, the method used in setting limits may relieve the firm of the embarrassment in revealing its extent to any customer. Even when no such method is used, tact in revealing the limit will do much to prevent any ill feeling. Finally, no sagacious credit manager would fail to keep track of a customer's orders and remittances no matter how much of his authority is delegated on routine matters.

Wide Use of Credit Limits.—Despite some of the objections indicated, credit limits are used widely. There is hardly an establishment in which limits are not used to some extent. Sometimes, such limits may exist merely in the mind of the proprietor or whoever is charged with the performance of the credit function. Usually some limit is placed on each account in the ledger or on some record used for credit checking, or both. The disadvantages in establishing credit limits are trivial when examined in the light of the benefits derived therefrom.

CREDIT LIMITS SET BY BANKS

Limits for Business Borrowers.—Commercial banks frequently set a credit limit, known as a line of credit, for its business borrowers. Sometimes no formal arrangement is made to that effect so that it cannot be used for advertising or insurance purposes, but it may take the form of an understanding or gentlemen's agreement. This gives the borrower an idea of how far he can go in relying upon the bank for accommodations during a season or the ensuing year. When conditions are uncertain or bad, as during periods of depression, banks often refuse to commit themselves by setting lines of credit but wish to handle each application for a loan on its merits.

In setting lines of credit, a bank is governed by several considerations. First, there are regulations which limit the amount that can be loaned to any one borrowing interest. It is usually limited to 10 per cent of the bank's paid-up and unimpaired capital and surplus, although there are many exceptions to this provision arising out of the nature of the loans. This provision is intended to prevent a concentration of risk, so that the failure of any one borrower would not cripple the institution, and to bring about a wide distribution of banking funds throughout the community. Second, the bank's policy in dealing with certain kinds of business is a factor. A bank that has specialized knowledge of a given type of business is more apt to advance a larger line of credit to borrowers in that field than one that is unfamiliar with it and hence overcautious. Third, rigidity of the bank's requirements of borrowers in maintaining bank balances and in clearing up the account at least once a year will have a bearing on the line of credit extended. Ordinarily, a commercial bank, especially in cities, requires from its borrowers a balance of about 20 per cent of the amount actually borrowed, but this percentage in actual practice is said to vary from 10 to 25 per cent. Other requirements may be set up by some banks and not by others. Fourth and most important is the borrower's banking needs. If a bank is to perform its function properly, within the limits specified above, it behooves it to serve the legitimate needs of its business clientele.

In establishing a line of credit, the banker prefers to have the applicant make the request and state the amount needed, although the former may solicit information on possible requirements during a given period of time. If the borrower deals with more than one bank, account must be taken of his total bank borrowings; otherwise the bank will consider the customer's needs, and, if they can be served in line with the bank's policy and legal requirements, the line of credit requested will be granted.

Limits on Personal Loans.—A number of commercial banks maintain personal loan departments, but practically all of them make some personal loans. When this type of business is departmentized, an upper limit is usually established, within which the credit limit of any one borrower is set on the basis of his ability to pay as agreed and the purpose for which the loan is made.

SETTING CREDIT LIMITS FOR CONSUMERS

Assigning Limits on Retail Charge Accounts.—A method somewhat favored by retail credit managers is to inquire of the prospective customer at time the application is filled-in as to what amount he would like to have credit with the firm. If the reply is indefinite, it may then be possible for the credit clerk to inquire as to whether a certain amount will cover it. Such an understanding places the credit department in a favorable position later on when the limit is being exceeded. It is then possible to call the customer's attention to the arrangement and use it as pressure to reduce the indebtedness to the desired figure.

When limits are assigned by the credit manager without any aid from customers, one of several methods may be used. In some houses the amounts assigned are governed largely by the method of checking or authorizing, depending upon whether the system is centralized or decentralized. Thus one prominent concern places its limits in six groups from $25 to $200, depending upon whether the risks have limited buying power, are fair, need watching, are good, well-to-do, or wealthy. Another house classifies its accounts for rating purposes as follows: employees' accounts; temporary and "accommodation" customers; $25, $50, $100, and $500 accounts; and those which have an unlimited paying capacity.

Some stores base their credit limits on the reports from credit bureaus, by taking the average figure of the customer's other accounts and allowing him the highest amount he has met within a certain number of days, the latter being governed by what the terms of the house under consideration are. Occasionally, limits are based on time. Under such conditions, a store will allow a customer, say, purchases over a 2 months' period. Similarly, when an account becomes 60 days past due it is closed until payment has been made. Dairy companies ordinarily set a limit on purchases by consumers from their drivers on the basis of time. One such

company, for example, classifies its customers into weekly, biweekly, triweekly, and monthly, expecting each account to be liquidated within the time specified, giving the usual amount of grace.

Probably, in most cases limits are set arbitrarily. It is because of this fact that limits are frequently nothing but figures above which charges become refers, requiring more than the usual attention given in the normal routine of authorizing purchases. A study made by a student under the author's supervision shows a variety of bases used in setting limits, including personal appearance, financial standing as obtained from the banks, agency ratings, place of employment, income, and location of residence.

Assuming willingness on the part of the customer to pay his bills, probably the best method of determining limits in a retail store is to calculate the amount that the customer might be expected to purchase from the store within the credit period allowed, plus the usual number of days of grace. A store selling on 30-day terms would then be justified in allowing credit covering the purchases over a period of about 50 days, provided, of course, that such purchases are confined to a single store of the type under consideration. If it is found that patronage is divided among two or more such stores, only part of the requirement in this particular line of merchandise over the period stated should be taken as a basis for setting the limit on the account. The problem of making limits low enough to prevent overbuying and yet high enough to avoid too many refers is one that requires judgment and skill. Fortunately, as a result of studies made by the Bureau of Labor Statistics and the Department of Agriculture, much valuable information is available on budgets of families of various sizes and in different income groups. From these data, it should be possible to determine how much of one's income would be available for certain goods and services, supplementing the other information gathered by the credit manager in computing a credit limit at least semiscientifically, taking into consideration both the customer's requirements and his ability to pay.

Setting Limits on Deferred-payment Accounts.—On instalment transactions the limits set are ordinarily much higher than those used on charge accounts, because high-priced goods are bought on deferred payments, the time for the liquidation of the debt is longer, and much of the merchandise so purchased is durable so that more security is had. Nevertheless, a limit must be set to prevent customers from overbuying and to keep the store's losses down to reasonable proportions. To do this, the capacity of the customer to pay becomes a cardinal factor, as it is in any type of credit. In measuring ability to pay, all obligations on the instalment plan must be taken into account and it is suggested that the total of such obligations should not exceed 10 per cent of the customer's

monthly income for a period of 1 to 2 years, depending upon the nature of the merchandise bought, the period within which the particular instalment contract is to be liquidated, and the customer's earning stability. In actual practice, setting limits on instalment customers is still a matter of rule of thumb.

ASSIGNING LIMITS IN MERCANTILE INSTITUTIONS

Factors Involved.—It goes without saying that all factors used in arriving at a credit decision of any kind must also be considered in connection with a determination of credit limits. It is necessary that due attention be given to character, capacity, capital, and to the customer's past performance. All this must be studied with reference to the customer's particular line of business and his type of organization, and related to the policy of the house with regard to such matters.

These factors will determine whether or not the customer will be willing and able to pay the amount to be extended within the terms of sale. It is not a matter of ultimate payment so much as it is a question as to whether payment may be expected within a specified time. Similarly, in determining credit limits not only should the present condition of the customer be taken into account, but careful attention must be given to possible subsequent developments in order to gage the possibility of obtaining payment when due.

Another factor to be considered is the length of the credit period. While it may be hazardous to extend a given amount to a customer on 90-day terms, such amount may be safely granted on a 10- or 30-day basis, because of the shorter duration of the risk and also because under such circumstances the debtor will be more cautious in incurring obligations, knowing full well that they must be met within a short period of time. Above all, the credit manager must give due regard to the customer's requirements and keep all credit extensions within those limits; otherwise, capital so obtained may be used for purposes of paying other creditors or for needs outside the business.

Prevailing Practice.—Credit limits constitute one of the aspects of credit management on which there seems to be little agreement as to what may be regarded good practice. Even among the most progressive firms many differences in methods of setting limits may be revealed. A sample study made under the author's supervision showed that out of ten large companies investigated, no less than ten different methods of determining credit limits were in use. The organizations covered included wholesale grocers, two of the largest oil companies, manufacturers, a general jobbing house, and a milk company.

While there is no unanimity of opinion as to methods of setting credit limits, a pioneer study of the field by the author points to some degree of

uniformity, at least as far as the basic thoughts underlying the different methods are concerned. One of the methods commonly used is to allow as much credit as other creditors have been allowing to the same account, provided these creditors are engaged in a similar line of business. It is a matter of following somebody's judgment as revealed from credit reports and direct interchange, which may or may not be sound. Another method frequently encountered is to start a customer with a small amount arbitrarily determined and raise this amount gradually, as the risk proves satisfactory, until a certain predetermined limit is reached. Thus a large rubber and supply company starts a customer who is just beginning his business career with $25 or more, depending upon the size of his operations. If the customer discounts his bills promptly, the credit limit is extended to $75 or $100 for the small dealer and to a larger but fixed amount for the large dealer.

A modification of the plan just outlined is to start a customer with an amount of credit covering his purchases over a certain period of time, say, one week. If the terms are complied with promptly several times in succession, the amount is increased to cover purchases over a longer period of time more or less arbitrarily determined, or based on requirements and custom.

In a number of mercantile concerns no limits are set on an account as long as it discounts its bills or pays promptly. This means that new customers have practically unlimited credit for a while, but are rigidly controlled as to the amount and terms if they become slow-pay.

Some concerns rely a great deal on net current assets as a basis for setting credit limits. In such cases, the usual method is to divide net current assets, commonly known as working capital which is secured by deducting current liabilities from current assets, by the number of firms that the credit risk is dealing with. The assumptions underlying this process are that net current assets measure the debtor's ability to pay within a short period of time and that he buys equally from the number of firms used as a divisor. Should such assumptions be unwarranted, necessary modifications must be made in order to make the calculation more reliable.

Instead of net current assets, some firms use net worth as a basis for credit limits, which are obtained by dividing the number of principal sources of supply or creditors into it. In a number of instances it has been found that a specific number is used as the divisor. This number is usually based on the company's experience with certain types of customers. If it is discovered through an analysis of a firm's customers that on the average its customers buy the major portion of their merchandise requirements from about eight different sources, eight may then be used for the purpose of arriving at the credit limit, by dividing it into net

worth. It is interesting to note that some companies use net worth instead of net current assets as a determinant of debt-paying power because they feel that a truer picture may thus be obtained, particularly when a customer's assets consist largely of fixed properties and very little is invested in current assets.

In a surprisingly large number of cases mercantile agency ratings are used as a basis for assigning credit limits. A schedule is usually prepared showing what limit should be assigned to each customer, on the basis of the rating he has in the mercantile agency reference book or in the special report. Especially is this true of concerns carrying credit insurance policies. In such instances the common practice is to follow the limits of coverage indicated in the policy opposite each rating of whatever agency has been chosen for the purpose. A careful check-up of a number of companies operating on this plan has convinced the author of the unscientific nature of this procedure. There seems to be no close relationship between the amount covered by the policy and the amount of credit that might justifiably be extended to one's customers, considering all the circumstances in any individual case. Furthermore, it means that too much reliance is placed on ratings, regardless of the fact that ratings change frequently and that they are merely approximations based to no inconsiderable degree on the judgment of mercantile agency officials which may not in many instances coincide with the judgment of the individual credit manager.

Inadequacy of Prevailing Methods.—While all of the methods now in use have some justification and some of them are fairly commendable, they are inadequate for those who are interested in a scientific approach to the problem. Regardless of opinions to the contrary, it is possible to calculate limits mathematically and on a scientific basis, although it is not possible or necessary that the figures be absolutely exact. Heretofore all such attempts at analysis and calculation have been, however, too involved and too cumbersome to be of practical application. In one such study, for example, it has been suggested that net current assets be used as a starting point. This figure is then modified by a consideration of what is bought with these current assets in order to arrive at the figure in which a given creditor may be interested. The rate of stock turnover is introduced next as an additional modifier, followed closely by the creditor's terms of sale. Finally, the total number of suppliers from whom goods are purchased by the customer must be given due consideration. Not only the total number of such suppliers but the way in which purchases are distributed among them is also a factor in the case. This type of calculation, while based largely upon sound logic, does not offer any real solution to the problem, for it is so complicated as to discourage most credit managers.

Suggested Methods.—The problem of scientifically determining credit limits in the mercantile field involves a decision as to which of two possible bases should be emphasized, for both must be given consideration. There is the possibility of setting credit limits, first, on the strength of the customer's debt-paying power, and, second, on his probable requirements. It becomes a matter of using ability to pay as a basis as against an approach to the problem from a sales point of view. Perhaps both bases should be used to supplement each other.

It is important to bear in mind that in all discussions of credit limits it is assumed that the customer is *willing* to pay his bills. It is assumed that his character is unimpaired; otherwise credit may be refused or the limit confined to a relatively small amount.

Debt-paying Power.—The method of procedure in determining the credit limit on the basis of a customer's ability to pay is somewhat as follows: The working capital, or net current assets, of the merchant under consideration is multiplied by the rate of working capital turnover which has been determined by past experience. In this manner the amount which will be available during the year for the payment to creditors for goods purchased will be ascertained. This amount is then divided by the number of principal sources of supply from which the customer is now buying. An examination of a credit interchange bureau report will prove very useful for this purpose. This will show approximately how much of the total available for payment of creditors during the year will be given to each of the principal creditors. The next step is to divide this amount by the usual rate of stock turn, on the assumption that the terms on which credit is extended to the customer coincide roughly with his rate of stock movement. The result is a figure up to which credit may be safely extended, provided the customer is willing to pay his bills, so long as the creditor considers himself a source of supply equal in importance, as far as this particular customer is concerned, to the other principal creditors. Should the creditor consider himself of greater importance or vice versa, adjustments in calculations should be made accordingly.

To illustrate, let us assume that a concern, according to its last available financial statement, has net current assets of $20,000; that its rate of working capital turnover is eight times a year; that its stock turns approximately five times annually; and that it is reasonable to assume that the major portion of, or practically all, its goods are purchased from 20 sources, or that the goods of one supplier constitute about one twentieth of the entire stock of merchandise. The annual payment for goods of this particular concern would be $160,000 ($20,000 × 8); its annual payment to a single supplier would be $8,000 ($160,000 ÷ 20);

and its credit limit at any given time from one source of supply, $1,600 ($8,000 ÷ 5).

Requirements.—A superior method of establishing credit limits is that based mainly on the probable requirements of the customer. In this connection, one should be warned against the common practice of indirectly allowing the debtor himself to fix his limit. Many a credit manager works on the theory that the proportion of goods purchased from any one source would be regulated by the customer himself, and that such a customer will not exceed his requirements. Quite frequently, credit agencies state in their reports that the subject "is good for his requirements," implying that he is entitled to all the credit desired by him. That this assumption is unsound is witnessed by the large amount of overbuying on the part of many merchants and a considerable amount of buying beyond what the purchasers are able to pay for within the credit period. What is suggested here is that the requirements be determined by the credit grantor and not by the purchaser.

The steps in this calculation are as follows:

1. Obtain the customer's annual volume of business. This may often be estimated by the salesman and noted in his new-account report or by the credit manager himself. This estimate may be made on the basis of the number employed by the subject or some other factor on which statistical information is available. Experience has shown that the task of estimating a given customer's business is not so difficult as it may appear at first blush. Very often sales are given in the mercantile agency report or in the financial statement submitted by the risk. Let us assume that the subject is in the grocery business and that his sales are $50,000 a year.

2. Find out what proportion of his business is in your lines. This information can be obtained from an analysis of some of the firm's customers' businesses as has been done in a number of cases or from governmental sources, especially the Censuses of Business which show sales by commodities for different wholesale and retail businesses and from reports issued by the Bureau of Foreign and Domestic Commerce. Let us assume that the retailer's business includes merchandise handled by your firm amounting to 20 per cent of the total. His requirements in your line are, therefore, $10,000 a year.

3. Determine what proportion of this business you can reasonably expect to obtain. This amount will vary, of course, with the nature of competition and with the type of customer. We shall assume that since the standing of your firm with your customers is such as to warrant one fourth of the business in your lines of merchandise, you may expect to obtain one fourth of $10,000 during the year, or $2,500.

4. The next question is: How many days of sales will you allow the customer on credit? Since your terms are, say, 30 days, with an average of 50 days outstandings carried on the books, we shall assume that as many as 50 days of sales will be allowed, provided that the number of days in outstandings is regarded as satisfactory. The credit limit, at retail prices, is then determined by dividing 50 days into 365, and dividing the result into the amount to be extended, at retail prices, during the entire year, which gives the figure of $342 (365 ÷ 50 = 7.3; $2,500 ÷ 7.3 = $342).

5. Reduce the credit limit thus determined by the average gross margin of profit on which retail grocers normally handle your line of goods, say 20 per cent, and you have a credit limit of approximately $275.

Another way of ascertaining roughly a customer's requirements during the customary credit period is to ascertain the cost of goods sold during the year, which can be obtained from the financial statement, and which may be regarded as approximately equivalent to the annual merchandise requirements. This figure must then be divided by the customary credit period to obtain the amount that would be required during such time. Finally, the amount is divided by the number of principal suppliers to arrive at the credit limit to be set by each of such suppliers. Thus, if we assume the cost of goods sold to be $180,000 for the year, and the customary credit period 60 days, then the amount needed for such a period is $30,000 worth of goods. This amount is then divided, say, by 15 principal suppliers, resulting in a credit limit of $2,000. This calculation can be expressed by means of the following formula:

$$\frac{\text{Terms in days} \times \text{cost of goods}}{\text{Days in year (360)} \times \text{number of suppliers}} = \text{credit limit}$$

The best recommendation for this method of ascertaining credit limits is its relative simplicity. The naïveté of the underlying assumptions, however, is more than surprising. It assumes, for instance, that the customer deals in but a single line of merchandise or else how can one apply the same terms of credit to all of his goods? Even in the same line of merchandise the terms offered by different suppliers vary greatly. It assumes, further, that payments are made exactly within the credit period, which is pure fiction as the outstandings of any creditor will show. It disregards the relative position of the vendor in the competitive market, and the numerous secondary suppliers. Then it requires information from outside sources which the first method suggested does not.

On old accounts the requirements can be determined by past sales to them, the limit being fixed at a number of days of sales to the customer

commensurate with the days of sales outstanding for the business as a whole.

Selected References

PRENDERGAST, W. A., and STEINER, W. H.: "Credit and Its Uses," Chap. 15.

Questions and Problems

1. What is the purpose of credit limits?

2. Mr. X, the credit manager for a large retail store, does not believe in credit limits. You are asked by the management to convince Mr. X of the value of such limits. What arguments can you advance in favor of the adoption of the new plan?

3. What objections should be anticipated against the use of credit limits in Mr. X's store? How could they be met?

4. Of what special value are credit limits to the credit manager of a wholesale house? Are they of equal value to a manufacturer? To a bank?

5. Suppose the manufacturer were following a policy of selling through a limited number of outlets, would the adoption of credit limits be as necessary and as valuable?

6. Criticize the present-day practice of determining or setting credit limits:

a. In the retail field.

b. By mercantile institutions.

7. What factors should govern the determination of credit limits?

8. Which of the two suggested methods of setting credit limits is superior? Why? Can one be used to the exclusion of the other?

9. Mrs. Jones wishes to open an account at your store, which is one of three department stores in the city. She also has an account at another department store with which she has traded on open credit for some 3 years. Mrs. Jones has a family of five; her husband is a railway engineer, earning approximately $300 a month. They live in their own home, the rental of which is equivalent to $65 a month. The family drives a Ford sedan. Mrs. Jones appeared during the personal interview to be very well dressed; the coat she wore costing probably around $250. What credit limit would you place on her account, assuming that your terms require settlement on or before the tenth of the month for all purchases made during the preceding month?

10. You are in the coffee-roasting business selling directly to retail grocers. You received a first order from the A.B.C. retail grocery store, which has an annual volume of business amounting to $65,000. The store is located in your home town where you occupy a rather strong position in the sale of coffee, so that you normally obtain about one fourth of the coffee business in your community. It is estimated that approximately 2.8 per cent of all sales in a grocery store in your community is in coffee. Assuming that the order has been approved, what credit limit would you allow the customer? Show how this limit should be determined.

CHAPTER XXXV

CREDIT AND COLLECTION INDEXES AND CONTROL RECORDS

Credit limits constitute but one method of controlling the credit and collection operations within certain predetermined bounds. To this should be added a number of other devices and records that may be called into use for more effective control which, in turn, can be measured by one or more of several indexes that will be outlined presently.

Old Method of Measuring Credit Department Efficiency Inadequate.—As a general rule, a credit department's efficiency is judged primarily by the manager's skill and ability to reduce losses, incurred from bad debts due to failure to collect doubtful accounts, to a minimum. Every now and then one may hear of a credit manager boasting of the fact that his concern has lost nothing during the year or that the losses amounted to a very insignificant fraction of 1 per cent of credit or total sales. However, an exceedingly small-loss record alone constitutes, in fact, an inferior basis on which to judge performance efficiency, since it is a comparatively simple task to accomplish such a feat by practicing conservatism to the *n*th degree and accepting only A-1 risks. The result often is a diversion of trade to competitors and a loss of possible business profits which might have, perchance, exceeded the losses incident to the assumption of a more liberal attitude on the part of the credit manager.

To illustrate, let us assume that orders for $1,000,000 worth of business are received during the year by the credit departments of each of three competing houses. Let us further assume that the first concern, A, pursues a rather conservative policy and rejects 50 per cent of the business; that the second house, B, follows an extremely liberal policy and rejects only 10 per cent of the business submitted; while, C, the third house, steers a middle course and rejects 20 per cent of the orders. For purposes of comparison, it is also assumed that the percentages of net profit prior to the deduction of bad-debt losses is the same in all three instances, namely 5 per cent. The results of the difference in credit policies are indicated below:

A. Ultra-conservative Policy

Business Accepted	$500,000
Profit Prior to Deduction of Losses	25,000
Bad-debt Loss (two tenths of 1 per cent)	1,000
Net Profit	$ 24,000

B. Too Liberal Credit Policy

Business Accepted	$900,000
Profit Prior to Deduction of Losses	45,000
Bad-debt Loss (1.6 per cent)	14,400
Net Profit	$ 30,600

C. Ideal Credit Policy

Business Accepted	$800,000
Profit Prior to Deduction of Losses	40,000
Bad-debt Loss (one half of 1 per cent)	4,000
Net Profit	$ 36,000

These illustrations show that the first house has kept its losses down at the expense of possible profits from an increased volume of sales; that the second firm, by pursuing too liberal a credit policy, incurred a loss out of proportion, yet it fared considerably better than the first concern. The third house, however, by steering a middle course, reached the ideal of securing a maximum of business profit with a minimum of loss.

In view of the foregoing illustration which is not altogether imaginary it would appear that losses from bad debts alone are at best inadequate as a test of credit department efficiency. Some very poor credit departments may have small losses, and vice versa. Many other factors need be taken into account, as will be shown in the following pages.

Need for Analysis of Results and Policies.—Much has been written in a general way of the value of certain credit policies, but little or no discussion is to be found concerning the means by which actual progress made under these policies may be definitely ascertained. Yet every credit manager appreciates the value of reviewing and analyzing the results of his department's efforts in order that intelligent comparisons may be made of the various operations of his department. It is essential, therefore, that the accomplishments of the credit and collection parts of the business be tabulated and recapitulated at certain intervals for the credit manager's own use in directing the activities within his domain and for presentation to the executives in the form of a report summarizing the department's activities and their effect.

To be sure, different kinds of business require different sets of facts. Nevertheless, the ideas suggested here may prove useful in almost all lines of business when properly adapted. While they are by no means exhaustive, they may prove suggestive and helpful.

Relation of Credit Business to Total Sales.—In all business enterprises, wholesale and retail, it is important to know what percentage of the total sales are represented by credit. It may even be advisable to determine the percentage of business done on each type of credit, as for example, instalment credit, charge accounts, C.O.D.'s, and so forth.

When compared over a period of years, it affords a valuable picture of the firm's credit business and probable effects of its policies with regard to credit accommodations. To secure the percentage of credit business, divide total net sales into total credit sales. This figure may be further compared with similar figures for other firms operating under substantially similar conditions.

Until recently only fragmentary statistics of this sort were available for comparison, largely as a result of studies by university bureaus of business research or by trade associations. The latter were often limited to the use of a small and intimate group of members. Now more or less complete and representative data, at least on some points discussed in this chapter, can be obtained from the first Census of Distribution and the two subsequent Censuses of Business conducted by the Bureau of the Census, from the annual Retail Credit Survey made by the Bureau of Foreign and Domestic Commerce with the cooperation of the National Retail Credit Association, from the Mercantile Credit Survey conducted by the same governmental agency, and from the monthly data on manufacturers' and wholesalers' sales and collections inaugurated in 1936 by the Bureau of Foreign and Domestic Commerce with the cooperation of the National Association of Credit Men.

To illustrate, a department store operating on a cash, open credit, and instalment combination basis, may compare its results with those shown in the Retail Credit Survey. In 1937, according to this study, such stores obtained 46.7 per cent of their business from cash transactions, 43.2 per cent consisted of charge or open credit business, and instalment credit sales contributed 10.1 per cent of the total volume. If the store in question has a smaller volume of credit business than indicated, it may be due to its strict credit-granting policy or its lethargy in developing such business. The former conclusion can be verified by the rejection percentage index discussed below. If, however, the store has a much higher percentage of credit business, the bad-debt index must be consulted to see whether such business is obtained at a higher cost than warranted. In any event, the index of credit sales to total volume reveals in a general way the effectiveness of the concern's policy with regard to the credit-granting function, one of the two principal functions of a credit department, *viz.*, that of keeping sales at a maximum.

Bad-debt Loss.—Even though losses from bad debts cannot be regarded as the sole criterion of a successful credit department, they are important nevertheless. These losses should be expressed in terms of credit sales, except where practically all the sales are on credit terms. To obtain this figure, divide bad debts incurred during the period under consideration by total credit sales. These percentages will naturally vary with different lines of business, with competitive conditions, with the

month or season of the year, and with general business conditions. They will also vary inversely with the collection percentage, as might be expected.

The bad-debt loss index is the second most important measure of a credit department's efficiency. It shows primarily how the other of the two principal functions of a credit department is being performed, that of keeping losses down to a minimum commensurate with a given sales volume. Thus, for department stores the percentage of bad debts to credit sales on open credit in 1937 was 0.3 and on instalment sales 0.8. If the store used in the illustration has a bad-debt percentage higher than normal for the group it may signify either a lax collection policy, which can be checked through the collection percentage index, or a lax policy of credit granting which, as already indicated, can be checked both through the credit sales index and the rejection index.

Collection Percentage.—The collection percentage is one of the most commonly used of the credit control indexes. The percentage of collections to outstandings is determined by dividing the total amounts collected during the month by the total accounts and notes receivable outstanding at the beginning of that month. When plotted on a chart, the resulting curve indicates the general trend in collections. When collections are unfavorable, improvements in the handling of accounts may be inaugurated and other steps taken to inquire into external causes that may be responsible for the condition. By extending such a study over a period of time, a credit manager will be able the more closely to estimate his collections, an item of considerable importance to concerns operating on a budget plan. Thus, if experience has shown that collections amount to 80 per cent in June and 75 per cent in July, figures might be drawn off in the following fashion:

June 1, Receivables	$100,000
Estimated Collections for June	80,000
Overdue June Receivables	$ 20,000
Estimated Sales for June (furnished by Sales Department)	75,000
July 1, Receivables	$ 95,000
Estimated Collections for July	71,250
Overdue July Receivables	$ 23,750

To continue with the illustration from the department-store field, the Retail Credit Survey shows for 1937 a weighted average collection percentage per month of 47.1 for open credit and 16.5 for instalment credit. A higher percentage for the store which makes the comparison indicates

a sound collection policy, provided it does not result in too low a credit sales to total sales index. If the collection percentage is much below the average and the credit sales index is also much lower than the average, then the fault must lie in the collection policy and system of the store. It is important to bear in mind that all the relationships discussed herein vary from year to year with general business conditions and they may also vary somewhat with the geographic sections of the United States and with the size of the store. For these reasons the data are usually presented by cities or other geographic areas and by size of store groups. Collection percentages also vary with the month of the year, hence this particular index should be developed on a monthly basis.

Turnover of Receivables.—Collection percentages can be converted into the turnover of receivables in terms of days of outstandings. To determine the average collection period or turnover, in days, it is necessary to take into consideration the regular terms of sale and the percentage of accounts receivable, as of the first of the month, that has been collected during that month. If the usual terms are 30 days, all receivables outstanding at the beginning of the month must be collected during the month if collections are to equal 100 per cent. If only 50 per cent of the receivables have been collected, the turnover equals twice the length of the usual terms, or 60 days. Similarly, on a 25 per cent collection basis, the average collection period would be four times the normal credit period, or four times 30 days.

Another way of arriving at the same results is by the use of the formula $\frac{T}{C} \times 100$, T being the usual terms of sale or length of the credit period in days, and C being the collection percentage. Assuming that the usual credit period is 30 days and the collection percentage is 50, the turnover in days is 30 divided by 50 and multiplied by 100, or 60 days.

Delinquency Percentage.—This involves a determination of the proportion of all accounts, in amount and in number, that are past due. By dividing the total past-due amount by the total outstandings the percentage of past-due indebtedness is arrived at, which can be used as a barometer indicating whether the general trend is downward or upward. When this percentage increases faster than it should at any given time, proper steps can usually be taken to curb the trend or, perhaps, to bring it back to the normal position which can be ascertained after such record has been maintained for some time.

It is of utmost importance in this connection to make allowance for differences in amount of sales. For example, the percentage of past-due accounts may be 16 on Dec. 1, and 12 on Jan. 1, although the amount of past-due indebtedness in dollars and cents remains the same. This is so because the preholiday sales during the month of December effected

a considerable increase in the sales figure over the previous month on which this percentage is based. As soon as some of the accounts receivable are liquidated, the tendency is for the percentage of overdue accounts to increase, unless a material improvement is at the same time effected in collections of the more stubborn accounts.

Age Analysis of Accounts.—It is generally recognized that the distribution of accounts receivable, by months of origin or by the length of time they have been outstanding, has a direct and important relationship to the rate of collection and the probable net loss from bad debts. It is advisable therefore to age the accounts at least once or twice a year, and sometimes even on a monthly basis. When such a practice is followed, the accounts are usually divided in case of a retail store into those that are not due yet, those that are 30 to 60 days past due, 60 days to 6 months, 6 months to 1 year, and over 1 year. Mercantile establishments age their accounts on a shorter interval basis, namely, accounts not due, 30 days past due, 30 to 60 days past due, 60 to 90 days past due, and 90 days and over past due.

Many houses have adopted the wholesome practice of compiling lists periodically, usually monthly or quarterly, giving the names of the customers whose accounts are overdue, the amount involved, and the extent to which they are past due. Such lists are often arranged by salesmen, especially when salesmen are used extensively in the collection of accounts. They may provide spaces in which to list the various amounts becoming due each month over a period of 3 to 6 months, and the total past-due indebtedness at the end of such period.

In this connection it is interesting to note the relation between the age of past-due accounts and the amount of business that may be expected from them. An analysis made by the author for a wholesale automotive firm showed that only 11 per cent of all customers who were listed during the month of May as delinquent 90 days and over, purchased during the month on regular terms and in usual amounts. A little less than 8.5 per cent bought on credit but in smaller amounts than usual, while over 82 per cent made no purchases during the month on open account. This last percentage was even higher during the month of June, with the total accounts delinquent, 90 days and over, increasing about 20 per cent. Of the total number of such delinquents appearing during the month of June, only approximately 49 per cent also appeared on the slow list for May. Some of the customers in the last-mentioned group purchased a little on a C.O.D. basis, but the bulk of them made no purchases whatever. This would seem to indicate that the easiest way of losing a customer is to allow him to become delinquent over an extended period of time. An analysis made for a grocery firm in the South showed similar results.

In one of the retail grocery stores where such an analysis was made, 17 per cent of the customers delinquent 30 days failed to buy during the current month under survey, 28 per cent of those delinquent 60 days acted likewise, and only 30 per cent of those delinquent 90 days and over bought from the store during the month in question.[1] Moreover, accounts depreciate with age. According to one study, the depreciation followed the course indicated below:[2]

Age of accounts	Depreciation, %	Worth per dollar
30 days	5	$0.95
60 days	7	0.93
90 days	10	0.90
4 months	14	0.86
5 months	19	0.81
6 months	37	0.63
1 year	58	0.42
2 years	74	0.26
3 years	83	0.17
5 years	100 (almost)	0.00

A credit executive in one of the largest institutions, after testing hundreds of thousands of accounts reported the following results, based on the time an account is past due, as in the preceding analysis:[3]

Age	Depreciation, %	Worth per dollar
90 days	10	$0.90
4 months	15	0.85
5 months	25	0.75
6 months	50	0.50
1 year	70	0.30
2 years	80	0.20
3 years	90	0.10
5 years	100	0.00

Slow accounts also call for extra collection effort and expense, additional bookkeeping, extra interest costs in money tied up, and a higher cost of doing business. Furthermore, they may cripple the creditor financially, make it impossible for him to discount his bills, necessitate

[1] For a comprehensive discussion of this subject, see C. W. Phelps, "Age Analysis of Charge Accounts."

[2] *Ibid.*, p. 11.

[3] *National Clothier*, June, 1936, p. 22.

additional borrowing at the bank and otherwise cause unpleasantnesses and annoyances. Knowledge of the exact situation on this score is likely to lead to improved collections and to efforts to remedy it in time.

New Accounts Opened.—The number of new accounts opened during any given period will indicate the extent to which emphasis is being placed upon credit service and whether or not the business enterprise is alive to its opportunity for attracting new trade to the house. In the retail field, the number of new accounts opened may serve as a means of measuring the effectiveness of store publicity. In all types of concerns, this figure together with the rejection percentage will measure the strictness of the concern's credit policy.

Rejection Percentage.—A record of growing importance is that of the proportion of applications for credit declined. In department and women's ready-to-wear specialty stores this percentage varies from 8 to 30, depending upon whether the store is lenient or conservative in its credit granting policies and the stage of the business cycle. One source reports that the percentage of applications rejected by department stores in 1936 on regular charge accounts was 10.28 and on instalment applications it was 6.3.[1] In the mercantile field the rejection percentage is no doubt smaller, although no statistics of a reliable nature are available on this point. Not only is it valuable to have the percentage of applications for credit declined, but it may also be worth while to know how much business is lost by refusing to approve orders from old customers. Only then could an estimate be made of the total amount of business that has been rejected, which can be used as a gage in determining the relative strictness or leniency of the credit policy followed.

Suspense and Profit and Loss Ledgers.—It is the practice of some firms to transfer all doubtful accounts of a certain age, say accounts that are 90 or 120 days past due depending upon how lenient a policy any given vendor is following, to what is known as a suspense ledger. Thorough collection treatment is applied to all accounts thus transferred. If the treatment has been unsuccessful, the account is then transferred to the profit and loss ledger. In other firms, all accounts of a given age are transferred directly to the profit and loss ledger, dispensing entirely with the suspense ledger routine. Transfers to either of these ledgers are made periodically, usually once or twice a year. Monthly transfers are much to be preferred, inasmuch as they make available information that is timely and may lead to some unexpected recoveries.

Whichever method is being followed, it is advisable to prepare a chart at certain intervals showing the number of accounts and amounts charged to suspense; the amount recovered; net loss or amount charged

[1] HAGIOS, J. A., "Retail Credit Manual (1937 ed.)," National Retail Dry Goods Association, p. 45.

to profit and loss as uncollectible; the percentage of bad debts to total sales and to credit sales, respectively; and the balance in suspense.

Cost of Carrying Accounts Receivable.—Much light could be shed on the policy of charging interest on all overdue accounts, on the construction of terms of sale, and on other important credit and collection policies, if more knowledge were available concerning the cost of operating on a credit basis and of carrying receivables on the books. To be sure, bad debts afford one such measure, but losses from bad debts are but one item in the operation of a credit department. In addition to bad debts, there are other expenditures the total of which normally far exceeds all losses from bad debts. There is interest on the outstandings, bookkeeping expense incident to the operation on a credit basis, and other credit and collection expense including fees and dues for credit information and for outside assistance in making collections, cost of credit and collection correspondence, and salaries of the officials in charge of these functions.

While numerous estimates have been made from time to time as to the cost involved in operating a credit department, most of them have proved unreliable. Furthermore, they all failed to allocate the cost of carrying accounts receivable on the basis of their age and other factors. One such study[1] of a mercantile concern revealed that not only did the

COST OF CARRYING ACCOUNTS RECEIVABLE IN A MERCANTILE CONCERN WITH SOME 4,000 ACTIVE ACCOUNTS
(Expressed in per cent of net sales)

Item of expense	Actual terms				
	15 days	40 days	60 days	90 days	120 days
Interest, 6 %	0.25	0.666	1.000	1.50	2.00
Bad debts	0.52	0.587	0.640	0.72	0.80
Bookkeeping	0.51	0.700	0.900	1.10	1.30
Credit department and collection expense	0.39	0.450	0.494	0.58	0.64
Total expense	1.67	2.403	3.034	3.90	4.74

interest charge vary with the length that the accounts remained on the books of the creditor, but that there also was a direct relationship of losses from bad debts, bookkeeping expense, and other credit and collection expense to the age of the accounts. Thus, when accounts remained on the books 120 days the cost of carrying them was about twice as high

[1] HECKERT, J. B., "Relation to Net Profits of Cost of Carrying Accounts Receivable," *The American Accountant*, November, 1928; also J. B. Heckert, and I. J. Stone, "Wholesale Accounting and Control," p. 176.

as the cost of carrying accounts that remained 40 days on the books. This is but an indication of the need for actual knowledge of costs and of what may be accomplished through studies in this direction properly executed.

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Questions and Problems

1. Is it good practice to judge the efficiency of a credit department by the amount of loss from bad debts? Why or why not?

2. What are probably the four best indexes of credit department efficiency?

3. Store A has an annual volume of business of about $5,000,000, approximately 60 per cent of which is done on a credit basis. Its losses from bad debts average $15,000 a year. What is the percentage of loss from bad debts for the store?

4. Of what significance is knowledge of the relation of credit business to the total volume of sales?

5. The collection percentages for Company B are 70 for the month of September, 85 for October, and 80 for the month of November. The receivables at the beginning of September were $65,000. The sales during the months of September and October are estimated to be $150,000 and $98,000, respectively. What collections can be expected during the months of October and November as a means of providing for cash disbursements?

6. Convert the collection percentages for the months of September, October, and November into a turnover of receivables in days by use of an approved formula.

7. What purpose or purposes can be served by an age analysis of accounts receivable?

8. How can the relationship of loss in business to past-due accounts best be brought to light? Explain.

9. Is the rejection percentage alone an adequate indication of a firm's credit policy? How can it be checked up?

10. What is involved in the cost of carrying accounts receivable? What factors tend to influence such cost?

APPENDIX

CUSTOMARY TERMS OF SALE IN DOMESTIC TRADE

The following customary credit terms in the mercantile field are submitted to acquaint the student with some of the practices in different lines of trade. Much of the information has been gathered together by W. H. Steiner for the Federal Reserve Board and charted by John Whyte, formerly Director of Education and Research of the National Association of Credit Men. Certain portions of this list were adopted from a compilation made by R. F. Prudden in his book, "The Bank Credit Investigator." For a few lines of business the data were obtained from the "Mercantile Credit Survey" of the Bureau of Foreign and Domestic Commerce, Domestic Commerce Series, Nos, 74, 77, and 78, U.S. Government Printing Office, 1932. For a number of industries and trades the terms of sale were secured from the various National Recovery Administration Codes of Fair Competition and from "A Study of Open Price Filing in the Electrical Manufacturing Industry," Vols. I and II, by W. L. Thorp and A. H. Caesar, published March, 1936, by the Division of Review of the National Recovery Administration. The remainder of the list was supplied by the author on the basis of original investigation.

Anthracite Coal: S.D.-B.L. to 30 or 60 days net. In certain cases terms are one half per cent 10 days, net 30 days.
Automobile Accessories: Manufacturers' terms, 2/10, net 30 days.
Automobiles: To dealers, S.D.-B.L. attached.
Automotive Supply Houses: 2/10th prox., net 30 days.
Bacon: One half per cent 10 days; also one half per cent 10 days, net 30.
Bale Goods: 2/10, net 60.
Bars (Sheet): One half per cent 10 days, net 30.
Beans: One and one half per cent in 10 days, net 30 days.
Bearings: 5/10, net 30.
Bedding and Pillow Material: 2/30, net 60.
Blankets (Retail): 2/10, 60 days extra.
Blanks (For cut glass): 1/30, net 60.
Bolts, Rivets, Nuts: Less than ½ inch, 1/10, net 30.
Bottles: 1/10, net 30.
Boxes: 1/10, net 30.
Brass, Copper, Rods, Wire Sheeting and Tubing: 1/10, net 30.
Brick (Common): Five per cent E.O.M.; varies as low as 2 per cent, depending on locality, etc.
Brick (Face): 1/10 days; also 2/10 days.

Builders' Supplies: Two per cent, tenth proximo.

Building Wire (rubber covered): 2/10th prox., net E.O.M. prox.; to wholesalers: 2/15th prox., net E.O.M. prox.

Candy (Bulk): 2/10, net 60 days.

Canned Goods, General (Maine and Colorado): 1½/10, net 60.

Carpets (Regular Stock): 4/10, 60 extra.

Carpets (Made to Order): 4/10, net 60 days.

Cement: 3/10 days.

Chemicals and Drugs: 1/10, net 60; also 2/10th proximo; medical and technical, 1/10, net 30; chemicals, Pacific Coast, 1/30, net 60; drugs, general, 2/10 days; drugs, general, large wholesale houses, 2/10, net 60 days.

Chili Con Carne: One and one half per cent 10 days, net 30.

China: 1/10 days.

Cigarettes: 2/10, net 60.

Cigars (Imported): 1/10, net 30; domestic, 1/10, net 60; in some instances terms run net to 4 months.

Clams (Minced, Pacific Coast): 1½/10, net 30.

Clothing Material (Men's): 2/60, net 120 days.

Clothing (Men's): 4/60 days; 6/10 days; 7/10 days; 8/10 days; 9/10. Probably the commonest terms are 7/10, 60 extra to 4 months net; also 7/10 season's dating, 30 days net; and 2/10, 30 to 60 days net.

Coal and Coke: S.D.-B.L. to 30 or 60 days net; to retailers: no cash discount, net 30 days.

Coat Leather: 2/10, net 30.

Coats and Suits: 2/10, net 30; also 5/10 days.

Coffee: Green, to small jobbers, one half per cent 10 days, net 30; roasted, 2/10, 30 days extra; roasted, in West, 2/10, net 60; green 2/10, net 90 days; jobber to retailer, roasted, 1 to 2/10, net 30 days.

Collars (Men's): 5/30 days; also 6/10 days.

Confectionery: Manufacturers' terms, 2/10, net 30 to 60 days.

Containers, Shipping (Shooks): 1/10, net 30; 2/10, net 60.

Corduroys (Men's and Women's): General terms, 10/10 days; also 8/60 days.

Corsets: Local trading, 2/10, net 30; Pacific Coast, 2/10, net 60; terms 5/10 used to moderate extent; retail terms, 5/10, 60 extra, also 7/10 days.

Cotton (Raw): S.D.-B.L. attached.

Cotton Goods: 2/10, 60 days extra. Also season's dating, which is October 1 and April 1. Delivery is usually made from May for October dating and from November for April dating.

Cultivators (Wheel): 1/30, net 60.

Cut Glass: 1/30, net 60; also 2/10, net 30 days.

Decorations (Interior): 6/10, net 60 days.

Drugs and Chemicals (See "Chemicals and Drugs").

Druggists' Sundries: 2/10, net 30.

Dry Cells: 2/10 or 10th prox., net 30 or 60 days.

Dry Goods: 2/10, net 60 days; also 2/10-60 with an extra 1 per cent for payment within 10 days. Other terms in common usage are 3/10, 2/10-60 (Extra), net 90 days.

Electric Arc Welding Apparatus: Net 30 days.

Electric Fans: 2/10 days, net 30 days.

Electric Heating Appliances (Domestic): 2/10, net 30 and 2/10, 90 days net.

Electrical Products: 2/10 to 5/10, with net terms varying from 30 to 60 days.

Envelope: Wholesale, 3/10 days.

Fabrics (Worsted): 7/10, 60 extra.
Feathers: To manufacturers, 10 per cent E.O.M.
Fish (Canned): One and one half, 10 days, net 30 days.
Flashlights: 2/10 or 10th prox., net 30 or 60 days.
Flour: One and one half per cent 10 days, net 60 are used extensively; 1/10, net 30 used in rare cases. Terms vary according to grade, size of shipment, keenness of competition, and the like. S.D.-B.L. often employed on carload shipments.
Food products, Wholesalers and manufacturers selling to retailers: No cash discount, 30 days; 1/10, 30 net; 2/10, net 30 days.
Fruits and Vegetables (Canned): By packer, 1½ to 2/10, with net period varying from 30 to 60 days; wholesaler to retailer, 1/10, net 30 to 2/10, net 60.
Furniture: General terms on less than carload lots are 2/30, net 60 days; on carload lots, 5/30, net 60 days. Occasionally, 4/10, 60 extra. Terms are not strictly adhered to due to competitive conditions.
Furs: 2/10 days on cheap grade; 7/10 days on best grades.
Gasoline and Oil: No cash discount, net 30 days; 1/10, net 30; 2/10, net 30.
Glass: Window plate, 1/10, net 30 days; flint and lime, 1/15, net 30.
Glove Leather: 1/10 days; also 2/10, net 30; also 2/10, net 60; also 3/10 days.
Gloves: 5/30; also 6/10 days; 6/30; and 7/10 days.
Gray Goods (Unfinished): 3/10, net 60 days.
Groceries: General items, wholesale, 1/10, net 30; canned goods, 1/10, net 60 days. Wholesaler to retailer, there are three classes of goods from standpoint of credit terms:
1. "Shelf Goods" are sold on 1/10, net 30 to 1½/10, net 60.
2. Sugar, butter, etc., are sold on 30 days net with no discount.
3. Teas are sold 3/10, net 3 to 4 months.

Hams: ½/10 days; also ½/10, net 30 days.
Hardware: 2/10, net 30 to 60 days. On "builders' hardware" proximo terms are frequently employed. "Shelf hardware" is often sold on 2/15, net 30 days and R.O.G. terms; also 2/10, E.O.M.
Harness Leather: 2/30, net 60 days.
Hats (Panama): 2/10, net 30; also 5/10 days.
Harvesting Machinery: 5/60 days; 5/30 terms used as a seasonal variation.
Hay Cutters: 5/60 days; 5/30 terms used as a seasonal variation.
Heating and Plumbing: 2/10th prox., net 30; 2/10th prox., net 60; 2/10, net 30 to 60 days.
Hides and Skins: S.D.-B.L.
Hosiery (General): 1/10 days; to retailers, terms very extensively used are 2/10, net 30 days; heavy woolen, 2/10, 30 extra, and 2/10, 60 extra; also 2/10, net 90; other general terms are 5/10 days to retailers, and 6/10 days.
Implements (Agricultural): 2/10, net 60 with season's dating.
Ingots: One half per cent 10 days, net 30 days.
Iron (Pig): Net 30 days.
Iron (Rolled): One half per cent 10, net 30 days.
Japanese Goods: 2/10, net 60 days.
Jewelry: 5/30, net 4 months. Plain gold rings sold on 30 days net. Loose diamonds sold on 6 to 9 months, settlement being commonly made by note or acceptance. Silverware, of both the "flatware" and "hollowware" types, is sold on 2/30, net 4 months.
Kerosene: 1/10 days in Middle Atlantic States.
Ketchup, etc.: 1/10, net 30, and 2/10, net 30 days.
Laces: 7/10, 60 extra; small industries, domestic, 8/10 days.

Lard: 2/10, net 60 days.
Lead (Chemical Sheet): 1/10, net 30; to manufacturers, 2/15, net 60.
Lead Pipe (Chemical): 1/10, net 30.
Leather: 1/10 on glove leather; on fancy goods, russet, collar and coat, 2/10, net 30, and 2/10, net 60; also 3/10 days; shoes, soles, 3/30; also 4/10; uppers for shoes, 4/30, and 5/10 days.
Lever and Disc Harrow: 1/30, net 60.
Linseed: To manufacturers, 1/10, net 30 days.
Luggage: 2/10, net 30 days.
Lumber: 1/10, and 2/30 days; wholesale, 2/10, net 30; 2/10th prox., net 30; 2/10, and 2/30, net 90. Also S.D.-B.L. to 30 or 60 days net on timber lien notes, freight net cash upon receipt of each car.
Machine Tools: 2/10, net 60 days.
Meats: Smoked and cured, 2/10, net 60; also net 30 days with no discount; canned meats, S.D.-B.L. attached on carload shipments; otherwise ½ to 1/10, net 30 days; fresh meats sold on "cash terms," meaning that goods must be paid for within 7 days after delivery.
Medicine: 1/10, net 60 days.
Merchandise (General): 2/10, 60 extra terms used extensively.
Milk (Condensed and Evaporated): To wholesalers, 2/10, net 30.
Mill Supplies: 2/10, net 30 days.
Millinery: General, 4/60; 5/30; 7/10, 60 extra; and 9/10; millinery and braid, 6/10 days.
Motors, Electric (Fractional Horse Power): net 30 days.
Musical Instruments: 2/10, net 30.
Neckwear: 5/10, 60 extra.
Nightwear: 2/10, 30 extra; 2/10, 60 extra; and 3/10 days.
Office Appliances: 2/10, net 30; and 2/10, net 60.
Oils: 1/10, net 30; branded, carload or less, 1/10, net 60; linseed oil, 2/10, 30 extra.
Overalls: 1/10; 2/10 days.
Paints: 1/10, net 30; paints and varnishes, dry packets, 2/10, net 30; mixed paints, 2/10, net 60. Paint, oil varnish, and wall paper houses selling to retailers: 2/10, net 60 days.
Paper: 2/10, 30 extra on book paper, printing paper of fine grade, towel and toilet, and waxed paper; 2/30, net 60 days on wrapping paper, wholesale; and 3/30 days on book, cover, mill, and wrapping paper. Cash discounts largely used and net terms are unusual. Paper and paper products sold to retailers: 2/10, net 30; 2/10th prox., net 30 days.
Peanut Butter: 1/10, net 30..
Phonographs: 2/10, net 30.
Piece Goods: 7/10, net 4 months; woolen, 10/10, net 30.
Pipes, Tubings, and Fittings: 2/10, net 30 or 60 days.
Pottery: 1/10, 2/10, net 30.
Preserves: 2/10, net 30.
Rails: ½/10, net 30.
Rivets: One half inch and larger, ½/10, net 30 days.
Rods (Wire): ½/10, net 30.
Sardines (Maine): One and one half per cent 10 days, net 60 days.
Sauces: 1/10, net 30; 1½/10, net 30; 2/10, net 30.
Saws: 2/10, net 30 days.
Seeding Machines: 5/30 days.

Seeds, Vegetable and Flower: 1½% in 10 days, 60 days net; 2/10, net 60; Farm and Grass Seeds often sold on cash terms.

Shipping Containers (Shooks): 1/10, net 30; 2/10, net 60.

Shirts (Working): 1/10; 2/10, 2/10, 60 extra; others 2/10, net 60.

Shoes: 1/10 days in New England; to retailers, 2/10, net 30; 2/10, net 60; 3/10; to department stores, all styles, 5/10 days.

Silk: Thrown, 2/10, net 90 days; 6/10, 60 days' dating, with season datings January 1 and July 1. Raw silk, European, 60 days. Japanese raw silk, 4 months net, settled mostly by trade acceptances. Spun silk, 6/10, net 30; broad, ribbon, 6/10, net 60.

Silverware (Sterling): 2/10, net 30.

Skirts: 2/30; 3/10; and 8/10.

Soups (Canned): 1/10, net 60; 1½/10, net 30.

Spices: 1/10, net 30; 2/10, net 60; whole, 1½/10, net 30.

Spools: 1/10 days.

Stationery: 2/10, net 60.

Steel: ½/10, net 30 days.

Sugar (Refined): To wholesalers and manufacturers, 2/7 R.O.G.

Suspenders: To jobbers, 2/10, 60 extra.

Teas: Importer to wholesaler, 3/10, net 4 months; wholesaler to retailer, 2/10, net 120 and 5/10, net 60 to 120 days.

Textiles: Cotton cloth, 2/10, 60 extra. Cotton in the gray, 10 days net. Woolens (piece goods), 7 to 10 per cent discount with net period varying from 30 days to 4 months. Dress goods, including worsteds, 7/10, 60 days' dating; also season datings; sometimes 30 days net E.O.M. Silk goods, 6/10, 60 days' dating; sometimes 7/10 E.O.M. Linens, "regular terms," 6/10, 60 days' dating; "net terms," 2/10, 60 extra; "net net," spot cash, with no discount and no dating; also 3/10 E.O.M. and 3/10 R.O.G. Velvets, including plushes, 6/10, 60 days' dating, with season dating as of April and October 15; to manufacturers in the millinery trade datings are as of January and July 1.

Tiles: General, 3/30, net 60 days; hollow, building, 5/15 days.

Tin Plate: 2/10, net 30 days.

Tire Rims: To retailer, 5/10, net 30 days; 5/10th proximo.

Tires (Rubber): 5/10th proximo used extensively when discount is given.

Tobacco: Smoking, twist, plug, 2/10, net 60. Tobacco products sold to retailers: 2/10, net 30 and 2/10th prox., net 30 days.

Towel Material: 3/10, net 60.

Trousers: 5/60; 6/30; and 7/10.

Tubes: Seamless, 2/10, net 30; welded, 2/10, net 60.

Underwear: Knit, wholesale and retail, 1/10, net 30; heavy weight, wholesale and retail, 1/10, net 60; light weight, wholesale and retail, 1/10, 60 days extra; cloth, wholesale and retail, 2/10; 60 extra; general, 2/10, net 90; light weight, wholesaler, 2/30; cotton, women's, 7/10; 60 days extra; muslin and cotton, women's, 8/10.

Upholstered Furniture: 2/30, net 60 in most cases; 5/30, net 60.

Upholstery (Auto): 2/10, net 60; 6/10, net 60.

Varnishes: 1/10, net 30.

Varnishes and Mixed Paints: 2/10, net 60.

Velveteens: 6/10, net 60.

Wagons: 5/30; also 5/60.

Waists: Women's, cheap grade, 2/10.

Watches: Trade-marked, 6/10 to 30 days, net 4 months.

White Goods: 2/10, net 60; also 2/10, 60 extra.
Wire Goods: 2/10, net 60.
Woolens and Worsteds: 7/10, net 4 months; also see "Textiles."
Yarn: 1/10; 2/10; net 60; yarn and thread, rare instances, 1½/10, net 60 days.
Zinc: High-grade, usual terms are ½/10 days; for purchasers of high standing, ½/10, net 30 days.

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