Monthly Review

FEDERAL RESERVE BANK OF ST. LOUIS

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Bank Loans to Business

SUMMARY REPORT OF FEDERAL RESERVE SURVEY OF BUSINESS LOANS

Commercial banks have been playing a significant part in postwar business financing—a more important part than many anticipated in view of the large liquid asset holdings of business firms. The sharp increase in bank loans relative to investments in the postwar period marks a reversal in the downward trend which had been under way since 1920, particularly since 1929. Loans constituted 62 per cent of Eighth District member bank assets at the end of 1920 and 56 per cent at the end of 1929. The drastic shrinkage in loans which accompanied the depression, together with an appreciable increase in bank investments, dropped the ratio to 27 per cent in 1935. After a slight increase in the ratio of loans to total assets in the later thirties, a decline in loans over the war years and the tremendous gain in Government security holdings of banks resulted in the ratio declining to a low of 16 per cent at the end of 1944. The sharp rise in loans after V-J Day raised the percentage of loans to total assets to 17 per cent on December 31, 1945, and together with a decrease in investments, to about 23 per cent at the end of 1946.

The war and postwar trend in loans in the Eighth District is portrayed in the chart. The demand for bank credit during the war period was influenced primarily by two opposing forces: the stimulative effects of the war production program and the contractive effects of controls and limitations on nonessential civilian production. Prior to the inauguration of controls, the defense program initiated an expansion which lifted commercial and industrial loans of Eighth District member banks 94 per cent from June, 1939, to December, 1941. This compares with a 70 per cent gain for all member banks in the United States. After Pearl Harbor, nonessential activity began to be curtailed and the liquidation of old loans more than offset the new business loans for war purposes. Important contractive factors were a decrease in the number of operating businesses, higher ratios of sales to inventories and accounts receivable, and a reduction in finance company borrowing due to a decreasing volume of consumer credit. The result was a decline in commercial and industrial loans, the wartime low being reached in June, 1943. Except for seasonal movements, there was little change until June, 1945. Reconversion and replacement requirements, rising ratios of inventories and accounts receivable to sales, and increasing consumer credit engendered a rise in Eighth District member bank commercial and industrial loans from $258 million in June, 1945, to nearly $500 million at the end of December, 1946—an increase of 90 per cent. The increase for the country as a whole was approximately 80 per cent.

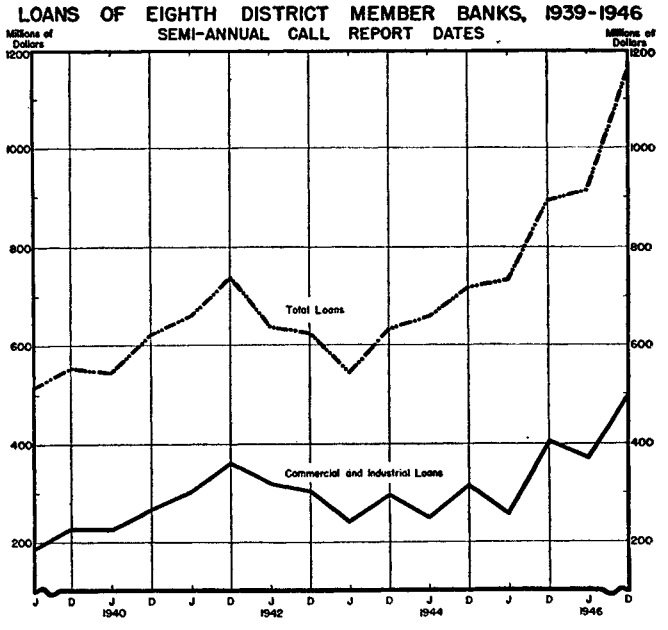
Business loans are important to the banks, the borrower and the community. They are important to the banks because they constitute a large amount of total loan portfolios and provide a substantial share of total bank earnings. In Eighth District member banks, commercial and industrial loan volume currently is about 40 per cent of total loan volume, and total loans provide about 35 per cent of total earnings. They are important to business because they provide a major source of funds for

working capital and for the expansion and replacement of plant and equipment. They are important to the community because an adequate supply of credit on terms adapted to the needs of the borrower is essential for economic growth and development.

THE SAMPLE OF REPORTING BANKS

Despite the general significance of business loans, relatively little information has been assembled as to such things as the terms on which loans are granted, the characteristics of the borrowers, and the extent to which small business is being financed. It was to provide information on such questions that the Federal Reserve System conducted a survey of commercial and industrial loans and real estate loans extended for business purposes, outstanding as of November 20, 1946. In this district, reports were received from a carefully selected sample of 121 member banks. About 25 per cent of the member banks in the district were included in the sample and these banks held about 65 per cent of the commercial and industrial loans of all district member banks on June 29, 1946. The reports of these sample banks provide the basis for the estimates of the number and dollar amount of business loans for all member banks in the district.

This bank's method of obtaining the requisite data for its loan survey was similar to methods employed by other Reserve banks. All member banks in the district were divided into four size classes (based on their total deposits) and each of these size groups was subdivided into three smaller groups (on the basis of geographic location, relative amount of commercial and industrial loans, and type of charter). From each of these groups a sample was drawn at random. It consisted of about one-sixth of the very small banks, one-quarter of the next larger size group, and almost all of the two largest size groups. The reason for the heavy proportion of large banks was that such banks hold many more individual loans than do smaller institutions. To make the sample representative and at the same time avoid placing too much of a burden on the large banks, these institutions were asked to classify all of their large business loans (those of more than $100,000 or $1,000,000, depending on the size of the bank) but only one-sixth of their remaining business loans. The smaller banks were asked to classify all of their business loans. To get roughly equivalent proportions of loans classified by small and by large banks, it thus was necessary to request reports from relatively more large banks than small banks. This procedure spread the work load of getting up the survey data among almost all of the large banks rather than concentrating much heavier work loads on a few such institutions.



This technique provided a sample that was well-balanced and apparently very representative of district banking. Each of the banks drawn into the sample was asked to classify its individual business loans, giving data on amount of loan, term, maturity, business and asset size of borrower, and other details. The response of the banks in the sample was gratifying—about 85 per cent of those originally selected turned in usable reports. In surveys of this type, where a relatively small sample is used, it is highly important that the sample originally selected report in order to avoid possible bias. This condition was met adequately in the business loan survey.

CHARACTERISTICS OF THE BORROWER

It is estimated that all Eighth District member banks held about 29,000 loans, aggregating $547 million, to commercial and industrial firms on November 20, 1946. These loans included commercial and industrial loans (as classified in Schedule A of the call report) and real estate loans for business purposes. They were distributed among businesses engaged in a wide variety of economic activity. Over 5,000 loans for a total of $164 million were to manufacturing and mining concerns, 3,800 loans for $158 million were to businesses engaged in wholesale trade, 11,000 loans totaling $58 million were to borrowers in retail trade, and 8,600 loans aggregating $163 million represented loans to other borrowers, such as transportation and other public

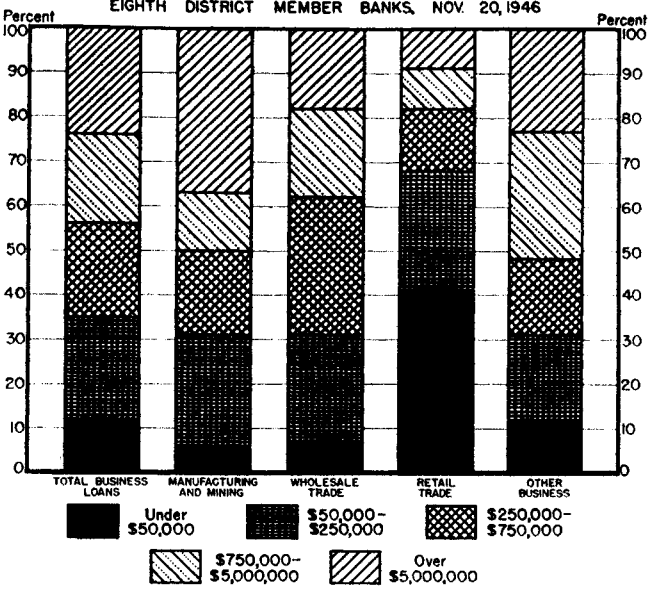
utilities, building and construction and service establishments.

One interesting characteristic of the borrowing firms is that 18,600 of the loans, or 65 per cent of the total, were to firms with total assets of less than $50,000. Another 7,100, or 25 per cent, were to businesses with total assets of $50,000 to $250,000. Hence, almost 26,000 of the 29,000 loans, or 90 per cent of the total, represent advances to businesses with total assets of less than $250,000.

There is considerable variation in the size of borrower among the major classes of business. The small concern is predominant in retail trade and "other business." Some lines in this miscellaneous category are characteristically big business, but most of them, notably small transportation units, building and construction, service establishments, etc., are characteristically small business. About four-fifths of the retail trade loans and two-thirds of the loans to "other business" were to firms with total assets of less than $50,000. Less than 3 per cent of the borrowers in retail trade had total assets of $250,000 or above. This reflects the localized nature of retail trade and the dominance of the small business, measured in terms of the number of stores, in that line. The average size of firm in manufacturing, mining, and wholesale trade is larger and only 47 and 43 per cent, respectively, of the loans in these groups were to businesses with less than $50,000 in assets. Even in these groups, however, only slightly more than one-fifth of the loans were to firms with assets in excess of $250,000.

While the small business accounted for a large majority of the total number of loans, total dollar volume was more equally distributed among the size groups. The concerns with assets under $50,000 accounted for only 12 per cent of total dollar amount of outstanding loans as compared to 65 per cent of the total number of loans. Each of the other four size groups accounted for from 20 to 24 per cent of the dollar volume, the average size of the loan being considerably greater for the larger businesses. In manufacturing and mining and in "other business," 50 per cent and 52 per

DISTRIBUTION OF DOLLAR AMOUNT OF BUSINESS LOANS BY TYPE AND ASSET SIZE OF BORROWER
EIGHTH DISTRICT MEMBER BANKS, NOV. 20, 1946



cent, respectively, of the dollar volume of loans outstanding were to firms with total assets of $750,000 and above. Business firms with assets of $5,000,000 and over accounted for 37 per cent of the total amount of loans to manufacturing and mining companies, reflecting the larger average size of firm which is typical of these businesses. In retail trade the large proportion of the aggregate dollar volume of loans going to the small businesses—41 per cent of the total to those with less than $50,000 of assets and 28 per cent to those with $50,000 to $250,000—is further evidence of the small-scale operations prevalent in this field.

The business loan portfolio of district member banks is well diversified, both the number and dollar volume of loans being distributed among businesses engaged in many different types of economic activity within the major classifications.

The importance of food, liquor and tobacco products in this district is reflected in the distribution of business loans. The processing of these products accounted for 41 per cent of the loan volume to manufacturing and mining concerns and 12 per cent of the district total of all business loans. Metal

NUMBER OF BUSINESS LOANS BY ASSET SIZE AND TYPE OF BORROWER
EIGHTH DISTRICT MEMBER BANKS, NOVEMBER 20, 1946

Asset Size of Borrower	Total*		Manufacturing and Mining		Wholesale Trade		Retail Trade		Other	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Under $50,000	18,630	65	2,370	47%	1,630	43%	8,780	78%	5,780	67%
$50,000-$250,000	7,140	25	1,510	30	1,300	34	2,250	20	2,040	24
$250,000-$750,000	1,830	6	690	14	510	13	180	1	440	5
$750,000-$5,000,000	630	2	240	5	130	4	70	1	180	2
$5,000,00 and over	360	1	150	3	60	2	20	†	130	1
Unclassified	280	1	50	1	150	4	20	†	60	1
Total	28,870	100	5,010	100	3,780	100	11,320	100	8,630	100

* Includes 130 firms not classified by type of business.
† Less than ½ of 1 per cent.

products, machinery, automobiles and transportation equipment were also important borrowers in the manufacturing group. Food, liquor, tobacco and drugs constituted the largest number and dollar amount of loans to firms engaged in wholesale trade, except for the "all other" group which includes, among others, farm feed, jewelry, fuel and paper. Transportation and other public utilities, sales finance companies and "others," including forestry, fishing and real estate, were among the important borrower groups, each taking nearly 8 per cent of the total dollar amount of business loans. Sales finance companies were large borrowers both as to aggregate amount and the size of loan, the latter averaging $117,000 per loan.

DISTRIBUTION OF LOANS BY BUSINESS OF BORROWER
EIGHTH DISTRICT MEMBER BANKS,
NOVEMBER 20, 1946

Business of Borrower	Number of Loans	Amount (In millions)	Percentage Distribution Number	Percentage Distribution Amount
Manufacturing and Mining				
Food, liquor and tobacco	1,130	$ 67	3.9%	12.3%
Textile, apparel and leather	280	7	0.9	1.3
Metals, metal products, electrical machinery, automobiles and transportation equipment	830	35	2.9	6.4
Petroleum, coal, chemicals and rubber	1,020	27	3.5	4.9
All other (incl. lumber, furniture, paper and printing, and stone, clay and glass)	1,750	28	6.1	5.1
Total	5,010	$164	17.3	30.0
Wholesale Trade				
Food, liquor, tobacco and drugs	1,370	$ 38	4.7	6.9
Apparel, dry goods, shoes and related raw materials	260	11	0.9	2.0
Home furnishings, hardware, machinery and metal products, lumber and building materials, plumbing and heating equipment	810	11	2.8	2.0
Automobiles and parts, petroleum	450	2	1.6	0.4
All other (incl. farm feed, jewelry, fuel and paper)	890	96	3.1	17.6
Total	3,780	$158	13.1	28.9
Retail Trade				
Food, liquor, restaurants, tobacco and drug stores	3,720	$ 13	12.9	2.4
Apparel, dry goods, shoes, department stores, mail order houses, variety and general stores	1,300	14	4.5	2.5
Home furnishings, furniture, electrical appliances, hardware and farm implements, lumber and building materials, plumbing and heating equipment	2,840	11	9.8	2.0
Automobiles and accessories, filling stations	2,380	13	8.2	2.4
All other (incl. farm feed, fuel, and jewelry stores)	1,080	7	3.8	1.3
Total	11,320	$ 58	39.2	10.6
Other				
Transportation, communications, other public utilities	2,250	$ 43	7.8	7.8
Services (hotels, repair, amusements, personal, domestic and professional)	2,840	13	9.8	2.4
Building and construction	1,600	22	5.6	4.0
Sales finance companies	360	42	1.2	7.7
All other (incl. forestry, fishing, real estate)	1,580	43	5.5	7.9
Total	8,630	$163	29.9	29.8
Unclassified	130	4	0.5	0.7
GRAND TOTAL	28,870	$547	100.0	100.0

One of the most significant results of the survey with regard to asset size and type of business borrower is the close correlation between the number of loans going to businesses with assets of less than $250,000 and the proportion of all small businesses to total number of businesses. About 9 of every 10 business loans made by banks in this district went to borrowers which (in terms of asset size) would be classed as small business. According to most widely accepted definition, about 9 of every 10 business firms in the United States are small businesses. This district, representative in so many repects of the nation as a whole, probably is equally representative in its proportion of small business establishments to all business establishments. Similarly the proportion of total dollar amount of loans to borrowers in the two smallest classes is in general agreement with the relative share of employment or of sales volume of small business firms as traditionally defined. It appears, therefore, that the banks of this district are not neglecting the financing of small business.

TERMS OF LOANS

One criterion of a good credit system is that lenders fit the terms of their loans to the needs of the individual borrowers. Among the important loan terms are the interest rate, the length of maturity, the type of security and the method of repayment.

DISTRIBUTION OF BUSINESS LOANS BY INTEREST RATE
EIGHTH DISTRICT MEMBER BANKS,
NOVEMBER 20, 1946

Interest Rate* (Annual)	Number of Loans	Amount (In millions)	Percentage Distribution Number	Percentage Distribution Amount
1 to 2 per cent	690	$136	2%	25%
2 to 3 "	1,220	96	4	17
3 to 4 "	2,710	135	10	25
4 to 5 "	7,510	117	26	21
5 to 6 "	6,120	34	21	6
6 to 7 "	8,710	26	30	5
7 per cent and over	1,910	3	7	1
Total	28,870	$547	100	100

* The range in each case is up to, but not inclusive of the higher figure.

Rates charged business borrowers by Eighth District member banks ranged from a low of 1 per cent to a high of 12 per cent. Six per cent was the most frequent charge, this being the annual rate on 8,700 loans or 30 per cent of the total. The majority of the loans were made at rates from 4 to 7 per cent, 77 per cent of the total number falling within these limits. The reverse is true when dollar amount is considered, the bulk of the loan volume being carried at the lower rates. Borrowers representing one-fifth of the dollar total paid 1.5 per cent, and 88 per cent of the dollar total was at interest rates below 5 per cent. Thus banking charges vary according to the size of loan, the large

loans usually being made at rates considerably below the small ones.

The typical business loan in the Eighth District is for one year or less, this category accounting for 75 per cent of the total. The maturity distribution varies, however, both according to size of bank and business of the borrower.

MATURITY DISTRIBUTION OF BUSINESS LOANS OF EIGHTH DISTRICT MEMBER BANKS, NOVEMBER 20, 1946,

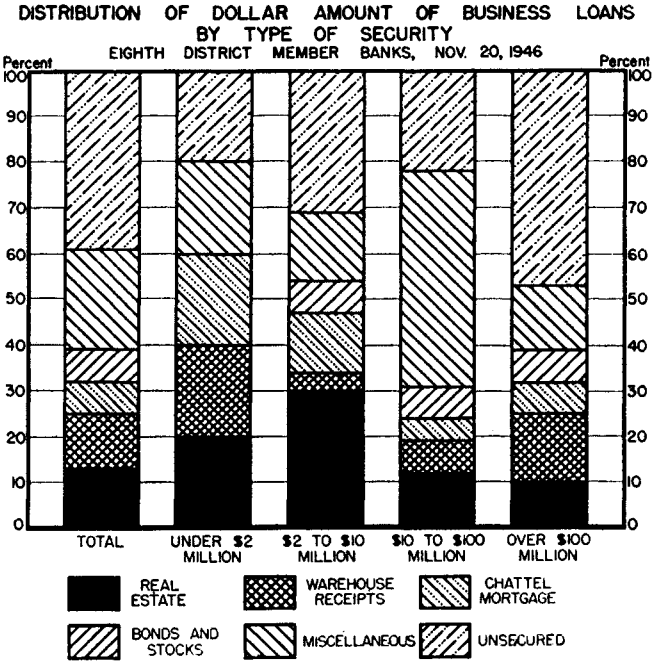
BY SIZE OF BANK

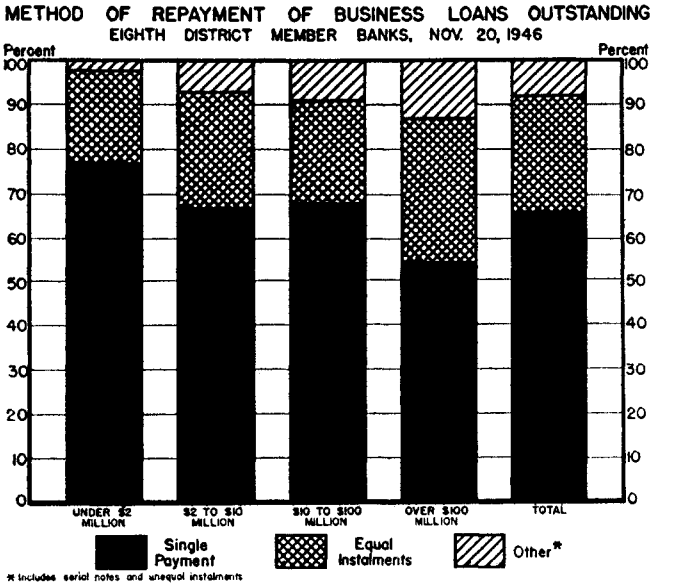
Size of Bank	Amount (In millions) One Year or Less	Amount (In millions) Over One Year	Percentage Distribution One Year or Less	Percentage Distribution Over One Year
Under $2 million	$ 4	$ 1	82%	18%
$2-$10 million	38	17	69	31
$10-$100 million	118	20	86	14
Over $100 million	252	97	72	28
Total	$412	$135	75	25

BY TYPE OF BORROWER

Business of Borrower	Amount (In millions) One Year or Less	Amount (In millions) Over One Year	Percentage Distribution One Year or Less	Percentage Distribution Over One Year
Manufacturing and Mining	$108	$ 57	66%	34%
Wholesale Trade	148	10	94	6
Retail Trade	40	17	70	30
Other	116	51	69	31
Total	$412	$135	75	25

Banks with deposits of $10 to $100 million had 86 per cent of their business loans maturing in one year or less. This is due largely to the fact that nearly one-half of the loans of this size group were to firms engaged in wholesale trade, 94 per cent of such firms' borrowings being for one year or less. Banks with deposits under $2 million also held only a very small amount of business loans maturing in more than one year. Banks with deposits of $2 to





$10 million and over $100 million held a larger proportion of longer-term loans, the latter particularly holding a large volume of term loans to manufacturing, transportation and public utility concerns. Businesses of this type have been borrowing to meet rather heavy expenditures for plant and equipment.

Of the $547 million of business loans outstanding, 75 per cent were for one year or less. Businesses engaged in wholesale trade with relatively small fixed asset requirements and a high rate of inventory turnover, borrowed only 6 per cent of their funds for more than one year. The heavy expenditure for fixed assets and the greater need for longer-term credit is reflected in a larger proportion of longer-term loans in manufacturing and mining, transportation, and other public utilities. Nearly one-third of the loans to retail trade were for more than a year also, perhaps due partially to the establishment of new businesses which required some credit for the purchase of fixed assets such as building and furniture and fixtures.

The small banks are more likely than the larger ones to require the borrower to pledge some specific security for repayment of the loan. Only 20 per cent of the dollar amount of business loans of banks with deposits under $2 million were unsecured as compared to 47 per cent for the banks with deposits in excess of $100 million, and 39 per cent for all district member banks. Real estate was pledged as security for 13 per cent of the $547 million of business loans, warehouse receipts secured another 12 per cent and stocks and bonds and chattel mortgages secured another 7 per cent each.

The single payment continues to be the most

widely used method of repayment, 66 per cent of the total number of loans utilizing this plan. There seems to be no definite tendency for banks of different size to favor any particular method of repayment. Banks with deposits under $2 million used the single payment method in 77 per cent of their business loans as compared to an average of 66 per cent for all banks, but a larger proportion of their loans were short-term advances to retail trade—a type of loan for which the single payment method is well suited. The big banks make a larger proportion of instalment loans but they also make a larger percentage of longer-term loans for which this method of repayment is well adapted.

CONCLUSIONS

The demand for business credit depends upon general business conditions and business policies regarding such factors as credit sales, retained earnings, inventory to sales ratio, and the expansion and replacement of fixed assets. Business demand for bank credit, however, depends in addition upon the willingness and ability of the banks to adapt their lending policies to the changing needs of business. Although certain factors, such as the short-term nature of deposit liabilities and regulations affecting bank loans and investments, limit the flexibility of banks in adjusting to new conditions, they must do so as far as possible if they are to compete successfully with other lending agencies.

The loan survey indicates that banks are attempting to meet the credit needs of business and to adapt the terms of their loans to the needs of the borrower. Where credit is needed for fixed assets such as plant and equipment, the longer-term loan is becoming more prevalent. The latter is giving rise also to repayment by instalments which reduces the risk to the lender and facilitates repayment by the borrower. Moreover, many banks are willing to accept a number of different types of security and, if the credit standing of the borrower is sufficient, to dispense with pledged security altogether. In adapting their lending terms to the changing needs of their business borrowers, the banks will profit from a larger loan volume and from business development in the local community.

Clay J. Anderson.

Survey of Current Conditions

The sharp contrast between the first part of 1947 and the comparable period in 1946 well illustrates the restrictive effects of maladjustments in the economy. So far this year, production is running appreciably ahead of early 1946—in terms of the Federal Reserve index of industrial production, about 15 per cent higher. This situation reflects a much more smoothly operating industrial plant now than in January-February, 1946. Labor management friction is considerably less than a year ago, materials flow is much better geared to output, and labor productivity is rising. A vivid example of better conditions is found in the basic steel industry. January production of ingots and steel for castings was almost twice that of a year ago and was at an annual rate only 6 per cent below the wartime peak.

The apparent efforts of top business and labor leaders in some important segments of industry, for example steel, to arrive at mutually satisfactory settlements of their differences without disrupting production, are encouraging. Such efforts, when they occur in the basic commodity producing industries, take on special significance. They reflect not only in continued employment of large numbers of workers (with consequent maintenance of income) but, equally, perhaps even more important, are conducive to a steady flow of key raw materials to manufacturers throughout industry.

Recent price trends emphasize the importance of maintaining industrial output at a high level. Wholesale prices of manufactured goods in January averaged slightly higher than in December, while semi-finished goods and the broad list of commodities other than farm and food products increased at a considerably higher rate. Consumers prices reflect some of the recent increases at the producers' level but constant upward adjustments of wholesalers' prices invariably result in additional pressure at the retail level. Further wage increases may provide temporary relief for some consumers but fundamental and more than short-run benefits can come only as a result of lower prices, which are dependent, primarily, on continued large-scale production. Thus, the relatively stable level of industrial relations so far in 1947 has basic implications with respect to the outlook for employment, production and prices.