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Remarks of H. P. Willis at the Conference of the

NATIONAL ASSOCIATION OF CREDIT MEN

New York, March 9, 1917.

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MR. CHAIRMAN AND MEMBERS OF THE CONFERENCE:

More than a year has elapsed since I had the opportunity of discussing with you the subject which forms the principal topic of consideration this morning. The months have passed rapidly, full as they have been of financial and banking developments of first importance both to the business public and the nation at large. In such times attention tends to be diverted from permanent and underlying problems to those whose nature is immediate and urgent even if of relatively transitory interest. I am pleased to think that in this case, however, the broad question how to improve our commercial paper has not been allowed to become wholly submerged. Real progress has been made, and if this progress seems comparatively small when stated numerically and contrasted with the great figures representing the growth of our total banking operations or of our foreign trade, nevertheless I believe it is general and represents actual advance in the right direction.

The experience of this past year has impressed upon my mind with even greater force than in the past, the belief that the trade acceptance question is not solely a banking problem, and that

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it is not likely to be solved by bankers alone. I believe it is essentially a business man's question - a problem of credit and sales practice, and, as such, to be dealt with chiefly by organizations like your own which have to do with the conditions upon which credit is extended. Theoretical students of banking and the Government officers in charge of banking affairs can and should do much toward the promotion of progress in the use of acceptance. The practical banker can lend his aid by establishing better rates for satisfactory paper, and there is every reason to think that he will do so. Indeed the attitude of the American banker toward the trade acceptance question has been on the whole not only intelligent and understanding, but encouraging and helpful. It remains true that important changes are never effected without pioneer work, and it has become plain that such work will become necessary in order to bring about the general adoption of the acceptance system.

What I have said probably suggests to you that I do not believe it very necessary for me or for anyone to devote much attention to advocacy of the use of the trade acceptance. Every one now knows why it should be used. Every one at all interested in the subject, or led to investigate it, recognizes that the experience of the past, the dictates of good commercial practice in our country at the present time, consideration of economy among

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ourselves, and the broader arguments derived from banking theory, all combine with the idea of preparedness against emergency conditions to dictate the broader use of the trade acceptance. Arguments against its use are those which spring from inertia, custom, unsound competition, and various obstacles of an artificial nature. That it is wise for the buyer of goods to close up his transactions by obligating himself to pay a certain sum at a certain time, thereby reducing his liability to the lowest terms, is evident. That it is good business policy for the seller to obtain a distinct, recognized obligation evidencing indebtedness of the buyer in enabling him to obtain economical credit at his bank, is also beyond question. That it is desirable for the bank to base its loans upon paper evidencing a commercial transaction, and hence limited by the volume of such transactions, protected by two satisfactory signatures and adjusted in such a way as to distribute liability, so far as practicable, is equally evident. When these premises have been admitted, the case is practically closed, as the adverse arguments based upon existing practice in granting trade discounts, difficulties in allowing for defective goods, problems of invoicing, etc., which are rendered more difficult through the use of the acceptance, are of no particular interest except as a mere statement of obstacles to be overcome in introducing the better situation represented by paper of this type, as compared

with the direct loan on single-name paper protected only by open accounts of customers.

Believing, therefore, that the question at issue is no longer a matter of theory, but a problem in commercial education, our discussion of it is at once considerably simplified because the field is narrowed. It is essentially the problem: How shall those who believe in the trade acceptance (as we all presumably do) make their views effective? In this, as in all matters of education, the first appeal must be to the intelligence of the business community. And just here the question arises: Do those who advocate the use of the trade acceptance know exactly what they want? There has apparently been considerable doubt in the minds of many persons who are urging the use of the trade acceptance as to precisely what should be the form of the documents they are advocating. This has led to confusion and difficulty. The Federal Reserve Board has devised a trade acceptance form of its own which is being distributed to those who make inquiry. This form is as follows:

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X. Y. Z. MOTOR CO.

No. _____

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Milwaukee, Wis., _____, 191____.

TRADE ACCEPTANCE

Accepted _____

Payable at _____

Designate bank or

selves _____ Dollars

in settlement of our invoice No. _____ dated _____

amounting _____ dollars, _____ % discount

being deducted for payment of this bill at maturity.

To _____

Place of payment

Signature of acceptor.

X. Y. Z. MOTOR CO.

By _____
Cashier.

The form proposed by the Federal Reserve Board is, of course, not the only one that could be employed to advantage, and doubtless as time goes on, it will be improved. What is important is that all those who believe in the use of the trade acceptance should, as soon as they can, agree upon a form which they are prepared to recommend, and more important still, to explain to the business men who are interested in using it. Personally, I hope that the form which will thus find favor in the eyes of all may be that which is recommended by the Federal Reserve Board; but the only thing that is really necessary is that discussion as to the proper contents of the form, and the conflict between competing types of the trade acceptance should be ended as soon as may be.

Second only in importance to the necessity of agreeing upon and standing firm in support of a good form of trade acceptance, ^{of} is that/agreeing when and under what conditions this trade acceptance is to be used.

I regret to say that views on this subject, which certainly are erroneous and which may be dangerous, have developed and are being spread abroad. I have noted that at various places where trade acceptances are discussed, it is occasionally suggested that they may properly be used to close up old accounts, or that the proper medicine for a doubtful account is a dose of trade acceptance. Of course, if this thought becomes widely diffused, it would mean that the trade acceptance paper of the country would be decidedly inferior

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in value to paper based on quick, active, open accounts. Nothing could more quickly injure or discredit the trade acceptance movement than such an outcome. It should be distinctly and positively understood that the trade acceptance is, in its true form, nothing more than a representative of live indebtedness, and that the acceptance has not been created for the purpose of giving a better hold to the creditor over the debtor, but has been produced in order to create definite evidence of indebtedness which is available for banking purposes. That there will always be in any aggregate of banking paper some items that prove doubtful or slow, is unavoidable and consequently to be expected; but to inject into such an aggregate items known and recognized as slow or doubtful, is quite another matter. To create a volume of paper essentially consisting of slow or doubtful items, would be anything but a reform in banking. This proposition seems to me so obvious that I have noted with surprise in literature sent out from usually authoritative sources the thought that the acceptance as such is intended to liquify "frozen credits." Its real intent is, of course, that of preventing credit from becoming frozen, and anything that tends to obscure this essential character in the trade acceptance, must be regarded as distinctly injurious.

Granting now that we are agreed on the kind of trade acceptance to be used, and agreed also as to the time and circum-

stances under which it should be used, how shall we broaden its application? Shall we wait for the gradual evolution of an understanding on the part of business men who hope that it will, in a certain sense, win its own way to success, or shall we take more direct and vigorous steps in the matter? My own inclination is strongly in favor of the former course. Nevertheless, I recognize that much can be done by force of example, and by a process of education and clarification of ideas. In all such work leadership is essential. I do not think it would be fair to ask the buyer of goods to sign trade acceptances if, by so doing, he should transfer all of the benefits of the open account system direct to the wholesaler or manufacturer. The latter must have his share of the advantage, but not more. The first question to be dealt with, therefore, is whether those who are engaged in extending credit, like yourselves, will figure their requirements down to a point where distinct encouragement is held out to the buyer to make use of the trade acceptance. Undoubtedly there is too much effort to temporize with existing conditions, and to arrange for trade discounts and for the retention of other elements in the present methods of settlement which are inconsistent with the acceptance plan. The proper way of meeting the situation is, I believe, the direct way, that is, the buyer must be met on a business basis and must be offered satisfactory inducements.

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When the buyer has recognized the value of such inducements and has received the benefits thereof in the form of lower prices, he should be compelled to perform his fair share of the bargain by scrupulously settling the acceptance when it falls due. There should, under ordinary circumstances, be no expectation of a renewal of the acceptance. Speaking on this general subject some months ago, Governor Harding of the Federal Reserve Board, presented the following analysis of the acceptance situation:

"The Federal Reserve Act distinguishes clearly between commercial banking and investment banking, and specifically excludes from purchase or discount 'notes, drafts, or bills covering purely investments, or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds or notes of the Government of the United States.' * * * * * It is clear that the intent of the Act is to safeguard the self-liquidating character of acceptances, as securities of an investment nature are barred, and provision is made that the transactions should be based upon either an actual sale of goods or upon the conveyance of legal title to goods which can be readily marketed so as to protect the acceptor.

"The Board was obliged to face, soon after the establishment of the Federal reserve banks, the question of renewals

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of acceptance credits, and ruled that certain renewals of such credits, which clearly grew out of the shipment of goods in the first instance, need not, as a matter of principle, be excluded. American acceptances now are quite well established in the world's market, and while we may expect to see this acceptance business grow into very large figures, we must not permit either our ambition or our desire to assist others, or considerations of profit, to cause us to disregard long-established and sound banking principles."

While these cautionary words were used primarily with reference to bankers' acceptances growing out of foreign transactions, the principle involved in them is equally as applicable to domestic trade, or perhaps even more so, since in domestic business the average period of the representative transaction is, or at least should be, shorter than in foreign trade, while the conditions under which business is carried on are more fully within our control than they are in those cases where we are dealing with foreign nations. The trade acceptance, in short, grows out of an actual business transaction involving a sale of goods, and its natural life closes with the termination of the transaction which gave rise to it, and with the transfer of the goods to the consumer. To renew acceptances from time to time would place them on the same basis with all paper evidencing an ordinary loan at a bank, and there would be no reason

why they should be considered entitled to greater favor than any two-name accommodation paper. This phase of the situation is, in a measure, one with which the banker is directly concerned, since it is to him that we must look for the application of rigid principles with regard to renewals. Much, however, can be done by strong and sound elements in the commercial community, since they can establish a general atmosphere of public opinion relating to this subject which will reduce or eliminate the tendency of some to look for renewals of such paper at the hands of these bankers. If trade acceptances have been properly made in the first instance, however, and do in fact represent transactions of the kind they are presumed to represent, the danger that they will become a medium for renewal credits is not serious; and it may be expected that a very moderate amount of education and expression of opinion will correct any such tendency in that direction as may exist.

To so much perhaps most persons would agree. They would be prepared to admit the essential character of the trade acceptance, the conditions of its use, and the proper attitude to be assumed with respect to its liquidation. There is another ^{is} phase of the subject ~~that~~/probably less obvious, but on that account deserves attention. In every case where an acceptance of any kind is given, the question is naturally raised: What becomes of this acceptance? In the case of trade acceptances there are

not a few firms among those which are now encouraging their customers to give these acceptances, who have no intention to use them as a basis for discount. They are seeking to develop the practice of giving such paper in payment, because it is a cleaner and better way of doing business, and because it provides them with a body of discountable paper if they see fit. There are others which are desirous of developing the business because it enables them to get credit at banks in a better and more satisfactory way. It is with this latter class that the question of the means of discounting the acceptance becomes vital. In this connection the most immediate problem is: Where should the trade acceptance be discounted? Under the existing regime, we may assume that "A" is a wholesaler who sells a bill of goods to "B", a retailer, carrying an account in favor of "B" on his books for perhaps 90 days. If "A" feels the necessity of accommodation, he may obtain from his banker a loan on his own paper equivalent to the indebtedness of "B", confined with that of hundreds or thousands of customers like "B". "A's" bank in this case has furnished the capital with which to finance the dealings of "B", and the group of dealers to which he belongs. The capital has come through the medium of "A" and on the strength of his guarantee, but it has been furnished to "B" and the others. If under the trade acceptance system "A" has, let us say, 1,000 trade acceptances made by "B" and others, he may take them to his bank and may discount them there en bloc. He may, however, arrange with the bank in the city where the buyer "B" is located, to take the draft and hold it until maturity, giving him credit for the proceeds. Here there is a system of credit distribution whereby the duty of furnishing capital is widely diffused among the banks of the country. The banker knows "B", the retailer, and when the paper has been accepted by

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him, is willing to discount it-particularly as, in the event of difficulty, it is a liability of "A". The situation contrasts sharply with the present situation because it amounts to an equitable distribution of loan credits among a considerable number of banks, with the

result that liability is minimized and diffused, while the banks themselves have an opportunity of obtaining good paper which otherwise might not be open to them. Undoubtedly many a large dealer feels that it is no part of his duty to encourage a customer who is unable to obtain the aid of banking institutions to finance himself, or to extend his own credit to such customer in lieu of the aid which the customer should get from institutions close to him. We are now past the period when it was the duty, or at all events the necessity, of the producer to supply their customers the means of carrying on business. To-day there is abundant opportunity for borrowing, and the effort of the Federal reserve banks has been to standardize rates for standard paper. The function of the producer and wholesaler, therefore, is essentially that of enabling the customer to obtain the credit to which he is entitled. On the other hand, the financial institution is aided in extending its credit upon a sound basis, by supplying to it the evidence or data it needs in assuring itself of the true nature of each transaction, so that it can feel certainty that every application grows out of a commercial transaction, and is eligible as a basis for the extension of accommodation. Under the trade acceptance plan the development and application of this view of the relation between the business man and the bank becomes very much easier and simpler than under the

old system. Credit is rendered more stable, and the flow of business to the smaller banks of the country is greatly facilitated. The situation becomes far more wholesome and normal than it is when large banks furnish through the wholesaler or producer the means of "carrying" the smaller business man of a whole trade or occupation. This is a view of the matter that should appeal not merely to the banking community at large, but particularly to the good business man. Such a plan establishes relations between him and many banks the country over for the ascertainment of the credit condition of buyers, and brings the latter into more satisfactory relations with their banks than could otherwise have prevailed. It is, moreover, one of those general aspects of phases of a great commercial problem that appeals most strongly to those who are studying and dealing in credits. This makes it appropriate to present the matter with special force to you because you are better equipped and more directly concerned in its settlement than perhaps any similar group of men.

Although a substantial number of concerns are now using the trade acceptance in their business, this number is a very small percentage of those who might so employ it. There are various parts of the country where practically no change in the older situation has developed. The field, therefore, has been barely scratched, and its intensive cultivation must be

undertaken and pressed forward by those who are brought into that direct contact with business men throughout the country that makes their words persuasive from a practical standpoint. The matter is not, however, solely one of self-interest. It is one phase of the improvement of national credit, the progressive strengthening of business methods, and the elimination of those unsound or doubtful elements of accommodation which tend to weaken all business, and which thereby pave the way for periods of over extension and consequently of expansion. It requires vision and far-sightedness to realize that what is done in urging forward this movement will have results very much broader than those which directly show themselves in cheaper and better rates at banks.

3/8/17