Remarks of H. P. Willis, before

NATIONAL ASSOCIATION OF MANUFACTURERS,

New York, May 16, 1917.

Mr. Chairman and Members of the National Association of Manuracturers:

The subject assigned me opens an almost unlimited field of inquiry. There are many aspects of the relationship between the manufacturer and the bank on which we could profitably spend much more time than is allotted for this meeting. The significance of the topic, I take it, is however found in the fact that just at present there are certain important relationships between the bank and the business world that require attention; while among business men the manufacturer may be considered as having a peculiar and special duty, because of his central place in the productive system of the country.

It will probably always be true that the action of manufacturers with regard to the terms upon which goods are sold will profoundly influence the type of commercial paper, available for discount at banks. So far as anyone can predict, it is likely moreover, to be the fact that the relations between manufacturers and banking institutions will be widely copied by those whose dealings are smaller in volume and less directly in touch with modern methods of finance and production. The manufacturer thus has a double responsibility on every occasion when changes in banking methods are suggested. The present time is one of these occasions, and the question offers itself: What is the duty of the manufacturer in his relationships with the bank at this moment? I like to think that this question is synonymous with this other way of putting it: What is the highest self-interest of the manufacturer in his relationship with the bank? The welfare of the community is best served by the legitimate and genuine prosperity and success of the manufacturer. Anything that advances the true interests of his business, therefore, tends to advance those of the community, and vice versa.

For three years the Federal Reserve Banking System has been in process of establishment. It is not fully organized even as yet; its membership is not complete; its establishment of branches has only just begun; its foreign relationships are only now beginning to be worked out. Domestically it has but just addressed itself with seriousness to its ultimate mission - that of improving the banking and credit conditions under which the business man today lives and works. When we say that the System is fully organized, that it is in working order, that it is rendering yeoman service to the country, that it is affording most valuable aid in the flotation of Government loans, and that in many other ways it has already amply warranted the cost and trouble involved in its establishment, we do not mean that its work is complete. Indeed, as I have already intimated, it has barely begun to perform some of its most important functions.

At the bottom of all better banking and commercial methods in the United States today lies the problem of improved control of credit and the adoption of better methods of issuing commercial paper. It is encouraging that the business men of the country have so promptly interested themselves in this question of better credit and better bank paper. When the Federal Reserve Act was first passed many thought that it was of interest primarily to bankers and that such reforms and improvements as could be introduced would come through the effort of bankers. Experience is showing us more and more that, helpful and necessary as the aid and sympathy of the banker is, we must look to the business man himself for the initiative that will bring about better methods in the two particulars I have spoken of. So, as time goes on, it has been recognized that if there is to be any important improvement in American methods of financing business, the movement must be taken in hand by yourselves. As things have developed, the concrete issue presented to the business public has been this: Are you willing to substitute commercial paper for your open accounts; and will you in this process employ the trade acceptance and banker's acceptance as your media of extending credit? I am happy to know that this question has been answered in the affirmative by some of the most progressive manufacturers in the country. They have set themselves actively to work to adopt this acceptance paper in actual practice; and, although the movement is thus far very young, it has lasted long enough to make plain the fact that there is a genuine appreciation of what may be done and a genuine disposition to do it. It has, moreover, lasted long enough to show that the use of the acceptance paper is beneficial, and there are many manufacturers who to-day testify to the aid they are realizing from the substitution of acceptances for their open accounts. This is most satisfactory and helpful. It is a real benefit, even from the very narrowest standpoint, that the seller of goods should close up his transactions with an acceptance in this way. He gets a definite recognition of the satisfactoriness of the consignment; he receives an acknowledgment of indebtedness; he simplifies his relationships with the buyer, and in every way he is benefitted. The customer likewise finds himself aided by the new method. He is encouraged to be prompt and efficient in his treatment of his indebtedness. There is, furthermore, every reason why he should, if he wishes, retain all of the advantages of the cash discount system, for the acceptance plan has been so developed as to render this entirely feasible of application. The progress already made deserves high commendation, and warrants us in urging those who distribute large quantities of goods but who have not adopted the acceptance system to go and do likewise.

In this matter, however, as in most that involve forward steps in any branch of business, public, or political activity, there is a tendency to attribute imaginary virtues to the remedy offered for a particular evil. As a nation, we are prone to over-praise or over-depreciate what we like or dislike. In the trade acceptance movement it has become too much the fashion to speak of the new form of paper as "creating credit" or as "liquefying frozen accounts", or as a means of "rendering dead accounts available". There is no doubt in my mind that these exaggerated claims tend to alienate sound and careful thinkers who would be attracted by a more sober presentation of the case, while, on the other hand, some who take up the new method but find that it hardly fulfills the predictions of its advocates, are disappointed, throw it down and are lost to the movement. On the other hand, the constant insistence upon certain aspects of the trade acceptance which are less important to its real progress than others tends to divert the attention of some who might become interested in it under more favorable circumstances. I think it is worth while, today, therefore, to consider as simply and plainly as I can, exactly what the trade acceptance may be expected to do, and more important still, to indicate the conditions under which alone the full benefit of it can be realized.

Let me first sketch the contrasting conditions under which goods may be disposed of. You may have sold $100,000 worth of goods to a hundred different buyers, averaging $1,000 each, who have received the consignments, have found them satisfactory and have placed them on sale with the understanding on your part that if they remit to you within a given number of days each man shall receive a discount of 3% on his $1,000 indebtedness, or, in other words, that he will be considered to have liquidated his account in full by sending you $970. The alternative plan in which the trade acceptance is used involves your asking him to accept a negotiable instrument at the time the goods are received and approved by him. This instrument may be drawn to give him the advantage of the discount or without any reference to discount. Let us suppose that he has given his acceptance for a sum representing the amount of the face of his discounted bill - in this case $970 - the maturity being the last day upon which his discount would have been available. If this individual pays his acceptance promptly upon the day of maturity, the only difference between the two situations is that during the intervening time the seller of the goods has been in possession of a recognized legal instrument evidencing the indebtedness on the part of his customer. If the seller has held this acceptance in his safe during its life and has merely returned it to his customer upon receiving the latter's remittance, or perhaps has forwarded it to a local bank to be collected of the customer at maturity, the giving of the acceptance under the conditions set forth has not altered the relation of buyer and seller or the relation of either to the banks of the country. If the manufacturer who is in receipt of such trade acceptances has continued to finance himself meanwhile by giving "straight single name paper" to his bank his actual business methods have not changed. The same is true of the customer. He may be in the habit of borrowing at his bank in order to enable himself to take advantage of the discount on the goods he buys, and if the maturity of the acceptance is the same as the discount period allowed him, nothing has been done that will alter the amount for which he must habitually resort to his banker. There will have been some change in the accounting systems of both the seller and the buyer, but that is the principal change. To represent the acceptance under such conditions as a radical transformation in business and banking methods, profoundly altering the conditions which govern the sale of goods, would, I think, be a mistake.

Let us take a second case. Suppose that the manufacturer who has been in the habit of obtaining $100,000 worth of advances from his bank upon his own single name paper now takes to his bank acceptances amounting to $100,000 which he offers there for discount. Is there or is there not any reason to suppose that his relationship to the bank will thereby be altered as compared with its former status? In some quarters there seems to be a suggestion that whereas under the older conditions the manufacturer might be able to obtain from the banker credit of only say 75% to 80% of the value of his outstanding accounts, he will be able to discount the whole of his acceptances up to face; - that is to day, he will be able to obtain $100,000 of credit where he formerly obtained only $75,-000 or $80,000. If this suggestion be sound, it would mean that a method had been discovered for enlarging by one-third to one-fourth the total amount of credit at the disposal of business men, or in other words, that the business man, without possessing greater assets than before, had enlarged his borrowing power by one-third to one-fourth. Can this be true? The question is one which goes to the root of the whole matter and which is primarily to be answered from the standpoint of banking practice. What is it that determines the banker in any given case to advance funds? As a rule the careful banker makes his advance only after the most minute scrutiny of the statement furnished him by his customer or by the accumulation of credit data from many other sources. He does not want to restrict the credit of his customer unduly; on the contrary, he is usually only too anxious to find a borrower who, he feels, can safely be entrusted with funds. His purpose is to establish a "line" of credit up to which he can safely and wisely loan. When the trade acceptance is offered to him it is on the surface a primary obligation of the acceptor, and the indirect obligation of the drawer. The banker in the case I have described probably has little idea of the acceptor's position or circumstances. The manufacturer may have sent agricultural machinery to some small retailer in the Far West. The manufacturer knows from long years of experience that the retailer is honest and trustworthy, but the banker has no knowledge of him and could probably get such knowledge only by an investigation made through a local bank. When the bank discounts the trade acceptance for the manufacturer, therefore, it looks to him just as before to reimburse it. There is no reason why it should give to the manufacturer more credit than he formerly had.

Now let us take a third case. The manufacturer or shipper has decided to make arrangements with local bankers at the places where the buyers of goods are resident, to extend him the credit he desires. The buyer who accepts is, therefore, asked to make the acceptance payable locally, and the acceptance may be presented by the local bank and left in its hands until maturity, the local banker meanwhile remitting the face of the acceptance less discount to the shipper. Here the local banker has purchased or invested in the local commercial paper of his community. He is, or should be, in good position to make such an investment with safety to himself, because of his knowledge of local conditions. It may be that the purchaser of the goods, who is expected to give the acceptance, is already a customer of the bank. In such event, the discounting of the acceptance may result in altering the form of the credit which he will find it necessary to ask in any event, since he may be in the habit of going to his bank for funds with which to take up his outstanding bills at a time that will enable him to obtain the discount. The introduction of the trade acceptance has not in such a case resulted in increasing the amount of credit extended, but has merely altered its location, either shifting it from the manufacturer's bank at the point of production, to the purchaser's bank at the point where the goods have been received, or else perhaps merely lengthening the time for which the local institution which presented it to the buyer would in any case have carried the obligation. The advantage of the plan is found in the better distribution of credit, the greater certainty of getting accommodation where many banks are thus employed and generally in the wider and more satisfactory organization of business upon lines of recognized commercial accommodation.

The benefits of the plan to the smaller producer or business man are evident when the buyer of the goods is better known than the shipper. If, for example, the Standard Oil Company or the International Harvester Company has purchased goods from a comparatively unknown seller to be paid for in cash, say, 30 days after receipt of the consignment, the shipper would be greatly profited if he could offer to the bank the acceptance of the purchaser of the goods. Such paper would inevitably receive the rate accorded to the well known purchaser, rather than the rate charged by the local bank to the comparatively unknown seller; while he may likewise get distinct advances through the action of the seller in according him a lower price for the goods. One result of such an arrangement is to give to the seller of the goods, whoever he may be, the benefit of the better credit facilities that naturally grow out of the transaction, whether they be those that are produced by the name and standing of the manufacturer, or by those of the buyer. This suggests a thought that has not figured very prominently in the trade acceptance discussion thus far - namely, that it is a poor rule that will not work both ways. Some concerns which have "adopted the trade acceptance" seem to mean that they have required their customers to give them trade acceptances, but do not mean that they have themselves adopted the plan of giving trade acceptances to others. And yet a thorough going and impartial adoption of this method of settlement is necessary if it is to be successful. A plan whereby the small and doubtful customer gave trade acceptances, but the large and "gilt edged" buyer of raw material of other products never gave them but insisted upon the old style open account plan, would hardly promote the standing of the trade acceptance, but would be far more likely to impair it. This thought should be commended to those who are in the habit of suggesting that the business man employ both the trade acceptance and the single name method of financing. Apparently some of these believe that the acceptance plan should be employed in those cases where the credit is somewhat questionable and calls for the introduction of a legal instrument, while it may safely be dispensed with in those cases where credit is known and established and where the borrower's recognized standing enables him to obtain a good rate from his bank under all conditions.

If the local bank can be induced to give its own acceptance in place of the actual purchaser of the goods, protecting itself when necessary by some special arrangement with the buyer, the credit situation is still more satisfactory than it otherwise would be. The local bank has probably better facilities for informing itself regarding the credit status of its customers, than any other institution can possibly have, and if it determines to assume the legal responsibility for the payment of the bill at maturity, it will be still more careful in determining upon its course of action. Its decision in the matter will afford an unmistakable evidence of the opinion locally entertained with respect to the credit of particular individuals, beside placing the responsibility for the credit instrument definitely at the point where the goods are now owned, and where the proceeds from their sale will presumably be received. This method of managing the discount transaction is obviously the one to which the trade acceptance is adapted, and represents part of a banking and credit system to which the acceptance idea generically belongs. It is the plan of financing that is followed in other countries.

All this merely amounts to an elaborate statement of the fact that the trade acceptance is a method and not a material. It is a way of conducting credit relations, not a philosopher's stone for the manufacture of wealth or credit where it did not exist before. Inasmuch as it is essentially a method of financing or of securing credit, it must be applied systematically, sincerely and consistently in order to attain general success.

This analysis makes it clear that the trade acceptance from the banking standpoint is valuable only as it produces a direct effect upon the distribution of credit and lending power. If it proves a method of promoting the investigation of credit and ensuring a wiser and better use of bank funds and a strengthening of the credit structure generally it has an interest whose service can hardly be exaggerated. But, as has just been shown, this service can be rendered only by altering the distribution of accommodation, and the division of labor involved in passing upon and adjusting credits. That such a redistribution is desirable, if not essential, to the proper reorganization of our business system, many have long since recognized. Where the manufacturer or distributor asks for the trade acceptance, it is then re-mailed to him by the buyer at a great distance. The trade acceptance travels back to the point from which the goods were shipped, and may then be held for a longer or shorter period of time, according to its maturity, at the end of which it must again start upon its travels for presentation and cancellation at the place where it was originally accepted. The proceeds of the acceptance must in like manner be remitted by the shipper to the seller, while in the meanwhile the goods which constitute the basis of protection against the acceptance are held and disposed of by the buyer at the point of distribution. The European plan, whereby the local banker accepts the bill at the point to which the goods have been shipped through arrangements with the buyer not only places the problem of determining the buyer's credit in the hands of the local banking interests which are closest to him, but it would also shift to the bank the function of furnishing the funds that were needed when the time came to settle the acceptance. The local banker almost necessarily supplies the funds that were needed to carry the individual merchant in any case, but the thoroughgoing adoption of the acceptance system would give a far deeper insight into the affairs of the business man and a far closer relation to him than he could otherwise obtain. The shipper of the goods meanwhile would have secured himself definitely and positively against loss on the goods which he had thus shipped against a local banker's acceptance. Even if it should for the present prove too novel a step to obtain bankers' acceptances in the way just indicated there is at least the easy possibility of placing the trade acceptance of the local banker for discount and collection, and thus of effecting at all events the secondary object of the acceptance system - that of ensuring a wide distribution of discounts among the bankers of the country, and so far as possible the holding of local paper by institutions situated in the communities where it originates.

You may reasonably ask what advantage there is to be gained in making a transformation of method that would involve so many obstacles and so much genuine hard work as would this. The advantages of the trade acceptance from the narrowest standpoint have been so often set forth that I do not need to repeat them. I am now speaking of the help to be realized from the broader and more thorough application of the underlying principle of the acceptance. In a general way it directly aids the manufacturer and shipper by diminishing the extent of his dependence upon the bank. He does not need to ask for the favor or support of any single institution. He gets the assistance of every institution whenever he is able to present paper evidencing the existence of a bona fide commercial transaction. Better still, he enables his customer (if the idea of the bank acceptance has been carried through in good faith, as already explained) to finance himself at his own bank, and thereby he eliminates long range credits and the necessity of costly and elaborate investigations of credit on his own part. He is able to reduce the cost of the goods to the buyer whenever that buyer is in position to present him with an acceptance that guarantees him against loss, because he is thereby able to avoid any necessity of ensuring himself against bad debts by making excessive additions to the selling price of the commodity he is disposing of. He will succeed in eliminating from the business of the country a large element of bad credit, and in habituating the banks of the nation to the extension of credit upon uniform terms whenever there may be submitted to them concrete evidence of the existence of a real transaction warranting the extension of such credit. In the long run both producer and banker will make great savings in this way. There is nothing in the plan that in any way interferes with or necessitates the discontinuance of the cash discount system, although it permits the elimination of that system more easily and with less friction than any other plan that has heretofore been devised.

Is not this an improvement in business practice well worth contending for? The fact that so many able business firms are already recognizing the merits of the trade acceptance, even upon the incomplete and partial basis upon which it has thus far been applied plainly suggests an authoritative answer. The new system still has a long and difficult road to travel, for, as I have suggested, it is not merely the formal adoption of the method but the incorporation of it into actual financial practice that will bring results. That these results can be obtained only by a process of some length and difficulty is merely another way of stating that no good thing and no great reform is likely to be secured without paying its price in one way or another.

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