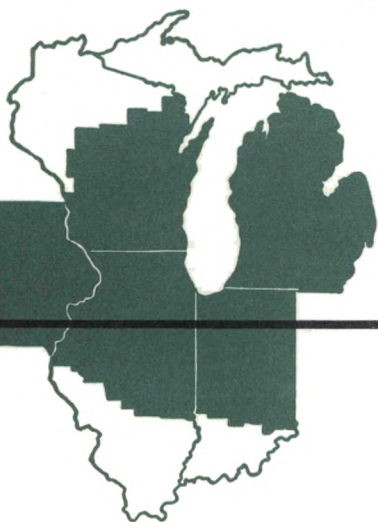


A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1959 February



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THE Trend OF BUSINESS

One of the most striking features of the current business scene is the virtual unanimity of opinion among businessmen and economists that 1959 will be a year of general prosperity. Bullish sentiment predominates, perhaps to an unprecedented degree in the postwar period, and perennial bears seem to have withdrawn, temporarily at least, into hibernation. Moreover, forecasters who are willing to spell out their current expectations in "figures" now commonly project a vigorous uptrend *throughout* 1959.

To be sure, there are exceptions to the ebullient views noted above. They are found in industries, firms and communities where employment, sales and orders have not responded proportionately to the improvement in general business. Individuals in these sectors are apt to be unimpressed by data on the nation's total output. On the other hand, sectors suffering further deterioration are virtually nonexistent. If the optimists are correct, firms back toward the caboose of the economic train will soon begin to feel the pull of acceleration already noted up the line.

Retail trade reports for December indicate Christmas sales reached an excellent volume—up 4 per cent from the record level of a year earlier. As a result, there has been little talk in trade and industry circles of the "first quarter blues" noted in recent years when a slowing of activity during the late winter months raised questions concerning the ensuing spring and summer.

Nevertheless, unemployment has remained relatively high. On a seasonally adjusted basis, wage and salary employment was no higher in December than in September, and the estimated rate of unemployment, off sharply in November, moved up slightly in December. But even here the situation is mitigated by the extent to which the rise in employment has been dampened by strikes and severe weather and by the fact that a further substantial rise in general activity, widely anticipated, can hardly fail to reduce unemployment further.

Dangers in overoptimism?

Some observers cite the unanimity of optimistic opinion to be a reason for taking the other side and suggest that current exuberance could bring about a "flash flood" of boom and bust. It is obvious that an exhilarating business atmosphere can produce overconfidence, with unfortunate consequences. Abrupt shifts in business sentiment have played important roles in some business fluctuations in the past. However, it can be pointed out that extremes of optimism are usually most dangerous after an uptrend has been under way for a considerable period of time. This one has been in process for only ten months.

At the present stage in the business "cycle," widespread expectation of further improvement may help to produce the anticipated result. Spending commitments of many kinds are more likely to be made in

the heady atmosphere of rising sales. Plans for expansion or modernization, temporarily shelved, are dusted off and new ones are formulated. The risk of carrying a larger inventory appears less formidable and the cost, in foregone profits, of an inadequate inventory looms greater. Consumers are more willing to buy new homes or durable goods, even if debt is involved, because prospects that their income will be firm or higher are enhanced. State and local governments are more sanguine about new projects to upgrade public facilities, both because the need for these outlays is more apparent and because the funds required from taxpayers or lenders seem more available.

Inventories starting up again

In November 1958, the book value of total business inventories rose for the first time in over a year. Many observers believe that the build-up will continue for some time to come.

The ratio of total business inventories to total sales reached a high point in March of 1958 at 1.7, that is, inventories were equal to 1.7 months' sales at the March rate. By November, the ratio was down to 1.5, which was just about the same as at the end of 1955 when the rise began. The fall in the ratio between March and November, of course, was a result of two factors—declining inventories and rising sales.

At the present time, inventories of manufacturing and trade firms are considered relatively low. For example, at the beginning of 1959 industry experts believed that steel inventories in the hands of users were near the depleted level reached after the 1956 steel strike. Special January sales of merchandise by retailers were probably less attractive than in other recent years because of the extent to which inventories had been worked down during December. The excel-

Retail sales up sharply in December



lent volume of orders reported at the furniture and home furnishings show in the Chicago wholesale market in January was attributed in part to the reduced levels of inventories in the hands of dealers. Finally, all major manufacturing lines showed sharply reduced holdings in November as compared with last spring.

The 3-4 per cent average annual growth in business activity during the past decade has been about matched by a proportionate rise in inventories. Therefore, business inventories can be expected to rise by about 3 billion dollars per year from present levels if postwar growth trends are to continue. The reduced level of stocks on hand suggests that the rate of increase may exceed the 3 billion figure as 1959 moves on.

Retail sales very strong

On the basis of department store sales, the Midwest participated fully in the vigorous level of retail sales late in 1958. In mid-November, sales at District department stores had lagged 1957 by 3 per cent. However, in

the six weeks ending December 27, a period which can be roughly equated with the "Christmas Season." District department store sales were 6 per cent over the 1957 level. Chicago and Indianapolis about equaled the performance for the District as a whole. Detroit, Milwaukee and Grand Rapids showed gains of 4, 3 and 2 per cent respectively, but many smaller cities recorded much larger increases.

Employment Improves

In late 1958, job totals were rising in all Midwest states, partly for seasonal reasons. However, employment remained appreciably below the previous year in most centers and unemployment was substantially higher. A promising note was sounded by the reports on new claims for unemployment compensation. In November, December and January new claims were well below year-earlier totals in most areas.

One reason for the slow drop in unem-

ployment is found in the growing use of overtime. In December, the average factory work week nationally was 40.2 hours compared with 39.4 hours in the same month a year earlier. Recent figures for Midwest states are not available, but it is apparent that substantial increases in average weekly hours have occurred. Many firms prefer to incur substantial overtime costs rather than hire additional workers. In part this is to avoid possible large-scale layoffs later on. This factor has been particularly important in the automobile industry.

Automobile outlook better

At the end of 1958, sales of new cars rose sharply, although December as a whole was no better than the same month a year earlier on a daily rate basis. Nevertheless, the recent improvement in sales together with prospects for a substantial rise in personal income during 1959 has tended to raise industry sights on prospective car output.

Projections during the January-March period call for 1,640,000 passenger car assemblies—about one-third more than in the same period of 1958. Actual production will depend, of course, upon sales and the extent of work stoppages. But even without a pronounced rise in consumer buying, car production should exceed early 1958. This is largely accounted for by the fact that dealer inventories of domestically produced cars were only 590,000 on January 1 compared with 750,000 a year earlier.

Steel buying on the increase

Steel capacity on January 1 was rated at 147.6 million tons nationally. This total reflected an increase of about 7 million tons in each of the two previous years. Capacity is now 30 million tons or 26 per cent more than the record output reached in 1955 and

Increase in factory man-hours lags production, indicating rise in productivity

December 1958 compared with
December 1956 December 1957
(per cent)

Durable goods

Output	- 7.9	+4.1
Production workers	-14.2	-6.0
Weekly hours . . .	- 2.9	+2.5
Man-hours	-16.6	-3.6

Nondurable goods

Output	+ 4.6	+7.1
Production workers	- 5.9	-2.3
Weekly hours . . .	- 0.3	+1.5
Man-hours	- 6.2	-0.8

1956. Despite ample over-all capacity, many steel users are stepping up their orders. This is partly because of greater current needs, but also because of the possibility of a strike when the current labor-management contract expires on June 30. In addition, there is the matter of availability of particular types of steel and the location of excess capacity. In

December, the rate of steel output was only 75 per cent of January 1 capacity in the nation as a whole, but it was 90 per cent in the Chicago area and 100 per cent in Detroit. Moreover, certain types of steel such as cold-rolled sheets, galvanized sheets and some types of plates are now in short supply and are being allocated informally to customers.

Agricultural exports at high level—but slipping?

World markets for agricultural products, always important to U.S. farmers, assume special significance as the shadow cast by agricultural surpluses lengthens. Even though the acreage planted to crops in 1958 was the smallest in 40 years, an unprecedented harvest was realized, 11 per cent above the output in any preceding year. A harvest of that size assures substantial additions to the already burdensome surpluses of several major crops. And, since the major outlet for these surpluses in recent years has been in foreign markets, the export horizon is being scanned with unusual interest.

One acre in six

Agricultural exports in the year ended June 30, 1958, represented the output of about 50 million acres of cropland—nearly one acre out of every six harvested. In the preceding year, when the volume of exports was at a record level, the shipments abroad accounted for the product of 60 million acres, or one acre out of every five. In only

two years, 1918 and 1921, did exports take the products of more than 60 million acres, and in those years yields per acre were much lower than now.

The importance of exports varies by commodity and therefore by agricultural area. In the 1957 marketing year, over half the production of cotton and more than one-third the production of wheat, tallow, rice and soybeans went into foreign outlets. But all areas feel the impact of shifts in agricultural exports whether or not they produce for export. For example, as cotton exports have declined, farmers in the South have shifted to field crops and livestock, thus expanding output of products which compete directly with the Corn Belt and other areas.

The United States is the leading exporter of agricultural products. Since the end of World War II, the value of U.S. agricultural exports has accounted for one-fifth to one-seventh of the world total. And in recent years it has been equal to the combined exports of Canada and Australia which rank

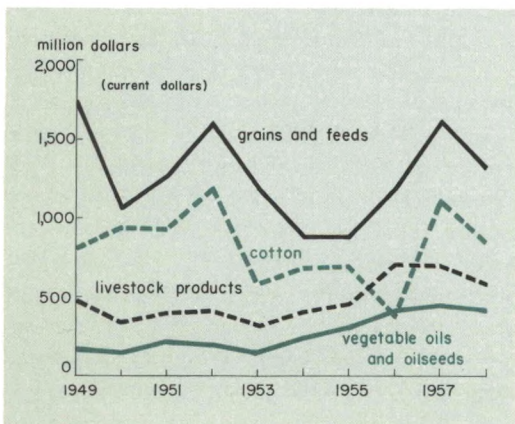
second and third in importance in exports.

Subsidized exports

The Government has played an increasingly important role in U.S. agricultural exports. For many farm products, the domestic price is far above the world price because of price support programs. In order to move price supported commodities into world markets, the Government has had to bridge the gap with subsidies to exporters, or purchase at domestic prices and sell for export at reduced prices. In addition, a number of other programs have been developed to help dispose of surplus commodities abroad. Under these programs, gifts of agricultural surpluses are made to countries threatened with famine, sales are made for "soft" currencies to be spent within the foreign country, agricultural surpluses are bartered for "strategic" materials, and agricultural products are sold on easy credit terms.

Of the 4 billion dollars of agricultural commodities exported in the year ended June

Exports of major crops decline from last year's peaks



SOURCE: U.S. Department of Agriculture.

30, 1958, one-third was under Government programs of sale for foreign currency, barter and grants. In addition, substantial subsidies have been provided to help move commodities in commercial export channels. In the case of wheat, exports both under the International Wheat Agreement and other commercial export sales have had a subsidy averaging 75 cents a bushel the last three years. Similar export subsidies are provided for cotton, corn and some other commodities moving through commercial channels.

More surpluses in the export crops

The biggest gains in crop production in 1958 were in important export commodities. Production of wheat was 50 per cent above the preceding year, output of soybeans was up 20 per cent and corn and other feed grains increased over 10 per cent. Even cotton production was increased 5 per cent in spite of a 20 per cent decline in acreage. Most of this additional output will end up in the hands of the Government, assuming no strong rise in market prices. Current indication is that the rise in stocks held by the Commodity Credit Corporation will more than offset the reductions achieved in three years of diligent efforts to dispose of surpluses and reduce CCC stocks. By mid-1959, the value of commodities held or under price support loans by the Government is expected to exceed the record 8.9 billion dollars in February 1956.

What are the possibilities for reducing the mountainous volume of surpluses going into Government hands? Most domestic surplus disposal avenues have been explored and utilized. The only major type of program not being used now is a food subsidy to low income families. With relatively high income and employment today, compared with 1939-41 when a food stamp plan was last in

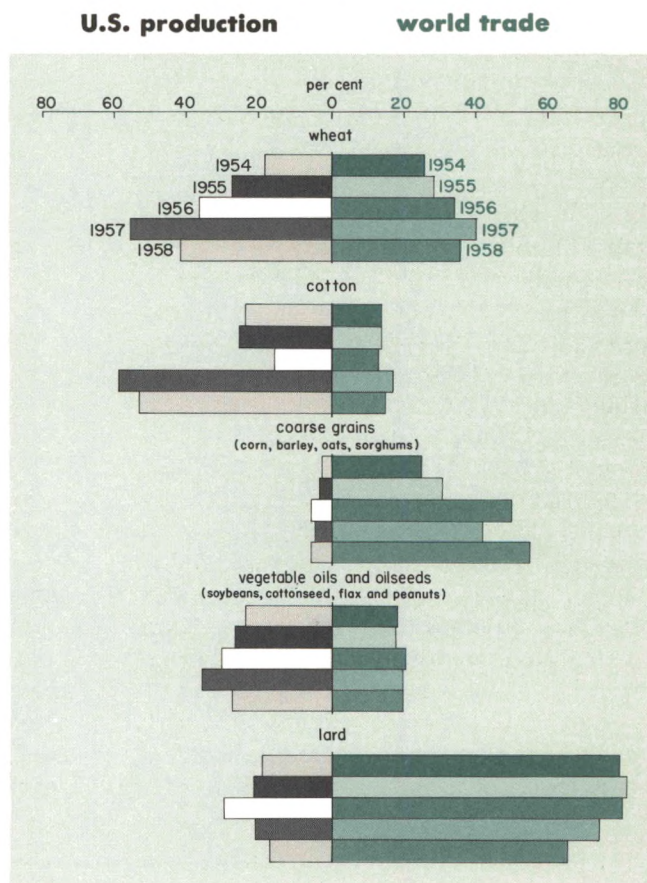
operation, the potential increase in food consumption through this outlet is, at most, modest. Thus, the intensive scanning of the export horizon.

When the expanded surplus disposal programs were instituted in 1954, the basic purpose was to work off the accumulated surpluses of agricultural commodities outside regular commercial channels while new modifications in Government price support programs would help bring an end to further additions to the surpluses. However, the vast increase in productivity in agriculture in the past several years has made what was hoped to be a temporary surplus problem into a chronic one.

Greater foreign demand—

Two events, one recent and the other near at hand, may provide some lift to U.S. agricultural exports. Just before the turn of the year, several European countries announced moves toward greater convertibility of their currencies. This relaxation of restrictions on foreign exchange enables anyone, except the residents of the individual country, to convert a local currency into any other currency, including dollars. In Germany, even the residents can convert marks freely into other currencies. This action could enable importers in these countries to expand imports from the U. S. However, these countries are reluctant to remove tariffs and import quotas on agricultural commodities so long as the U. S. has them.

Exports of these commodities by the U. S. take large shares of . . .



The second event is the official opening of the St. Lawrence Seaway later this year. While the channels into the upper Great Lakes have not yet been deepened to 27 feet, the new locks on the St. Lawrence River will provide entry to the inland by large ocean-going vessels for the first time. One study indicates potential reductions in shipping costs could be 15 to 20 cents a bushel of grain. This would help to strengthen the competitive position of Midwest farm

commodities in the world markets.

— and greater competition?

At the same time the European countries were easing restrictions on foreign exchange, Argentina announced a devaluation of its currency in a move to spur its exports, particularly of wheat. To this must be added increases in production of agricultural export commodities in other countries under the umbrella provided by U.S. support prices prior to our export subsidy program. Mexico, for example, has greatly increased its production of cotton. France, in the year ending June 30, 1958, was the third largest exporter of wheat. The U.S.S.R. has increased production and exports of wheat, although most of this goes to eastern European countries. Larger production of tobacco abroad is expected to bring reduced U.S. exports.

Thus, the prospect of expanding exports to accommodate the increased supply of farm commodities is not encouraging even

U. S. agricultural exports slip but remain at high level



with the aid of large subsidies. While foreign demand for most imports has remained relatively strong, except for cotton where the recession in foreign textiles has been felt, competition from other exporting countries continues to strengthen. The result is an indicated drop of possibly 5 per cent in U.S. agricultural exports in the current year.

Cyclical changes in retail trade

Year end found retail buying in the nation exceeding its pre-recession tempo. Preliminary figures indicate seasonally adjusted retail sales during December totaled 17.5 billion dollars, about 450 million above the previous record reached in the summer of 1957. At that rate, buying was up roughly

9 per cent from its recession low in February and March 1958. The greater-than-seasonal rise during the fourth quarter restored retail sales volume to roughly the same relationship to disposable personal income that prevailed before sales turned downward in the autumn of 1957.

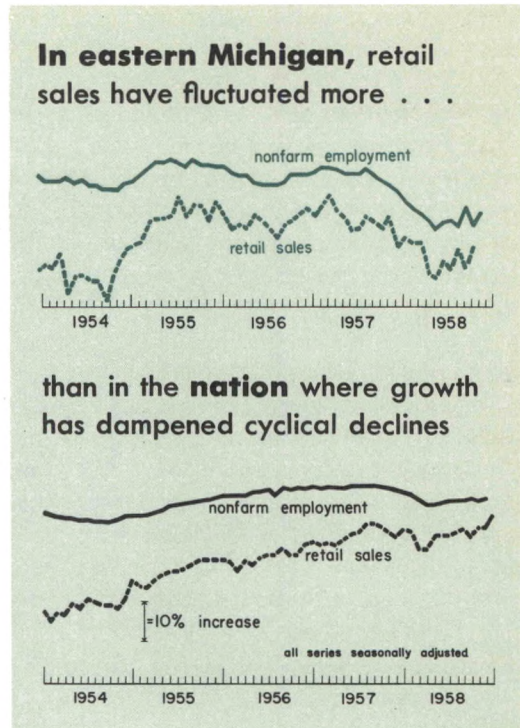
Like most national aggregates, however, total retail sales movements for the country as a whole conceal a variety of crosscurrents. As in most periods of change, not all kinds of business share equally in the current recovery of retail buying. Moreover, striking differences in sales trends are shown from area to area.

In some regions where employment and income declines have been most severe and prolonged, retail sales have only recently begun to show signs of an upturn. Eastern Michigan is such a region. The relatively sharp impact of the recession on retail sales in Detroit, Flint, Lansing and other eastern Michigan cities is tied closely to the ups and downs of the automobile industry. Because of the Michigan state sales tax, more information is available on retail trade patterns and changes in that key region than in many others. Indexes based upon tax collection figures provide an insight into the way consumers react to relatively wide swings in local employment and income in a highly industrialized region.

Area trade patterns

Since 1953, retail sales in 19 eastern Michigan counties have fluctuated between 6.7 and 7.6 billion dollars annually. The great bulk of the sales, of course, is in the larger centers. Stores located in the Detroit, Flint, Lansing and Saginaw metropolitan areas have accounted for 86 per cent of the sales in the region in the past five years. The other two metropolitan areas, Jackson and Bay City, accounted for an additional 4 per cent of the total; the smaller centers provided the remaining 10 per cent.

Consumers in eastern Michigan spend their money for about the same kinds of things as consumers elsewhere if the distribution of sales by kind of store can be taken



as indicative. Food stores and eating and drinking establishments account for the largest segment of retail trade, followed in turn by the automotive and the general merchandise sectors.

Employment and sales since 1953

Movements in nonagricultural employment tend to follow closely the expansion and contraction of business, reaching peaks and troughs roughly coincident with over-all economic activity. For highly industrialized regions such as eastern Michigan, nonfarm employment totals, while not a perfect yardstick, probably provide the best available measure of economic change. In this region, a relatively high proportion of workers is engaged in manufacturing—more than 40 per

cent of the 1957 nonfarm employment total compared with 32 per cent for the U. S.

To aid in comparing short-run movements, both employment and sales as shown in the accompanying ratio chart have been adjusted to eliminate changes of a primarily seasonal nature such as, for example, the decline in employment which accompanies the model changeover in the automobile industry in the fall of the year.

Both employment and retail sales declined in eastern Michigan during the final quarter of 1953 and in early 1954. From October 1953 to the third quarter of the following year, nonfarm employment fell 7 per cent, while retail sales dropped nearly twice that amount. By the end of 1954, however, both employment and sales in eastern Michigan, as in the nation, turned sharply upward. A

6 per cent increase in employment was accompanied by a rise of 24 per cent in retail sales between the lows of the two series in 1954 and their peaks during the following year. The rise in sales in eastern Michigan, moreover, was well in excess of the rise at the national level.

During 1956, employment and retail sales, contrary to the general pattern shown by these indicators for the U. S., slumped owing to a curtailment in auto production in Detroit, Flint and other Michigan automobile centers. As in 1953-54, the sales decline was roughly twice as great as the decline in employment.

From the fall of 1956 to mid-1957, a moderate recovery brought increases of 3 and 13 per cent respectively in employment and retail sales. This period of expansion was followed by a downturn that coincided roughly with the beginning of the 1957-58 business recession. In this latter period, eastern Michigan employment fell by 13 per cent, the sharpest decline observed over the entire five-year period, while retail sales dropped about 22 per cent.

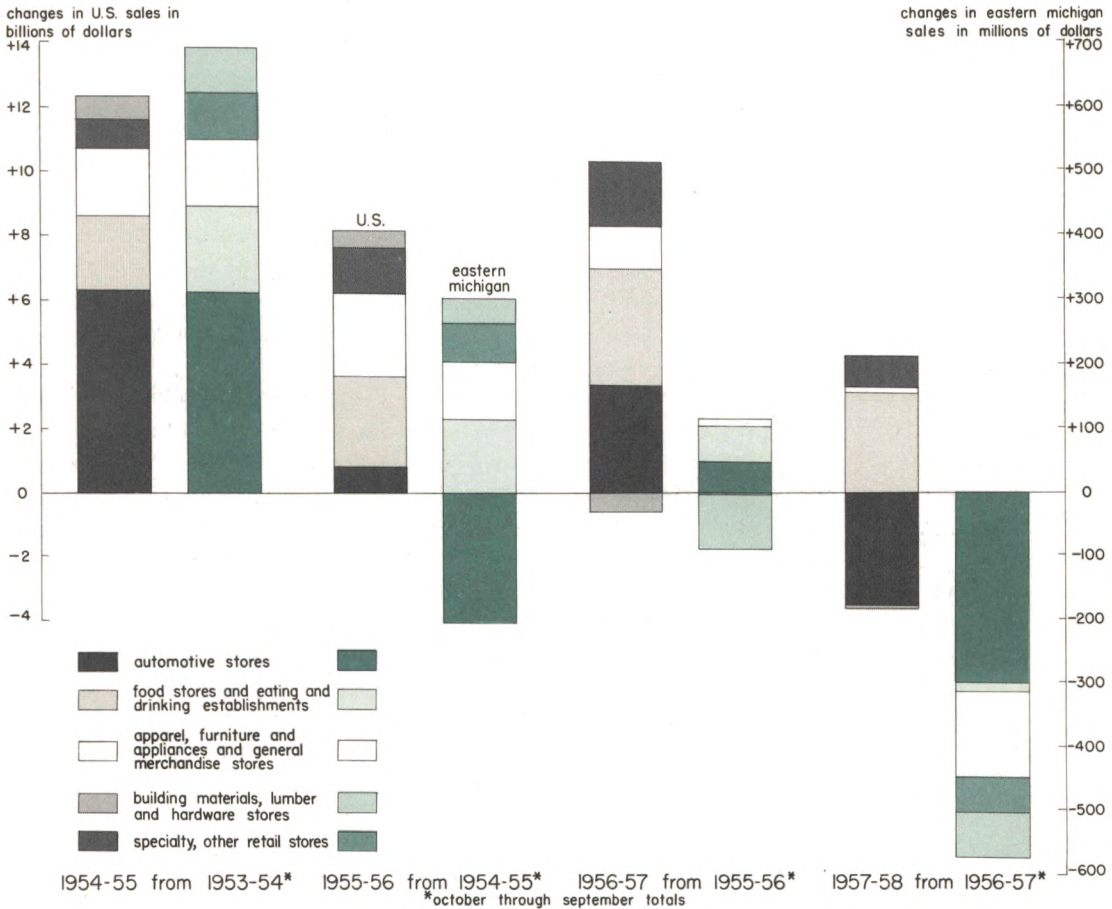
In summary, employment and retail buying in eastern Michigan have shown approximately coincident movements over the past five years. Changes in sales, however, typically have been of much larger amplitude than those in employment. On the upswings, the rise in sales has been three to four times the rise in employment; on the downswings, about twice as great. In part, this is because the number of persons at work does not reflect such factors as changes in the length of the work week, the amount of overtime or wage rates, all of which influence income and spending. Also, the accentuated response is undoubtedly due in part to substantial labor inflows and outflows from and to nearby states. As employment opportun-

Distribution of retail sales by kind of business, eastern Michigan counties, October 1953-September 1958

	Per cent
Food stores and eating and drinking establishments.....	30.9
Automobile, accessories stores and service stations.....	23.6
Clothing and homefurnishings stores....	19.6
Apparel.....	5.2
Furniture.....	4.8
General merchandise.....	9.6
Lumber, building materials, hardware stores.....	8.3
Other retail establishments.....	9.5
Nonretail firms*.....	8.1
Total retail sales.....	100.0

*Service establishments, manufacturers' outlets and wholesale firms which also sell at retail.

The contribution of various kinds of stores to changes in total retail sales, eastern Michigan and the United States, 1953-58



ities decline, the outmigration that typically occurs means there are fewer consumers in the market, as well as lower levels of purchases for those who remain. Conversely, an employment upturn brings new consumers as well as bigger sales to permanent residents.

Sales trends by type of business

The *pattern* of consumer spending as well as its level has shifted significantly in re-

sponse to cyclical changes over the past five years. In the accompanying chart, year-to-year gross changes in sales volume of five major categories of consumer goods are shown for eastern Michigan and the United States. Twelve-month totals are used in order to avoid the need for seasonal adjustment of the sales data for each kind of store. The time span chosen—October through September instead of the calendar year—gives 12-

month periods in which trends are more or less consistent.

Another way of looking at sales shifts is by comparing actual changes with those which would have occurred if each major category had changed by exactly the same percentage as total retail sales. For example, sales of the automotive sector actually increased by 312 million dollars in eastern Michigan between 1953-54 and 1954-55. If this sector's sales had shown the same *relative* increase as total retail sales in the region, the rise would have been only 181 million.

The wide swings characteristic of automobile sales are most prominent in the trade picture of the past five years; they were a major factor in the strong rise in total retail sales from 1953-54 to 1954-55. Such sales also rose faster than total retail sales from 1955-56 to 1956-57, in both eastern Michigan and the nation.

In the second year-to-year comparison, which roughly coincides with a decline in employment in eastern Michigan, automotive sales dropped by more than 200 million dollars. In the nation, sales increased, but at a slower rate than total retail sales. In the 1957-58 downswing, automobile sales dropped sharply, accounting for roughly half of the gross change in over-all sales in both eastern Michigan and the U. S. These wide fluctuations occurred in spite of the inclusion of service stations in this category. Sales of service stations are relatively insensitive to cyclical changes.

Shifts in the sales of building materials, lumber and hardware over the past five years have been more pronounced in eastern Michigan than in the nation as a whole. During the first two periods of change, building materials sales rose more than total retail sales, but subsequently declined at a faster rate. In the U. S., sales of building materials

traced a pattern more comparable to that shown by total retail sales.

Although sales of food stores and eating and drinking places take the biggest bite of the retail dollar, they typically accounted for only 20 per cent of gross changes in retail sales in eastern Michigan during the past five years. Food, of course, is typically the least sensitive of all consumer purchases to changes in income. The inelasticity of food demand is reflected in a rise in its share of the total retail dollar in eastern Michigan to about 37 per cent at the lowest point of the most recent recession. But even this segment showed a slight decline in sales during the 1957-58 downturn, perhaps further evidence of a softening in demand as a result of outmigration from the region. By contrast, national sales of food have increased steadily and lagged behind the total retail sales pace only in the first year-to-year comparison. Sales figures tend to overstate the changes in the *quantities* of food consumed because of price increases since 1955, upgrading and the trend toward more prepared food items.

In volatility, clothing and homefurnishings lie between the extremes of automobile and building materials sales on the one hand, and food sales on the other. Purchases in this segment are largely of a postponable nature and might be expected to be relatively sensitive to income fluctuations. Over the past five years, relative changes in sales of this sector corresponded more closely with changes in total retail sales than any of the other major categories. This has held for both eastern Michigan and the United States.

In summary . . .

In terms of both timing and amplitude, changes in retail sales in eastern Michigan have differed significantly from those in the nation since 1953. Consumer purchases of

goods in eastern Michigan have risen and fallen in response to relatively wide shifts in local employment conditions in the auto industry, which, in part at least, have been unrepresentative of the national employment situation.

National totals, reflecting as they do the net effect of increasing sales in some regions and declining sales in others, can be expected to move less erratically than those for

an individual area. In addition, U. S. retail sales have shown a strong secular growth throughout the past five years which has been lacking in the eastern Michigan region. This growth has tended to dampen the cyclical effect at the national level. Roughly the same effect is noted in the less pronounced cyclical swings in national nonfarm employment, where the trend since 1953 has been upward.

A broader horizon for field warehousing

Business firms who have ready access to credit on an unsecured basis are in an enviable position. That status is dependent upon a combination of factors including a good profit potential and a comfortable equity cushion. Unfortunately, these conditions are not universal. A large portion of the business population must depend upon secured credits if they are to obtain the funds or merchandise needed to maximize profits.

Receivables, arising out of sales to customers, can be converted into cash if they are sold or used as collateral for loans (*Business Conditions*, March 1958). But receivables are created only after sales are consummated. In many lines of business, final sales and production are not closely geared. As a result, a producer's or distributor's available working capital may be frozen temporarily in stocks on hand. The logical solution in many cases is a loan secured by inventory.

Receivables have advantages as collateral

for loans. They represent sales already made. The resulting claims can be assigned readily. Credit ratings of customers can be checked and the validity of their debts verified. The paper evidencing this outright or provisional transfer of claims can be stored safely and compactly.

Inventories as security

Inventories are another story. While the *eventual* sale of any goods at *some* price is seldom in doubt, it is ordinarily not possible to estimate the liquidation value of inventory under forced sale with any degree of precision. Lenders usually are loath to assume the role of merchant, which must be done if goods are acquired in satisfaction of a loan. The use of inventories as security requires that lenders satisfy themselves that the goods under consideration actually measure up to the specified quality and quantity. Also, it is necessary that the lender be assured that

the merchandise will not be reduced in value during the term of the loan through physical deterioration or unauthorized sale.

"Trust receipts" and "factors' liens" are legal devices for establishing a claim against inventory. But the control over goods established in this manner does not involve possession by the lender's agent, and, as a result, the element of faith in the willingness of the borrower to live up to the agreement is very large. Another possibility for inventory loans involves placing goods in a public warehouse so that warehouse receipts can be issued and presented to a lender. This arrangement is often impractical because of location or storage costs. An alternative plan brings the sealed and bonded warehouse, presided over by an independent warehouseman, to the premises of the firm. This device is known as field warehousing.

Under field warehousing the warehouseman usually leases or subleases a part of the client's facilities. The "warehouse" may be a separate building, floor, or room. It may simply be an area fenced off by studding and wire mesh. It can be a part of a petroleum tank farm or lumber yard.

The warehouseman inspects the premises and the goods and assigns a custodian to guard and care for them. This custodian may be an employee of the depositor but he becomes, temporarily at least, an employee of the warehouse company.

The Uniform Warehouse Receipts Act, effective in 48 states, applies to field warehousing as well as public warehousing. Court decisions involving the system have required, as a basis for its validation, that the warehouseman be in "continuous, notorious and exclusive" possession of the goods under his care. This relationship is established by the lease, by numerous signs prominently posted indicating possession by the warehouseman,

and by the fact that the warehouseman responds to the instructions of the holder of the warehouse receipt and not necessarily to those of the owner of the goods. In legal parlance the warehouseman is a "bailee," one who holds something of value in trust.

Goods are released to the "depositor" (the owner of the goods) for processing or shipment upon the order of the holder of the field warehouse receipt (the lender). This can be done on some prearranged basis delivering certain quantities per unit of time or upon the receipt of payment in the form of cash or other consideration. Thus, effective control over the inventory collateral is maintained by the lender, and this result is accomplished with a minimum of interference with the operation of the business of the borrower. In case of bankruptcy, the holder of the warehouse receipt has the exclusive right to the goods if the warehouseman has done his job properly, that is, if the "bailment is valid." If not, the warehouseman's bond should be sufficient to cover any possible loss.

Origins of field warehousing

The idea of field warehousing is at least a century old. However, it did not become a vital factor in American finance until the early 1920's. At that time it was found to be a convenient method of financing the inventory of California fruit and vegetable canners during the interval between preparation and shipment of the year's pack.

In the 1930's, the desire of commercial bankers for adequate security for business loans resulted in a substantial broadening in the use of the field warehousing technique. The number of "active locations" increased from several hundred to several thousand. The device spread to many different types of business.

The recent period of increased credit use, 1955-57, brought another rise in field warehousing activity. As a result, according to industry estimates, the number of active accounts rose to about 6 thousand, ranging in size from 25,000 to several million dollars. The total value of inventory under field warehousing was estimated in the neighborhood of 600 million dollars.

Over 400 lines of business are now represented among the clients of field warehousing concerns. In the 1920's, about 95 per cent of all clients were canners. By 1941, this proportion had fallen to 17 per cent; today industry estimates place it at about 5 per cent. This decline in the relative importance of the food processing industry in the field warehousing picture is a result not only of diversification of the field warehouse clients, but also of the substantial reduction in the number of individual firms engaged in the production and distribution of foods.

Although field warehousing is used in virtually all kinds of manufacturing and wholesale business, it is most applicable to those industries in which sales and production cannot be closely coordinated. In the cherry canning areas of Wisconsin and Michigan, for example, the entire pack is completed in a few weeks in the late summer, but sales are fairly steady throughout the year. Working capital tied up temporarily in inventory can be utilized for a secured loan to help pay for raw materials and other expenses.

Another example of an industry which is benefited by field warehousing is power lawn mowers. Here most sales take place in a few months in the summer, but it may be desirable to maintain production on a fairly steady basis throughout the year. The inventory of finished goods built up prior to the selling season can provide a basis for inventory borrowing.

Obviously, lending on field warehousing is consistent with the traditional "theory" of commercial banking. Banks were thought to be fulfilling their function most effectively when they were providing for the seasonal needs of business to carry temporarily swollen inventories.

Who lends on warehouse receipts?

In the early Forties, it was estimated in a study made by the National Bureau of Economic Research that nine-tenths of the lending on field warehouse receipts was done by commercial banks. Such credit amounted to about 2 per cent of the business loans of these institutions. Today the proportion of warehouse receipt lending done by banks may be somewhat smaller because nonbank lenders, including the commercial finance companies and the small Business Administration, have become relatively more important in this type of lending.

Virtually all of the larger banks in the Midwest have some loans in their portfolios which are secured by field warehouse receipts. Lending on this security is much less common in the smaller banks located in towns in the rural areas.

The amount of money loaned relative to the value of inventory under warehouse receipts varies from 50 to 90 per cent, with 65 per cent the most common proportion. The warehouse company keeps a record of the changes in the physical quantity on hand and the market value. But the lender has the responsibility of assuring himself that the margin of safety remains adequate. Rates of interest charged by lenders on loans secured by inventory generally are comparable with those charged on other secured credits.

Commercial banks are often able to exceed the "10 per cent of capital and surplus" limitation on lending to individual customers

if such loans are adequately secured by warehouse receipts on "readily marketable staple commodities." Under some circumstances, national banks can lend up to 50 per cent of capital and surplus to an individual borrower under this dispensation. In practice, however, banks do not often take full advantage of this fact.

The costs of field warehousing

Charges for the field warehousing service are based upon a percentage of the value of goods passing through the warehouse. This rate ranges from one-half per cent (in the case of very low cost accounts) to 2 per cent. The most common charge is about 1 per cent.

The warehouseman's charge is not greatly different in amount from the typical factor's commission. It can be a substantial item of cost if inventory turns over rapidly. And, of course, the field warehouse does not provide a factor's service in relieving business firms of their credit and collection problems.

Financing distribution

In the past five years, a less familiar application of the field warehousing technique has achieved increasing acceptance. It involves the use of field warehousing to cover shipments made by manufacturers to distributors or other manufacturers. In many cases no financial institution enters the picture.

Field warehousing enables sellers of goods to maintain control over merchandise after it is shipped to customers. This is one way in which large firms have been helping smaller customers whose resources do not provide the basis for adequate credit.

Whenever a supplier ships goods to his customers on credit, he is, in a sense, functioning as a "banker." In this capacity, however, it is ordinarily difficult to secure his financial interest in the merchandise should

the customer encounter financial difficulties. The field warehousing companies have been applying their knowledge and experience to this problem with considerable success. This plan, which is known by such copyrighted names as "Secured Distribution," and "Traveling Credit," or simply as "supplier credit," now accounts for 20 to 25 per cent of all of the business done by field warehousing concerns according to industry estimates.

As in the case of the financial institution in the usual field warehousing arrangement, the manufacturer is able to control the actual release of merchandise to his customer even though the goods are on the latter's premises. Legal title may or may not pass to the customer before release depending upon the form of agreement used. Under either plan, the goods cannot be attached by other creditors in the case of bankruptcy.

If need be, the manufacturer can use the warehouse receipt under supplier credit as security for loans from his own bank. In most cases this is not his object. Usually, his major interest is to place an adequate stock of goods at the convenience of the user without sacrificing control. Supplier credit has been used extensively in the case of shipments of cans from can companies to canners and in the distribution of appliances and air conditioning and heating equipment.

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