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An analysis of instalment credit within commercial banks

Wayne Atwell Freeland

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AN ANALYSIS OF INSTALMENT CREDIT
WITHIN COMMERCIAL BANKS

A Thesis
Presented to
the Faculty of the School of Business Administration
The University of Richmond

In Partial Fulfillment
of the Requirements for the Degree
Master of Science in Business Administration

By
Wayne Atwell Freeland
June 1958

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CHAPTER I

INTRODUCTION

Within the past two decades, the rapid expansion of consumer instalment credit activity by commercial banking has been a noteworthy development. Commercial bankers have made an about face in a brief period of financial history. As recently as the early 1930's the attitude of commercial bankers toward instalment credit was one of hesitance and reluctance. Since that period commercial banks have expanded to become the largest single holder of instalment credit.

Although banks have participated indirectly in consumer lending by making commercial loans to specialized consumer lending agencies, their current trend has been the establishment of their own direct personal loan and time-sales departments.

Consumer instalment credit is relatively new in the field of commercial banking, dating from the mid-1930's. The earliest date for which commercial bank data is available is 1939. At that time commercial banks held \$1,079 million or 24% of total instalment credit.¹ As of December, 1956, this figure has multiplied elevenfold to \$11,682 million

¹Federal Reserve Bulletin. (Washington: Board of Governors of the Federal Reserve System, May, 1957). p. 562.

and represents 37% of total instalment credit.² Commercial banks are now the largest holders of instalment credit. In the short period of time from 1949 to 1956, consumer instalment credit held by commercial banks increased at a rapid pace. Commercial bankers had to adapt the methods used in making commercial loans to procedures applicable to consumer lending. It was a learn-as-you-go process. This thesis will make an analysis of instalment credit in commercial banking.

PURPOSE AND SIGNIFICANCE OF THE STUDY

The primary purpose of this thesis is to review and evaluate the principles, methods and procedures used in the investigation and credit decision of consumer instalment credit as established by commercial banks.

Very few studies have been made concerning commercial banks' methods and experience in this relatively new field. The case studies will attempt to present the present methods of handling instalment credit applications through the entire process. This paper will attempt to point out by a review of the growth factors, the present trend of consumer instalment credit and the principles involved in establishing an

²Ibid.

instalment loan department and the policy decisions relative thereto.

ORGANIZATION OF THESIS MATERIAL

After a brief introduction pointing out the tremendous increase in consumer instalment credit which has been a cause for concern on the part of many economists, Chapter I reviews the purpose and significance of the problems in commercial banks and gives the sources of data used in the study.

In Chapter II a more detailed history is given of the role of instalment credit in commercial banks. The change from strictly commercial lending to the added specialization necessary for consumer lending is discussed.

In Chapter III the methods of credit interviewing and investigation for consumer instalment credit are discussed. An evaluation is made as to the best methods developed from the experience of commercial banks.

The formulation of the credit decision is outlined in Chapter IV. The financial, personal and economic factors used in credit analysis are discussed.

Case studies are given in Chapter V using the basic principles outlined in Chapter IV. These are actual records from bank files.

Chapter VI discusses the organization process in establishing a successful instalment loan department.

Chapter VII reviews the formulation of sound policies to guide the instalment loan department.

Chapter VIII concludes the study with a summary.

SOURCES OF DATA

Very few books have been written on the role of consumer instalment credit in the commercial banking field. As a result, it was necessary to depend on pamphlets and articles written in various publications, such as Federal Reserve Bulletin, The Consumer Credit Banker, Burroughs Clearing House et cetera.

Much practical knowledge has been gained during the past seven years of personal credit experience with The Bank of Virginia, Richmond, Virginia. The files of thousands of consumer instalment borrowers available from this source have enabled the writer to make evaluations and establish conclusions concerning various credit techniques.

Without the aid of the excellent library of the Richmond Federal Reserve Bank research department this study could not have been completed. The material has been assembled over a period of several years.

CHAPTER II

HISTORY OF INSTALMENT CREDIT

ORIGIN

Two shekels of silver have been borrowed by Mas-Schamach, the son of Adadrimenti, from the sun-priestess, Amat-Schamach, daughter of Warad-Enlil. He will pay the Sun-God's interest. At the time of harvest he will pay back the sum and interest upon it.¹

Archeology. Ever since this earliest known record of a loan, inscribed and baked into a clay tablet of Babylon some four thousand years ago, banking has been a part of man's social and economic development. The specialized lending field of instalment selling so popularly accepted today is not a modern development. Although numerous improvements have been made in instalment selling and hence in instalment lending in the past three decades, the system is actually a very old one. Many evidences have been found in ancient Babylonia, Phoenicia, Egypt and Rome. The Franciscan monks, history informs us, transacted a large small loan business in Italy during the fifteenth century. Each period of history has brought changes in the methods, records and systems used, but the basic principles of the lend-process have remained.

¹Elmer Mantz, "History of Banks." Encyclopaedia Britannica. 14th ed., Vol. III. (Chicago: Encyclopaedia Britannica Co., 1948), p. 67

Nineteenth Century. While instalment credit in one form or another has existed for many years, the use of instalment credit as known today is relatively recent in development. The earliest forms of consumer instalment credit in the United States appeared around the nineteenth century. In the year 1807, a New York firm known as Cowperthwait and Sons is said to have applied the consumer instalment credit principle to selling furniture.²

Reavis Cox in a later work on this subject has a different view on the formal beginning of instalment retailing. He states, "It seems probable that the system developed gradually and by imperceptible degrees out of other methods of selling on credit."³ Cox goes on to point out that factory owners often paid wages in the form of orders on local stores in which workers' purchases were charged to the employer. Cash wages sometimes were paid at quarterly or semi-annual intervals. For many stores, instalment selling amounted to little more than extending and formalizing established practices.

FACTORS INFLUENCING GROWTH

Invention and Technology. During the first decade

²E. R. A. Seligman, The Economics of Installment Selling. (New York: Harper & Bros., 1927). p. 14.

³Reavis Cox, The Economics of Instalment Buying. (New York: The Ronald Press Co., 1948). pp. 70-71.

of the nineteenth century, the machines that made possible production of large quantities of standardized furniture were invented. By 1900, invention and technology had reached a stage where standardization and rapid production could join hands. As faster production techniques were developed, it became necessary to speed distribution to the consumer. From this beginning instalment credit provided the means by which factory-made durable goods could be purchased by the consumer.

Early in the nineteenth century, New England clock manufacturers began to sell on instalments. In addition to manufacturing clocks to order, they began making a stock of clocks which could be carried to the ultimate consumer. The sellers used harvest terms to farmers and also sold on instalments to the townspeople.⁴

About the middle of the nineteenth century the Singer Sewing Machine Company began selling its product on the instalment plan.⁵ Sales were made largely to itinerant agents. Whereas the high-grade furniture firms were very selective in their customers, the itinerant agent was more persuasive in selling and not primarily interested in the purchaser's ability to pay. The class of trade was composed largely

⁴Seligman, op. cit., p. 15.

⁵Ibid., p. 16.

of purchasers of a little less financial means than the furniture customers. Delinquent accounts became more frequent and losses of both money and property became more common.

Because of the limited means of entertainment in the 1800's, the sale of books enjoyed wide coverage. Several instalment plans began about this period. One method was to solicit subscriptions to sets of books before publication and to collect cash in advance; another was to collect cash as the volumes were delivered. About the middle of the nineteenth century, the technique of printing had improved so that rapid production was possible. Full sets of books were delivered and payments made by instalments.

With new inventions and improvements such as refrigerators, vacuum cleaners, washing machines, oil burners and ranges, instalment credit had new outlets in which to grow. In Switzerland, master craftsmen perfected the small watch movements necessary to mass produce finished watches. What was a very small instalment jewelry business in the 1890's soon became the large credit jewelry business of today.

During the closing decades of the nineteenth century, the extension of instalment credit expanded to cover a lower unit cost commodity. Instead of a few large houses, a large number of small dealers appeared. Every type of article bought became a target for instalment credit. Abuses of the

plan became common and repossessions were not frowned upon as a detriment to reputation.

Product Demand. At the beginning of the twentieth century the majority of American families spent most of their incomes on what may be regarded today as the bare essentials of living. As disposable income increased, the amount left for discretionary spending increased. Along with rising incomes, improvements in working hours and leisure time took place. With increased income and leisure time, consumer durable goods began to find a greater market.

Advertising influenced the American family in the desire to acquire labor-saving and convenience products. Radios, refrigerators, central heating, washing machines and vacuum cleaners sales increased with the psychological impetus of mass advertising. Durable consumer goods have contributed in a most important way to the attainment of higher levels of living and consumption.

Not all people realize and appreciate that it is instalment credit which has enabled the masses in this country to secure and enjoy the benefits of consumers' durables of all kinds. "Many persons would never be able to buy certain necessities and luxuries without the instalment privilege because of the difficulty, if not the impossibility, of gathering the required sum in one lump."⁶ The use of

⁶Richard P. Ettinger and David E. Golieb, Credits and Collections. 3rd ed. (New York: Prentice-Hall, Inc., 1949). p. 31.

instalment credit has aided materially in the improvement of the American standard of living.

Industrialization and Urbanization. There was a time when each household was almost a self-contained economic unit. Food was grown and prepared by the household members. Clothing was made by the family. Few purchases were made outside the local community. However this picture was gradually changed by the growth of industry and the flow of people into the cities.

As the West became populated and towns grew beyond the Mississippi, instalment credit soon followed. After the Civil War, new industrial cities sprang up in the Mid-West. In the South the Reconstruction period brought industry and trade back to life again. Merchants used instalment credit to promote sales, particularly of furniture. In the northern cities a great host of immigrants became the recipients of instalment credit assets.

Another factor influencing the growth of instalment credit was the steady flow of people from farms to cities to provide the manpower for industries. During the late nineteenth and early twentieth centuries, industrial development and growth of cities brought people together in increasingly large numbers and made them more and more dependent upon one another for the necessities and luxuries of

everyday life. These people needed consumer goods and their regular wages provided a sound basis for regular instalment payments.

At this same time, items of consumer goods costing substantial sums of money began to be produced. With these higher unit costs, new means of distribution had to be developed. Instalment credit provided the vehicle for enjoyment of these higher priced consumer goods. As urbanization developed, the market area for instalment credit sellers became more concentrated which served to reduce their servicing costs.

The Automobile. The automobile, which was to provide the greatest impetus for growth of instalment credit, appeared in the late 1800's. From the creation of "tinkerers" and inventors it grew to become a rich man's plaything. By 1910 doctors, newspaper men and a few businessmen had proven that the automobile could do much or even more to change the American way of life than had the railroad or the steamship. More and more people of modest means wanted an automobile to make life more convenient or business more profitable. Thus the automobile began to be an expensive item needed and desired by a large number of persons. In 1909, the annual production rate of all motor vehicles exceeded 100,000,⁷

⁷U. S. Government, Historical Statistics of the United States - 1789 - 1945. (Washington: Government Printing Office, 1949). p. 223.

which was indicative of the increasing demand for automobiles. With such high unit costs it was apparent that a great financing program would be necessary for both dealers and consumers.

EARLY RELUCTANCE OF BANKS

The role of commercial banks in the field of instalment credit has been one of hesitancy. Even though provisions for instalment credit facilities for consumers had become established as a highly successful business, commercial banks were reluctant for years to enter the instalment credit field. The profitability of such financing was attested in the records of consumer credit companies which were accessible to banks. The principle that banks were only responsible for production credit was the predominant theme. The idea that credit should be extended for consumer goods without collateral and not be paid in full within thirty, sixty or ninety days was beyond their thinking.

One reason for their lack of interest in direct lending to consumers was that bankers were uncertain as to the amount of risk involved. Another was the social stigma attached to this new field. If a person was not able to purchase consumer goods for cash, it was the general social feeling that he should not enjoy the use of such commodities.

In addition, commercial banks had the privilege of rediscounting their commercial paper with the Federal Reserve Banks and no system had been established to rediscount instalment notes as such. Finally, the state banking laws did not, in most states, specifically give banks the right to finance consumers on an instalment basis at charges in excess of statutory interest rates. Thus doubt as to the legal status of bank activities served as an additional restraining influence. In addition, the traditional commercial lending methods were different from the instalment credit procedures.

CONTRAST BETWEEN COMMERCIAL AND CONSUMER LENDING METHODS

In the 1920's commercial bank loans were set up to mature in full on a due date. The usual maturities, as previously stated were thirty, sixty or ninety days. The rates charged by banks were not sufficient to justify weekly or monthly instalments. If a borrower could not pay when the loan became due, the loan could be renewed, with or without a partial payment. Each renewal, however, was a new transaction. This was supposed to give the commercial banks a high degree of liquidity inasmuch as all loans were on a short term basis and could be called in full at maturity.

The business of consumer instalment lending differs significantly from that traditionally engaged in by commercial banks. Each transaction has a small unit value.

The unit costs are high compared to commercial loans. In addition, specialized lending and collection techniques are required.

SALES FINANCE COMPANIES

When the automobile created the need for a great financial program, the commercial banks were not willing to supply that need. A new financial institution, known as the sales finance company, evolved to fill the gap.

The sales finance company is basically a different type of financial institution as contrasted to other lending agencies. The operation consists primarily of buying from dealers instalment contracts which cover merchandise purchased by consumers from these dealers. They do not make direct money loans to individual consumers. Thus, the dealer by prior arrangement with the sales finance company can offer his customers the convenience of buying on the instalment plan and can complete all contract requirements with the customer in his own business location.

Sales finance companies secure from stockholders and by commercial borrowing the funds which they risk in buying consumer instalment contracts. They do not accept deposits (savings or checking) from the public as do commercial banks.

It is impossible to state with accuracy just when automobile instalment sales financing actually began.

Certainly there are many unrecorded instances where automobile dealers allowed special customers or good friends to purchase cars on instalments. Many students of the early history of automobile instalment financing as we know it today, consider that it began around 1910-1911.

By 1910, the automobile industry was in need of the services of financial institutions which could supply the dealer with needed inventory credit, and at the same time, enable this dealer to make available to his purchasers, a system whereby these purchasers could pay for their automobiles in instalments. The amount of credit which could be extended to purchasers by automobile dealers relying upon their own financial resources, was severely limited. So dealers needed "consumer" credit.

At that time, commercial banks were unwilling to supply in any substantial degree these financing needs, if the manufacturers and dealers were to be served, and if persons of moderate incomes were to be enabled to buy automobiles. Consequently, it became apparent to some of the pioneer sales finance company executives, that there was an economic need for a new kind of financial institution, if these manufacturer and dealer needs were to be satisfied, and if the automobile was to take its place in the American scene.

Sales finance companies moved in to fill the gap not taken by existing financial institutions. By 1939, out of

a total instalment credit volume of \$4,503 million, sales finance companies held \$1,197 million.⁸ The growth of instalment credit handled by sales finance companies paralleled the tremendous growth of the automobile industry. And so it was that out of the recognition of these newly developed economic needs in the automobile industry, the modern sales finance company, as we know it today, was born.

PERSONAL LOAN COMPANIES

The personal loan companies (also known as small loan companies, family finance companies, or consumer finance companies) are much more widely known to the public than sales finance companies because of their widespread advertising and their direct contact with consumer borrowers. Their origin is unknown and probably grew from the earlier practice of salary purchasing by loan sharks.

These consumer finance companies, as they are more recently known, are engaged primarily in direct cash lending to consumers repayable on an instalment basis. The money is borrowed principally for such purposes as consolidating overdue bills, past purchases and medical expenses. Because the instalment loans made by consumer finance companies are

⁸Federal Reserve Bulletin. (May, 1957). p. 562

relatively small, risky and costly to handle, these companies are permitted by special state legislation to charge relatively high rates. Nevertheless, these companies perform a most important and worthwhile service for society. In 1957, consumer finance companies are expected to lend over \$3 billion in cash instalment loans to the American family.

MORRIS PLAN BANKS

Another important development in the history of instalment credit was the Morris Plan bank. A young lawyer in Norfolk, Virginia, by the name of Arthur J. Morris brought a new concept to banking in 1910. His Morris Plan banks provided loans to individuals for any worthy purpose repayable on a weekly or monthly basis.

Three basic principles were developed by Mr. Morris and guided him in his plans. First was the granting of credit primarily for consumption purposes. Second, loans on personal security without collateral. Here, Mr. Morris assumed that the individual himself was a running business with assets, liabilities and a net worth. As such, he constituted a sound banking risk. The final principle was the repayment of loans in instalments.⁹

⁹Trail Blazing Without Buckskin or Squirrel Rifle. (Washington: Consumer Banking Institute, 1943). p. 3.

Mr. Morris' program expanded to a nation-wide system of banks. While not their original intent, many Morris Plan banks have added all the services available in any commercial bank and many have dropped the name "Morris Plan" from their titles. The success of the Morris Plan banks served as an experience basis for the entrance of many commercial banks into the instalment credit field.

CHANGE IN ATTITUDE OF COMMERCIAL BANKS

Low Interest Rates and Accumulation of Funds. During the 1930's periods of low interest rates and limited demands for bank funds, the commercial banks looked to the consumer credit field to see what had developed. A desire to give a more varied and well rounded service, a desire to erase the growing feeling of critics calling them rich men's institutions began to change the staid thinking of commercial bankers. As surplus funds accumulated, the need arose to find new uses for these funds. The profit picture of Morris Plan systems along with their extremely low losses began to justify the instalment credit field.

Federal Housing Administration. Another influencing factor in the establishment of instalment credit was the introduction in 1934 of a federal system of insured instalment loans for the repair and modernization of homes. This plan was administered by the Federal Housing Administration.

Loans made by approved institutions under this plan were guaranteed by the Administration. The loans were payable in monthly instalments and usually ran from thirty to thirty-six months. The interest was taken out in advance, the discount rate being 5%, and the actual yield about 9.6%. The Administration limited its liability to 10% of the volume of loans made by each approved agent.¹⁰

STATISTICS ON GROWTH

The earliest data available on commercial bank participation in total instalment credit begins with the year 1939. At that time they held \$1,079 million or 24% of total instalment credit outstanding. By December 1956, they had increased their holdings to \$11,682 million or 37% of the total instalment credit which represents a 50% increase on the base.

In order to achieve such a tremendous gain in a short period, commercial banks used several methods to augment their instalment credit volume. The largest single factor in increasing volume was the recommendation of previous and current borrowers. The goodwill established each time a loan was granted did much to encourage new customers.

¹⁰Joseph D. Coppock, Government Agencies of Consumer Instalment Credit. (New York: National Bureau of Economic Research, Inc., 1940). p. 3.

All forms of advertising media have been used, such as newspapers, billboards, radio, movies, and more recently television. Special direct mailings to preferred groups of borrowers proved to be fruitful.

One particular plan proven successful has been the establishment of relations between the commercial bank and industrial or commercial firms whose employees are likely to be customers. Sometimes officers of such firms might even recommend the bank to their employees and allow payments to be deducted from the borrower's salary, thus giving the bank a preferred competitive position and reducing collection difficulty.

Further, loans of greater than average size have been solicited from preferred groups of salaried people in relatively secure positions. Generally, this type of business is obtained through direct mail solicitation. Executive plan loans of \$2500 or more may be extended to specially selected customers.

Other commercial banks have developed loan volume by arranging with doctors and dentists to have their accounts receivable paid off by means of personal loans to clients. Many such plans and their variations have added to the instalment credit volume handled by commercial banks.

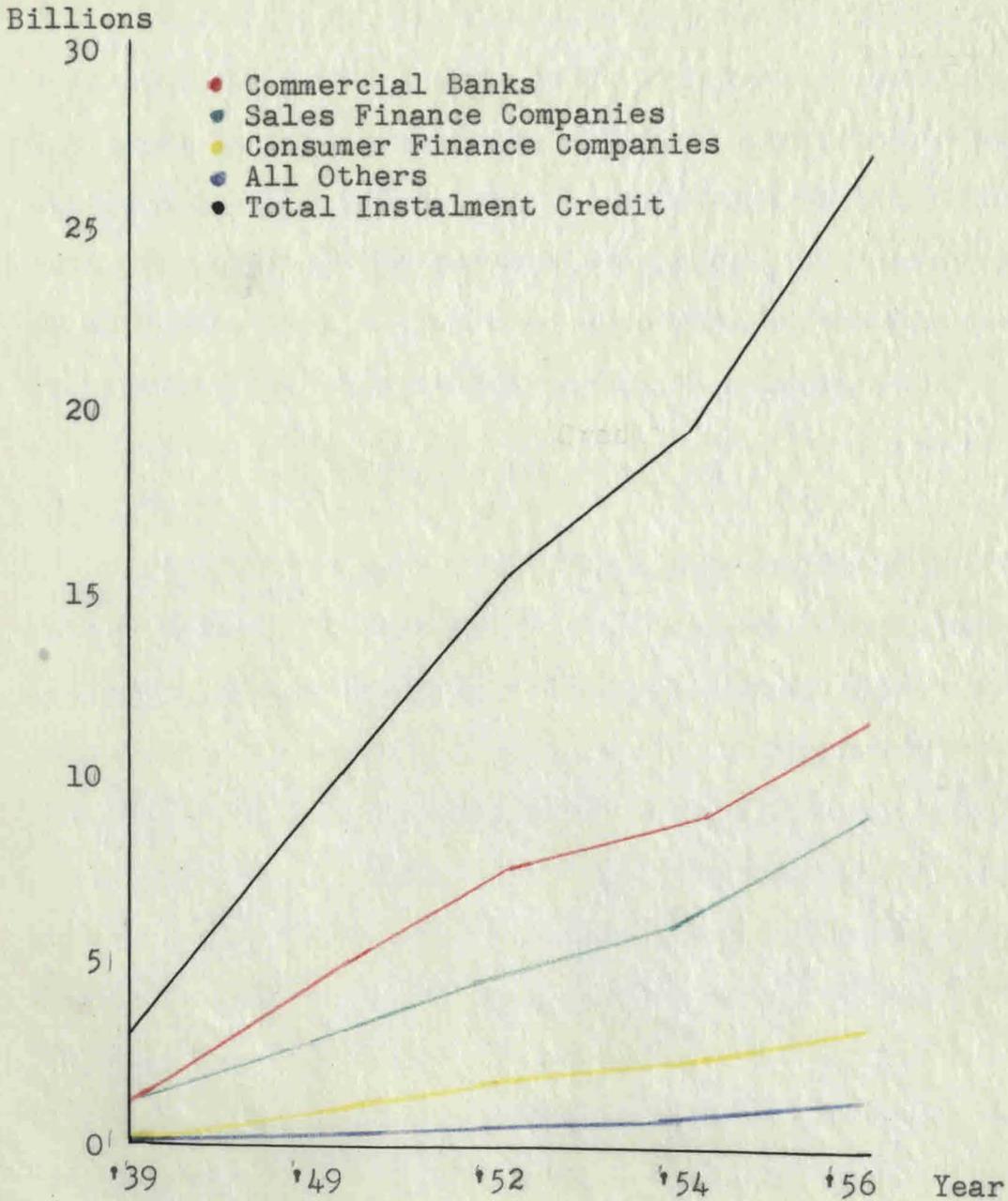
One of the largest sources of instalment loan volume has been that of the automobile sales finance paper. Commercial banks obtain these loans either from dealers or

directly from individual purchasers. One method, typical of automobile financing, is known as "floor planning," and involves the extension of credit on a dealer's wholesale stock. The dealer, in turn, arranges for his customers to finance their purchases through the bank. Thus the commercial banks have been competing vigorously with sales finance companies.

The graph on the next page illustrates the rate of growth of instalment credit held by commercial banks for selected years. Commercial bank instalment credit accounted for less than a quarter of total outstandings in 1939; by mid-1942 it had risen to 29% of the total. After the war years decline, commercial banks' share rose sharply. By mid-1947, they held 40% of total instalment credit. Since that time they have held their own in this increasingly competitive field.

For the past decade commercial banks have maintained a little under 40% of total instalment credit outstanding. This percentage has been held as total dollar volume has gradually increased from year to year. Commercial banks as a group have increased the ratio of their instalment loans to total loans in their portfolios from less than 1% in 1939 to approximately 16% in 1957. In terms of real growth, future holdings by commercial banks of instalment credit will

INSTALMENT CREDIT BY HOLDER
 FOR SELECTED YEARS
 1939 - 1956



¹¹Federal Reserve Bulletin. (May, 1957). p. 562.

FIGURE 1

show primarily an increase in dollar volume while maintaining their present percentage of total instalment credit.

CHAPTER III

ACQUIRING CREDIT INFORMATION

A credit decision is only as good as the facts and information assembled upon which to base that decision. The basic source of information is the applicant. Here the technique of the interviewer must be used to its fullest advantage. After the personal interview, the investigation is pursued with the idea that a prompt and fair decision is advantageous both to the applicant and the bank.

DIRECT FROM CUSTOMER

The Interview. The information collected at the time of the personal interview with an instalment credit customer is the basis for a successful loan. A good interviewer has a special technique that enables him to acquire data from the applicant in a casual manner. The following points should be covered in the interview: (1) the amount and purpose of the loan, (2) the plan and source of repayment, (3) the financial condition of the applicant, and (4) his honesty and ability.

The beginning conversation should be relaxed and pleasant in order to put the applicant at ease, especially if it is his first contact with the bank. If the applicant has had previous loan experience, the credit file should

be available as a guide to the interview. Regardless of whether the applicant is a new or previous customer, a credit application form should be used as a guide to the conversation. This lessens the chance of omitting valuable questions. A sample application is shown on the following page.

It is important that a thorough interview be conducted in the case of a new applicant even though the initial request is for a small amount. If, in the future, larger loans are requested, it will not be as difficult to get the desired information had only a hasty interview been made on the first application. A customer will sometimes resent a more thorough interview if in the past it has not been done. In a consumer credit department that has been established a number of years, more than sixty per cent of the applicants are previous customers. This would justify the effort of a careful initial interview.

Early in the interview the amount and purpose of the loan should be established. If the request is not in accordance with the bank's loan policy, then the applicant can be so informed immediately. Many purposes are not considered sound or desirable from the commercial banker's viewpoint. If the purpose is one of speculation, the natural conservatism of banks should discourage the application. The basic policies of the individual bank should be thoroughly understood by the loan interviewer.

THE BANK OF VIRGINIA

WEST BROAD STREET BRANCH

I hereby apply for a Loan of \$ _____ for _____ Days Months 1 Committee Approval: _____ Type of Loan: _____

AUTOMOBILE (If offered as security):

Year _____ Make _____ Model _____
 Date purchased _____ Serial No. _____
 Motor No. _____
 Aver. NADA _____ Purchase Price \$ _____
 Loan Val. \$ _____
 Down payment (if to purchase car) \$ _____
 Deferred balance or proceeds of loan \$ _____
 Title to come from: _____

Do not write in this space

F.O.B. \$ _____ Symbol _____ Total Prem. \$ _____

Comprehensive					
Collision { \$ 50.00 Ded.	{				
\$ 100.00 Ded.					
Fire					
Theft					
Combined coverage					
Stated amount					

UNDERWRITER'S COMMENTS:

Recommend insurance (our carrier)?
 Yes _____ No _____

Remarks: _____

INSURANCE:

A. Is applicant the owner of car being financed? _____
 B. Names and ages of drivers, other than applicant (if none, so state) _____

 C. Monthly mileage _____
 D. Has any Company cancelled a previous automobile insurance policy? _____
 E. If so, give name of Company _____
 F. Date _____
 G. Outline automobile insurance claims, if any: _____

 H. Outline in detail any record of infractions of motor vehicle laws, or other laws: _____

FIGURE 2 - LOAN APPLICATION FORM

After the amount and purpose of the loan have been established, the plan and source of repayment should be discussed. For consumer instalment lending, this will be limited to asking the applicant if he has budgeted any given amount for this particular loan request. The bank itself will most often inform the applicant of the plan and terms that will be acceptable after the investigation and credit decision.

The financial condition of the applicant is the next field to be covered in a thorough interview. The principal salary or income should be ascertained. This should be stated as either gross or net income. All other income should also be listed as this may be a deciding factor. Total debts should be listed and signed by the customer on a separate form such as is shown on the following page. This is of value if the applicant does not list his entire indebtedness and later files bankruptcy. The court can disallow the petition of bankruptcy if the listing of debts was not a complete and full disclosure. Experience has proven in instalment credit, that repeated questions are necessary to discover the total debts of applicants. Many times customers wish to consolidate certain bills and will only indicate these as debts and not mention other obligations such as an automobile loan or a personal finance

company loan. A full disclosure by the applicant makes it possible to investigate carefully. If, however, the applicant attempts to withhold some pertinent information, it is difficult to discover. If such is discovered to be the case, the loan should be rejected immediately as it indicates an undesirable character risk.

The personal checking and savings accounts should be noted on the application as they can provide a source of financial history, particularly if the accounts are carried at the bank of loan inquiry.

More friends are made by banks and more are lost in interviews with loan applicants than in any other phase of banking. A keen understanding of both the clearly revealed and the hidden motives of the applicants must be strived for. Finally, the interviewer must be sympathetic toward human problems.

Financial Statement. On larger loan requests a signed financial statement should be obtained. Much of this information should be verified as asset values can be overstated. All assets and liabilities should be listed and itemized as required on the statement form. A sample financial statement form is shown on the next page.

Personal financial statements are not as readily analyzed in terms of ratios as are business statements.

Please do not leave any questions unanswered.

**FINANCIAL STATEMENT
PERSONAL**

Confidential

S, STOCKS AND BONDS OWNED	
In name of	Market value

MORTGAGES OWNED		
In name of	Maturity	Amount

ESTATE OWNED				
Title in name of	Cost	Market value	Mortgage	
			Amount	Maturity

INSURANCE CARRIED		
Beneficiary	Cash surrender value	Loans

LOANS WHERE CREDIT HAS BEEN OBTAINED		
	High credit	Basis

THE UNDERSIGNED CERTIFIES THAT BOTH SIDES HEREOF AND THE INFORMATION INSERTED THEREIN HAS BEEN CAREFULLY READ AND IS TRUE AND CORRECT.

Signature

FIGURE 4 - FINANCIAL STATEMENT FORM

Total assets less total liabilities gives the net worth of the individual. This net worth should be analyzed in terms of liquidity of the assets it represents. What equity has been gained in home ownership? The equity in home ownership is generally one of the largest items in an individual's net worth. The financial statement analysis should reveal the applicant's financial ability and history.

Other information of value on the financial statement are contingent liabilities such as taxes and endorsements on other loans, and the schedule of life insurance owned. Often, the value of itemizing all assets and liabilities on the financial statement form gives the applicant a picture of his finances he has never seen before.

BANK FILES

Previous Loan Experience. The first step after taking the credit application would be to check the bank's credit files. This should be done regardless of whether the customer states he has had previous loans, since sometimes an unsatisfactory customer will try to avoid his previous record. The date of the last loan, the paying record and the highest credit extended should be determined. This record will give an indication of the character of the applicant and his paying habits.

Other Departments. Care should be taken to check the activity and stability of an applicant's checking and savings account. Some large depositors prefer to make a small loan rather than disturb a savings account. If the loan is rejected, the bank could lose a very desirable account.

OUTSIDE SOURCES

Credit Agencies. In larger cities, credit agencies such as Retail Merchants Associations and The Retail Credit Company are invaluable in investigating individual credit records. Retail Merchants Associations provide a central clearing house for credit information of local members. This speeds up the investigation procedure since many credit references can be investigated by one telephone call. Each report includes the date and record of last inquiry. Sometimes the last inquiry indicates the customer just recently borrowed money and is using it for a down payment on some consumer item he is requesting the bank to finance.

The Retail Credit Company publishes reports of character and financial evaluations. These reports are specially prepared and require several days to receive if not already in their files. Samples of these reports are shown on the following pages.

CONFIDENTIAL REPORT

CREDIT BUREAU of *Richmond, Virginia, Inc.*

CENTRAL NATIONAL BANK BUILDING
RICHMOND 19, VA.

This report is furnished to you in strict confidence in response to your inquiry and is for your own exclusive use and benefit as an aid in extending credit or the value or condition of an existing credit, and is not to be revealed to the subjects reported on or anyone else. The information is not our opinion, but has been obtained by us in good faith from sources deemed reliable, and we do not vouch for its accuracy, neither the Credit Bureau of Richmond, Va., Inc., nor any of its representatives shall be responsible for the violation of any of these conditions and by your acceptance of this report you specifically agree to the same, waiving all claims for any loss which may occur to the member through this report.



Report for BANK OF VIRGINIA (W. BRD)

Date 5-23-56 Reporter..... Typed by 111

IDENTITY

Name..... [REDACTED]

Address..... [REDACTED]

For. Add.....

Occupation..... [REDACTED]

FROM	ACCT. OPENED	HIGHEST CREDIT	OWING NOW	FOR MONTHS OF	LAST SOLD	LAST PAID	PAYMENTS
------	--------------	----------------	-----------	---------------	-----------	-----------	----------

Bank	8-54	\$188.00	00		4-56		18 at \$10.45 slow.	
Telev.	8-54	\$188.00		thru Central National Bank				
Furn.	12-49	\$217.18	00	4-54	4-56		\$5. a wk. fair.	
Furn.	4-53	declined.						
Furn.	11-47	\$63.00	00	9-51	2-52		warranted 1-52	
Jewl.	1-51	\$45.00	00				OK. \$5. a mo.	

JUDGMENTS:

Our records show 17 judgments dating from 1942 thru 12-55.

RETAILERS COMMERCIAL AGENCY Inc.
CREDIT REPORT



CONFIDENTIAL

DETROIT

OFFICE

Acct. No. 25649

File No. [redacted] ns

REPORT FROM RICHMOND
(If not city in heading) (State whether former addr., etc.)

7/29/57 23
[redacted] JAMES A. (KATHRYN)
Richmond, Va., [redacted] St.
asst. bus. agt., [redacted] Dept.

Transaction:
Amount \$
Mo. Notes \$

<p>IDENTITY:</p> <p>1. Are name and addresses correct as given above?</p> <p>2. How long known to file? (or state "no previous file")</p> <p>3. About what is age? (If around 21 verify if possible.)</p> <p>4. Is applicant married, single, divorced or widowed? No. dependents?</p> <p>5. What is racial descent?</p> <hr/> <p>EMPLOYMENT:</p> <p>6. Name of employer? (Give name of firm.)</p> <p>7. What is nature of business? (State the kind of trade or industry.)</p> <p>8. Position held—how long? (If less than 1 year, explain.)</p> <p>9. Work full time steadily? (If not, how many days per week?)</p> <p>10. Are prospects for continued permanent employment good?</p> <hr/> <p>FINANCES:</p> <p>11. What would you estimate NET WORTH?</p> <p>12. Of what does worth consist principally? (Real estate, cash, stocks, bonds, etc.)</p> <p>13. Does applicant own home, rent or board?</p> <p>14. What is ANNUAL EARNED INCOME from work or business?</p> <p>15. ADDED ANNUAL income from investments, rentals, pensions, disability, etc.?</p> <p>16. If spouse employed, give name of employer.</p> <p>17. Position held—approximate ANNUAL INCOME.</p> <p>18. Approximate number of years employed.</p> <hr/> <p>CHARACTER:</p> <p>19. Is reputation as to honesty and fair dealing good?</p> <p>20. Do you learn of any illegal activities, or domestic troubles? (If so, explain.)</p> <p>21. Any illness (physical or mental) affecting ability to pay? (If so, explain.)</p> <hr/> <p>CREDIT RECORD:</p> <p>22. Do you learn of any failures, bankruptcies, mortgage foreclosures, suits, judgments or garnishments against him? (If so, state which. Give details.)</p> <p>23. Does this person pay his bills, as agreed, as far as you can learn?</p>	<p>1. Yes</p> <p>2. no previous file</p> <p>3. 45</p> <p>4. married No. dependents 4</p> <p>5. AS</p> <hr/> <p>6. Chrysler Corp</p> <p>7. mfg.</p> <p>8. factory How long? 8 yrs.</p> <p>9. Yes</p> <p>10. Yes</p> <hr/> <p>11. \$ 4500 est. n.w.</p> <p>12. savings, personal eff.,</p> <p>13. rent</p> <p>14. \$ 4000 Exact <input type="checkbox"/> Estimated <input checked="" type="checkbox"/></p> <p>15. \$ none Source:</p> <p>16. no</p> <p>17. - Income \$</p> <p>18. -</p> <hr/> <p>19. Yes</p> <p>20. No</p> <p>21. No</p> <hr/> <p>22. No</p> <p>23. Yes</p>
---	---

24. CREDIT RECORD: Set out CREDIT RECORD in tabular form below.

25. BUSINESS-FINANCES: Comment on present and past business connections, irregular employment or lack of stability. Cover subject's financial position, giving breakdown on worth.

26. PERSONAL: Show how long subject has lived in the neighborhood—how regarded. Amplify any unusual information pertaining to domestic troubles, illness learned or other features that would affect earnings or paying ability.

Date Checked	Kind of Business	How Long Selling	Highest Credit	Terms of Sale	Amount Owning	Amount Past Due	Paying record on: Specify 30, 60, 90 days, etc. (Is this in accordance with terms?) If Contract Acct., so state.
7/29/57	Department store,						
7/29/57	Finance co.	2/54	\$150.00	10/8/55			2 good accounts.
7/29/57	Finance Co.						

BUSINESS-FINANCES: JAMES A. [redacted] has been employed by the Chrysler Corp. for 8 years working in the factory. His wages, according to the wage scale in this area is estimated at \$4000. We are not able to verify employment through the employer as they decline information. He left his employment in Detroit to work in Richmond Va. H.s wife is a house wife not gainfully employed. We estimate their net worth to be \$4500 consisting of bonds, savings, '57 Plymouth and personal effects.

PERSONAL: Subject is 45 years of age. He has been married for 23 years and has 3 children dependent. He is renting at [redacted], Detroit, where his family are still living, for 5 years. They will join him very soon in Richomnd. We can learn of no derogatory personal information.

jj;2c

Trade and Bank References. Many times it is advisable to contact some bank and trade references directly. Most firms are willing to cooperate and give information they have on file. In applications where speed is necessary, often one call to a bank reference will suffice to make a credit decision. With competition as keen as it is in some sections, speed in servicing applications is sometimes vital.

Character References. Applicants with little or no previous credit experience often are valuable potential customers. Too often the tendency is to turn down applicants because of no credit experience. The writer feels that in these special cases, a careful and determined investigation of character can provide a sound basis for credit extension. Employers or former employers, teachers, pastors or friends can do much to establish a character background worthy of credit extension.

SUMMARY AND EVALUATION

Successful acquisition of instalment credit information depends to a great extent on the initiative, resourcefulness and inquisitiveness of the investigator. In the opinion of the writer it is more advantageous for the instalment loan interviewers to be responsible for their own investigations. In addition to better and more complete information, the writer has found that a greater degree of

efficiency is achieved within the department by utilizing the interviewer as investigator also. Of course, during unusually busy periods clerical help will be needed.

By utilizing the application information and checking the bank's files, local credit bureaus and personal references, a factual summary can be created upon which a credit decision can be formulated.

CHAPTER IV

FORMING A CREDIT DECISION

Previous chapters have dealt with the historical background and investigation procedures used in instalment lending. The culmination of instalment lending is the formulation of the ultimate credit decision. At this point, multifarious matters come under the credit man's scrutiny. Three broad factors, each entailing a multitude of considerations, will be treated in this chapter. They are: the personal factor, the financial factor, and the economic factor. An outline guide is given to be used in instalment lending as a basic plan to the ultimate credit decision.

THE PERSONAL FACTOR

Four C's of Credit. There seems to be little agreement as to the relative weights assigned to the major factors which pertain to the advancing of funds for future repayment.¹ William Post, a prominent Philadelphia banker, has been credited with originating the now famous four C's of credit. His 1910 booklet entitled The Four Big C's set forth Character, Capacity, Capital and Collateral as the all-inclusive

¹Charles W. Williams, ed., The Credit Department as A Training Ground for the Bank Loan Officer. (Philadelphia: Robert Morris Associates, 1954). p. 89.

elements in extending credit. In recent years, writers like Edward F. Gee, vice-president, State-Planters Bank of Commerce and Trusts, Richmond, Virginia, have insisted on a fifth C - Conditions, meaning that combination of external factors playing on credit risks in the long run.

Character. The well worn term, Character, when woven into the personal factor is still meaningful. Character encompasses the ethical qualities of honesty, integrity, probity, trustworthiness and morality. While any credit man will readily admit that character is the basic essential human quality on which instalment or any credit must depend, the ability to discern such character is difficult.

For each instalment credit applicant, the credit man must attempt to determine character from clues gathered during the personal interview. Friends, associates, employers and family antecedents can be checked as to their opinion of the applicant's character. A review of previous obligations would give an indication of the character and capacity of the applicant.

It is in this scope of the investigation that commercial banks sometimes limit themselves. After the review of previous loan history and current paying habits, too often a final decision is made without a more complete character investigation. This writer believes many loan applications could be salvaged and completed if a more determinate

effort were made to establish a desirable character background. The applicant should be asked to give character references for the interviewer to investigate. Such people as the high school principal or teacher, or the pastor of the applicant can do much to establish the true nature of the applicant's character.

THE FINANCIAL FACTOR

Capacity. After determining that the purpose of the loan is reasonable, proper, and of assistance to the borrower, his capacity to meet this added obligation must be evaluated. Here a financial review is necessary. Total income and total fixed outlays are noted. Can the borrower meet the required payments? Is his income permanent? To properly evaluate his capacity, many factors must be known. All of his existing debts, family status, dependents, sources of income, accumulated assets, life and health insurance in force and contingent liabilities are to be ascertained and taken into consideration.

Capital and Collateral. Capital consists of assets that have been accumulated. Such items as cash on hand, stocks and bonds, real estate, automobiles and personal property make up an individual's capital. If a person has been able to accumulate capital, it is indicative of his

ability to accumulate and conserve assets. Thus a person who is a home owner or purchasing his home is considered a better risk than a person who rents. The financial statement should bring this information to light.

It is often necessary to pledge some of these accumulated assets as collateral in order to secure a loan. At the time a loan is made collateral should never be looked upon as a primary source of repayment. Collateral as such should never take precedence over character or capacity.

THE ECONOMIC FACTOR

Conditions. The general economic policies of the government and banking in general will influence the overall policies pertaining to instalment lending. These general economic conditions should be considered in formulating the lending policy. The continued rise in inflation has caused the Federal Reserve authorities to try to lessen its expansion by increasing their interest charges to member banks and by moral suasion, in which member banks are contacted directly to change certain policies. These outside influences can only be as effective as the individual bank's wish to enforce them. To the individual instalment loan applicant, these outside influences mean little and his only interest is whether his particular loan is to be approved.

NEW APPROACH TO CREDIT DECISIONS

The approach of commercial banks to instalment lending at the present time places the emphasis on the purpose of the loan as a guide to the terms and credit decision. Once the applicant has stated the purpose of the loan, an individual set of guiding principles automatically apply. As an example, an applicant wishes to purchase a car. Here the guiding precepts are a 25% to 40% down payment and terms from 12 to 36 months. Had the applicant wanted the same amount of money for remodeling his home, the rules would not require a down payment.

Hence, the question comes to the writer's mind: Why a different approach depending upon the purpose of the loan? The only commodity a bank has to offer is cash or its equivalent in demand deposits. To the writer, the basic question with each applicant should be: What is the maximum amount of cash credit that can be advanced to the applicant?

Commercial banks have always established lines of credit for their commercial customers which set the maximum amount to be lent to a particular customer. Department stores set limits on their accounts. Why not establish a line of credit for individual consumer instalment credit applicants?

Commercial banks have money for sale. Too often a customer applies for and receives a small loan for some specific purpose. In many cases, if a careful budget and financial analysis were completed, a much larger loan would be possible and would be more helpful in establishing the applicant on a sound financial program. The larger loan would not involve any more handling expense, but would increase the average size loan made. In effect, commercial banks would be establishing a line of credit similar to those handled in commercial lending. By establishing the limits of credit for the individual, both the applicant and the bank would benefit.

In order to determine the amount of cash to be loaned, the bank must do a better job of reviewing the applicant's financial position. Thus, the bank must act as a financial counselor as well as a cash lender. This would enable the bank to better serve the community and provide a profitable source of loans.

BASIC PLAN OF INSTALMENT LENDING

In order to establish a line of credit for an individual, it is necessary to complete all the interview forms and assemble the investigation data for a credit decision. However simple or complicated the particular loan application may be, the basic plan will remain the same. The basic

steps necessary in consumer instalment lending are given in the following outline:

- Preliminary Interview
 - Greetings and introductions
 - Discussion of purpose of loan
- Primary Interview
 - Name, age and addresses
 - Employment
 - Income
 - Other income
 - Total debts
- Credit and character references
 - Checking and savings accounts
 - Plan of repayment
 - Financial statement
- Credit Investigation
 - Bank's files
 - Loan experience
 - Checking and savings accounts
- Credit agency reports
 - Financial
 - Character
- Direct reference contacts
- Review and Analysis of All Data
- Determination of Line of Credit
- Credit Decision

The preliminary interview is used to set the individual at ease and to determine whether the loan request is within the policy established by the bank. The purpose of the primary interview is to assemble all pertinent data on the application forms. The credit investigation follows the plan established in Chapter III. After a review of the

data it is sometimes necessary to contact the applicant for further information or explanation of some of the investigation information before a final credit decision can be made. This basic plan will be used for the case studies in the next chapter.

CHAPTER V

CASE STUDIES OF CONSUMER INSTALMENT LOANS

The following case studies, using fictitious names and addresses, have been taken from actual records and should serve as a basis for reviewing the consumer instalment lending methods in commercial banks. The basic outline given in the previous chapter is used as a guide to describe the procedure followed in the approval or rejection of a loan application.

CASE A - SIDNEY D. FOWLER

Preliminary Interview. After the introductions and greetings, the interviewer directed the conversation toward the purpose of the loan. The applicant, Mr. Sidney D. Fowler, stated that he wished to consolidate his existing bills in order to reduce his monthly payments. Since loans of this type prove to be profitable because of their larger size and because they can help the individual in his financial affairs, the interviewer proceeded to take a written application.

Primary Interview. The credit application, co-maker slip and list of debts statement, as shown on the following pages, provide the facts as assembled from this interview.

THE BANK OF VIRGINIA

I hereby apply for a Loan of \$ 2,558.14 for 24 ^{Days} Months Repayable:

{ 23 @ \$106.50 } Monthly, Semi-Monthly, Beginning on 5-20-57
 { 1 @ \$108.64 }

Name (Full name): Sidney D. Fowler Age 37

Residence address: 518 Patterson Ave. City or town: Richmond, Va.

Business address: 710 Bank St. City or town: Richmond, Va.

Your position: Traffic Manager Regular salary or wages: \$ 7200 per yr

Other income: \$ 1300 per yr. From Pension source? no. Govt/Colonial Building & Loan support? 4

If you own or are buying real estate, give: Location 518 Patterson Ave. Value \$ 22,500

In whose name is title? Joint

Mortgage Held by: Mortgage Investment Corp.

Where is your savings account? First Federal Savings

Where is your checking account? First & Merchants

Automobile owned (Year and make) 1953 Ford Victoria

Amount of life insurance owned \$15,000

If renting, monthly rental 124.57

CO-MAKER'S STATEMENT FOR LOAN OF
 Name (Name of Maker) Sidney D. Fowler
 Amount \$ 2,558.14 No. 1 (Name - H/W or CM)
 Name (First name in full) Owene Age 35
 Wife's Name Owene Fowler
 Purpose of Co
 Residence Address 518 Patterson Ave. City or Town Richmond, Va.
 Name of Company you work for or business of your own Colonial Building & Loan Assn. How long there? 2 yrs.
 Business Address: 900 W. Broad St. Position Typist
 Regular salary or wages: \$ 1300 per yr. Other income: \$ 0 Source: Wife
 How long have you lived in this town? 4 How many persons do you support? 4 State your relation to applicant Wife
 If you own Real Estate give: Location 518 Patterson Ave. Value \$ 22,500 Amount of Mortgage \$ 12,500 Held By Mortgage Investment Corp.

LIST ALL DEBTS (Name and Address) DESCRIBE DEBT

See attached list

References (Preferably firms from whom you buy on credit):

- Thalhimer
- Miller & Rhoads
- First & Merchants National Bank
- Mortgage Investment Corp.
- Colony House

I hereby certify credit and Signature: _____

REFERENCES: (Preferably firms from whom you buy on credit)

- Miller & Rhoads
- Colony House Furniture
- First & Merchants National Bank

Do you wish to have borrower, without cost to you, protect you (by insurance) against loss in case of death? Yes

ACCOUNT No.	FACE	UNPAID	DEL.
A	No previous loan experience		
Cr. Checking A			
This Loan t A			
<input type="checkbox"/> In full C			
<input type="checkbox"/> No cur C			
H/W C			
A			
A			
A			
C			

Summary: Form 47 Rev. 11-53

Total direct liability: \$ 2558.14 Total indirect liability: \$ _____

Recap: No previous

FIGURE 7 - LOAN APPLICATION OF SIDNEY D. FOWLER

THE BANK OF VIRGINIA

I hereby apply for a Loan of \$ **2,558.14** for **24** ^{Days} ~~Months~~ Repayable:

23 @ \$106.50 Monthly, **1 @ \$108.64** Semi-Monthly, Beginning on **5-20-57**

Name (Full name): **Sidney D. Fowler** Age: **37**

Name of Company you work for or business of your own: **Chrysler Corp.** How long there? **6 yrs.**

Your position: **Traffic Manager** Regular salary or wages: **\$ 7200** per **yr**

Other income (From what source? How many persons do you support?): **\$ 1300** per **yr** **no. - Govt Pension** **Colonial Building & Loan** **4**

If you own or are buying real estate, give: Location **518 Patterson Ave.** Value **\$ 22,500**

In whose name is title? **Joint**

Mortgage Held by: **Mortgage Investment Corp.**

Where is your savings account? **First Federal Savings**

Where is your checking account? **First & Merchants**

Automobile owned (Year and make): **1953 Ford Victoria**

Amount of life insurance owned: **\$15,000**

If renting, monthly rental: **rental Hgs - 124.57**

Residence address: **518 Patterson Ave.** City or town: **Richmond, Va.**

Business address: **710 Bank St.** City or town: **Richmond, Va.**

Previous employment: **Richmond, Va.**

Previous address: **1859 River Dale Rd., Miami, Fla.** How long have you lived in this city? **3 yrs.**

Name and Address of Nearest Relative: **Owens Fowler - wife**

Wife's Name: **Owens Fowler - wife**

Purpose of Loan: **Consolidate debts - \$2200.00**

LIST ALL DEBTS (Name and Address)	DESCRIBE DEBT	DATE INCURRED	PRESENT BALANCE	MONTHLY PAYMENTS	AMOUNT PAST DUE
See attached list					

References (Preferably firms from whom you buy on credit):

1. **Malhiners**
2. **Miller & Rhoads**
3. **First & Merchants National Bank**
4. **Mortgage Investment Corp.**
5. **Colony House**
6.

ACCOUNT NO.	FACE	UNPAID	DEL.
A 13-3-7-81114	766.07	766.07	3-18-57
A			
A			
A			
C			
C			
C			

Total direct liability: \$ **2558.14**

Total indirect liability: \$

Recap: **No. previous**

I hereby certify that the statements given herein are for the purposes of credit and are correct as of the date the Loan is made.

Signature: _____

Do not write in this space

Cr. Checking Acct. of: _____

This Loan to be repaid: (Complete for all S. P. Loans)

In full at maturity. \$ _____ at maturity; renew for _____ mos.

No curtail at maturity; renew for _____ mos.

H/
/W

ACCOUNT NO.	FACE	UNPAID	DEL.
A			
A			
A			
C			

Recap: _____

FIGURE 7 - LOAN APPLICATION OF SIDNEY D. FOWLER

AUTOMOBILE (If offered as security):
 Year 1953 Make Ford Model Victoria
 Date purchased _____ Serial No. _____
 Aver. NADA _____ Motor No. _____
 Loan Val. \$ _____ Purchase Price \$ _____
 Down payment (if to purchase car) _____ \$ _____
 Deferred balance or proceeds of loan _____ \$ _____
 Title to come from: First & Merchants

INSURANCE:
 A. Is applicant the owner of car being financed? _____
 B. Names and ages of drivers, other than applicant (if none, so state) _____
 C. Monthly mileage _____
 D. Has any Company cancelled a previous automobile insurance policy? _____
 E. If so, give name of Company _____
 F. Date _____
 G. Outline automobile insurance claims, if any: _____
 H. Outline in detail any record of infractions of motor vehicle laws, or other laws: _____

Do not write in this space

F.O.B. \$	Symbol	Total Prem. \$
Comprehensive		
Collision { \$ 50.00 Ded. \$ 100.00 Ded.		
Fire		
Theft		
Combined coverage		
Stated amount		

UNDERWRITER'S COMMENTS:
 Recommend insurance (our carrier)?
 Yes _____ No _____
 Remarks: _____

DESCRIPTION OF COLLATERAL (except auto): **Conditional sales contract dated 3-18-57 in the amount of \$766.07 from Colony House Furniture Co.**

**Character reference from Mr. Didds, Chrysler Corp., Administrative Officer
 "Would recommend Mr. Fowler highly and feel your bank would be completely safe in granting this loan."**

CREDIT (do not write in this space):
**First & Merchants - 1/14/57 \$1104 12@ \$92.00
 Bal \$920 - Satis.**
**Mortgage Investment - 1/55 \$19,100 12h.57 mo.
 Up to date & satis. 18,346.70**
**Eastern Loan Co. - 9-10-56 \$200 20 @ \$12.87
 Bal 149.83 Prompt**

Type of Firm	Account Opened	DATE OF CREDIT REPORT				Remarks
		H. Cr.	Owes	Terms		
						See Individually Typed Reports in File

FIGURE 7 - LOAN APPLICATION OF SIDNEY D. FOWLER

For the purpose of obtaining credit at The Bank of Virginia, I hereby certify that the following list is a true and complete statement of my entire outstanding indebtedness:

NAME OF CREDITOR	BALANCE DUE		MONTHLY PAYMENT		WHAT FOR
First & Merchants National Bank	920	00	92	00	Auto Loan
Bank of Virginia	766	07	42	56	Rugs
Corley Co.	60	77	10	00	Cornet
Sears Roebuck Co. (Tires)	82	48	9	00	Tires
Sears Roebuck Co. (Reg. chg.)	31	09	10	00	Reg. chg.
Eastern Loan Corp.	149	83	12	87	Loan
Little Oil Co.	127	85	35	00	Oil
Miller & Rhoads	40	00	20	00	Reg. chg.
Thalhimer's	85	00	35	00	Reg. chg.
La Vogue	10	00	10	00	Reg. chg.
Barlow & Hicks Plumbing Co.	65	00	30	00	Plumbing
	2,338	09	306	43	
Pay roll deduction each month to purchase Chrysler Corp. stock			56	00	

(SIGNED) Sidney D. Fowler

Witness S. B. Morris

The circumstances of Mr. Fowler, age 37, married, with two children, indicate a settled family man. He has been with Chrysler Corporation for six years as traffic manager. His wife works part time at Colonial Building & Loan Association. His gross yearly income is \$7200 and Mrs. Fowler grosses \$1300 yearly. Mr. Fowler stated that he also receives \$113 per month tax free from a government pension. Their income is above average.

The total list of debts, as shown on page 47, shows indebtedness of \$2,338.09 with monthly payments of \$306.43. A financial statement was completed at this time since the loan application was for a substantial amount. This is shown on page 49.

Mr. Fowler wished to amortize this loan over a two year period. His savings account was held by Colonial Building & Loan Association and his checking account was located at First and Merchants National Bank. Mr. Fowler was asked to call the following day in order to learn the bank's decision.

Credit Investigation - Bank's Files. Mr. Fowler has an existing loan with the bank of \$766.00 which is new. This loan is for the purchase of furniture and was handled by the bank under a standing arrangement to purchase all contracts offered by the furniture company, if satisfactory.

SCHEDULE OF U. S. GOVERNMENTS, STOCKS AND BONDS OWNED		
Description	In name of	Market value
None		

SCHEDULE OF MORTGAGES OWNED				
Description of property covered	Date of acquisition	In name of	Maturity	Amount
None				

SCHEDULE OF REAL ESTATE OWNED						
Description of property and improvements	Date of acquisition	Title in name of	Cost	Market value	Mortgage	
					Amount	Maturity
518 Patterson Avenue	Jan. 1955	Joint	\$22,500	\$22,500	\$18,500	

SCHEDULE OF LIFE INSURANCE CARRIED				
Amount	Name of company	Beneficiary	Cash surrender value	Loans
\$15,000	Company term policy	Wife	None	

GIVE NAMES OF BANKS OR FINANCE COMPANIES WHERE CREDIT HAS BEEN OBTAINED		
Name	High credit	Basis
First & Merchants National Bank	0	Car
The Bank of Virginia	700.00	

THE UNDERSIGNED CERTIFIES THAT BOTH SIDES HEREOF AND THE INFORMATION INSERTED THEREIN HAS BEEN CAREFULLY READ AND IS TRUE AND CORRECT.

FIGURE 9 - FINANCIAL STATEMENT OF SIDNEY D. FOWLER

4-15-57
Date signed

19

/s/ Sidney D. Fowler

Signature

The loan papers were signed by Mr. Fowler at the furniture company office. This balance was correctly listed by Mr. Fowler on his list of debts statement. No previous loan experience was found in the credit file.

Credit Investigation - Credit Agency Reports. The Retail Credit Company report on page 51 shows the results of their special investigation. The informants on this report indicated they have known the applicant one to two years. The character background appears good from this report. The report also indicates a favorable financial condition.

The Retail Merchants report on page 52 gives a good report and paying record with no derogatory information. These reports can be brought up to date at the request of the inquiring bank. References as given by the applicant must be given to the credit bureau and they in turn will contact them for the latest report.

Credit Investigation - Direct Reference Contacts. Direct calls were made to First and Merchants National Bank, Mortgage Investment Corporation and Eastern Loan Company. The replies were all satisfactory and are found written on the reverse side of the application form (page 46).

A direct call to Mr. Didds of the Chrysler Corporation was made to establish a character reference. This reply was satisfactory and recorded on the application.

RETAIL CREDIT COMPANY
CHARACTER—FINANCIAL REPORT

CONFIDENTIAL



RICHMOND OFFICE

Dist., Agcy., File or Pol. #, Br., Cl. #
Mr. Freeland

Acct. No. 25649
8-26-57-22

REPORT FROM Richmond, Va
(If not city in heading) (State whether former addr., etc.)

SIDNEY-D. [REDACTED]
Richmond, Va., 58 [REDACTED]
Traffic Mgr [REDACTED] Motor Co

Transaction: ns
Amount \$ ns
Mo. Notes \$ ns

IDENTITY:	1. How long known to you and informants? 2. How long has applicant resided at present residence address? 3. About what is his age? (If around 21 verify if possible.) 4. Is he married? Number of dependents including wife? 5. Show racial descent.	1. You - Informants 1yr 2yrs 2. 2yrs 3. 30's 4. married Number of Dependents? 3 5. as
BUSINESS:	6. Show name of present employer. 7. In what line of business is applicant engaged? 8. What position does he hold? 9. How long with present employer?	6. [REDACTED] Motor Co 7. Traffic manager 8. same 9. since known
STABILITY:	10. Is he employed FULL TIME? (If not, show how many days per week he works, etc.) 11. Are prospects for continued permanent employment good? 12. Is he steady, progressive and does he live within his income?	10. full time 11. Yes 12. Yes
FINANCES:	13. Estimate applicant's net worth. 14. Of what does worth consist principally? 15. Does he own or rent his home? 16. What is applicant's ANNUAL EARNED income? 17. Estimate added ANNUAL income from pensions, rents, investments, disability, etc. Show source. 18. If wife employed, by whom? Her ANNUAL income. 19. Do you learn of any foreclosures, suits, judgments, failures, garnishments, bankruptcies against him? (If so, which, give details.)	13. estimated 8M 14. private property, savings 15. buying 16. \$ estimated 7M 17. \$ none Source \$ 18. No \$
CHARACTER—HOME SURROUNDINGS:	20. Are home surroundings favorable? (If not, explain.) 21. In what type neighborhood does applicant live? (Show middle class, wealthy, low industrial, etc.) 22. Any criticism of honesty, fair dealings, character or reputation? (If any, cover fully.) 23. Do you learn of any criticism due to illegal activities, domestic trouble, morals or habits? (If so, cover below.) 24. Do you recommend doing business with applicant?	19. No 20. Yes 21. upper middle class residential 22. No 23. No 24. Yes

REMARKS: 25. BUSINESS: Cover former and present business connections, success and general business reputation; prospects for future and general stability.
26. FINANCES: Comment on present and past financial standing, record for living within means, any illness or physical impairments that might affect his earning capacity.
27. CHARACTER-HOME SURROUNDINGS: Comment on character, habits, and morals, home surroundings and class of associates. Give type of neighborhood, stability and class of residents in the section.

BUSINESS: Since known Sidney [REDACTED] has been employed by [REDACTED] Motor co. in [REDACTED] Va. He has good business and personal standing. Prospects for the future are good. He is stable as known.

FINANCES: He has good present financial standing. He lives within his means and keeps bills paid. We learn of no illness or physical impairmentt that might affect earning capacity.

CHARACTER HOME SURROUNDINGS: He has good character, habits and morals, and home surroundings are good. His associates are of high type. He lives in upper middle class a-s residential home owners section, in the county, and this is stable residential section.

jrhlc

CONFIDENTIAL REPORT

CREDIT BUREAU of *Richmond, Virginia, Inc.*

CENTRAL NATIONAL BANK BUILDING
RICHMOND 19, VA.

This report is furnished to you in strict confidence in response to your inquiry and is for your own exclusive use and benefit as an aid in extending credit or the value or condition of an existing credit, and is not to be revealed to the subjects reported on or anyone else. The information is not our opinion, but has been obtained by us in good faith from sources deemed reliable, and we do not vouch for its accuracy, neither the Credit Bureau of Richmond, Va., Inc., nor any of its representatives shall be responsible for the violation of any of these conditions and by your acceptance of this report you specifically agree to the same, waiving all claims for any loss which may occur to the member through this report.



Report for **BANK OF VIRGINIA** **WB FREELAND**

Date **8/28/57** Reporter _____ Typed by **163**

IDENTITY

Name **[REDACTED] SIDNEY D.**

OWENE

Address **518 [REDACTED] Rd.**

For. Add. _____

Occupation **[REDACTED] Mtr. Co.**

FROM	ACCT. OPENED	HIGHEST CREDIT	OWING NOW	FOR MONTHS OF	LAST SOLD	LAST PAID	PAYMENTS
------	--------------	----------------	-----------	---------------	-----------	-----------	----------

Dept.	3/54	141.	60.	5-7/57	7/57	8/57	60 days to 4 mos.
Dept.	2/54	153.	20.		8/57	8/57	\$4. to \$85. ev. 30/90 days
Music	11/56	129.	00			4/57	ahead -- \$10. a mo.
Bank	small checking acct.						

FIGURE 11 - RETAIL MERCHANTS CREDIT REPORT ON SIDNEY D. FOWLER

Review and Analysis of Data. According to the results of the investigation, the character of this applicant is excellent. This is the type of account which would be considered desirable by any lending agency. The applicant's employment is stable and prospects appear good.

Total income of Mr. and Mrs. Fowler is \$8558 annually. After budgeting the mortgage payment of \$124.57 monthly and reasonable living expenses, sufficient funds appear available for a consolidated loan. Mr. Fowler has been paying \$306.43 per month on debts and has had a satisfactory paying record. The debts are reasonable in nature. He has a five year old car. The credit investigation was satisfactory with no derogatory information.

Determination of Line of Credit. As stated previously, the concept of developing a line of credit for individuals is new in commercial banking. In the case study of Mr. Fowler, the writer would suggest the following financial analysis in arriving at a line of credit. This presupposes a satisfactory character and credit background.

Monthly salary		\$600.00	
Monthly pension		<u>113.00</u>	
Total monthly income excluding wife's income			\$713.00
Less:			
Withholding and Social Security taxes	\$ 94.00		
Food estimate for family of four	121.00		
Mortgage, taxes and home repairs	190.00		
House operation (fuel, light, gas, telephone, etc.)	60.00		
Transportation	40.00		
Stock deduction from pay roll	<u>56.00</u>	<u>561.00</u>	
BALANCE			<u>\$152.00</u>

A further reduction of the \$152.00 to take care of advancement, recreation, church, charity, dues, and personal allowances would give an estimated balance available for debt retirement of \$120.00. Projecting this sum over a thirty month period, the author arrives at a line of credit for Mr. Fowler of \$3600.00.

Credit Decision. This actual loan was approved in the amount of \$2200.00 for a two year period with Mrs. Fowler's endorsement. A checking deposit account was requested as a condition to the loan.

CASE B - JAMES C. WALKER, JR.

Preliminary Interview. After introductions, Mr. Walker stated he wished to borrow \$350.00 to pay doctors'

bills and purchase a washing machine at wholesale cost. This was a reasonable and customary type of instalment loan request.

Primary Interview. The credit application as shown on page 56, was completed. Mr. Walker, age 31, married with four children, has been employed only five months on his present job. While this is a short period, he had held his previous job five and one-half years. His total income is derived solely from his employment and is listed as \$90.00 weekly.

His total indebtedness is \$2145.00, principally covering his car, freezer and fencing. These three accounts require monthly payments totaling \$78.46. His mortgage payments are \$70.00 monthly.

Mr. Walker wished to borrow this \$350.00 for a twelve to eighteen month period.

Credit Investigation - Bank's Files. The existing loan with the bank was a dealer home improvement loan and is being paid satisfactorily. Mr. Walker has had four previous loans, the highest credit being \$425.00. His checking account carries a small balance with no unsatisfactory transactions.

Credit Investigation - Credit Agency Reports. The report on page 57 from the Retail Merchants Association gives a satisfactory report on all of the accounts.

THE BANK OF VIRGINIA

I hereby apply for a Loan of \$ 350.00 for 12 ~~Days~~ Months Repayable:

@ \$ _____ Monthly,
 @ \$ _____ Semi-Monthly,
 @ \$ _____ Beginning on _____

Committee Approval: _____

Type of Loan: _____

Acct. Number: _____

Date: _____

Name (Full name): James C. Walker, Jr. Age 31

Name of Company you work for or business of your own: Johnson and Shawn, Inc. How long there? 5 mos.

Your position: Foreman Regular salary or wages: \$ 90 per wk

Other income: \$ 0 per _____ From what source? _____ How many persons do you support? 6

If you own or are buying real estate, give:
 Location: 1302 Timmons St. Value: \$ 12,000
 In whose name is title? Joint
 Mortgage Held by: Colonial Group \$11,500
 Where is your savings account? 0
 Where is your checking account? Bank of Virginia \$7 bal
 Automobile owned (Year and make): 55 Chevrolet
 Amount of life insurance owned: _____
 If renting, monthly rental \$: Mortgage \$70 p/m

Residence address: 1302 Timmons St. City or town: Richmond, Va.

Business address: 510 Bank St. City or town: Richmond, Va.

Previous employment: Jones Bros. 5 1/2 yrs.

Previous address: _____ How long have you lived in this city? _____

Name and Address of Nearest Relative: _____

Wife's Name: Mildred

Purpose of Loan: \$350 - Pay doctors and buy new washer wholesale

LIST ALL DEBTS (Name and Address)	DESCRIBE DEBT	DATE INCURRED	PRESENT BALANCE	MONTHLY PAYMENTS	AMOUNT PAST DUE
GMAC	55 Chevrolet		\$ 1000	\$ 44.91	\$
Doctors			130		
Sears & Roebuck			125		
Thalhimer's			60		
Bank of Virginia - fence	Fence		230	9.90	
Central National Bank	Freezer		600	24.05	
			Total	\$2,145	\$78.46

References (Preferably firms from whom you buy on credit):

1 See list of debts above

2 _____

3 _____

4 _____

5 _____

6 _____

ACCOUNT NO.	FACE	UNPAID	DEL.
A <u>11-6-6-9877</u>	<u>344.94</u>	<u>229.86</u>	<u>8-20-57</u>
A			
A			
A			
C			
C			
C			

Total direct liability: \$ _____ Total indirect liability: \$ _____

I hereby certify that the statements given herein are for the purposes of credit and are correct as of the date the Loan is made.

Signature: _____

Do not write in this space

Cr. Checking Acct. of _____

This Loan to be repaid: (Complete for all S. P. Loans)

In full at maturity. \$ _____ at maturity; renew for _____ mos.

No curtail at maturity; renew for _____ mos.

H/ _____

ACCOUNT NO.	FACE	UNPAID	DEL.
A			
A			
A			
C			

Recap: _____

Recap: 4 OK 1 Reject High Credit \$425

FIGURE 12 - LOAN APPLICATION OF JAMES C. WALKER, JR.

CONFIDENTIAL REPORT

CREDIT BUREAU of Richmond, Virginia, Inc.

CENTRAL NATIONAL BANK BUILDING
RICHMOND 19, VA.

This report is furnished to you in strict confidence in response to your inquiry and is for your own exclusive use and benefit as an aid in extending credit or the value or condition of an existing credit, and is not to be revealed to the subjects reported on or anyone else. The information is not our opinion, but has been obtained by us in good faith from sources deemed reliable, and we do not vouch for its accuracy, neither the Credit Bureau of Richmond, Va., Inc., nor any of its representatives shall be responsible for the violation of any of these conditions and by your acceptance of this report you specifically agree to the same, waiving all claims for any loss which may occur to the member through this report.



Report for **BANK OF VIRGINIA** **WB FINELAND**

Date **8/28/57** Reporter..... Typed by **163**

IDENTITY

Name..... **[REDACTED], JAMES C.**

MILDRED

Address..... **1506 [REDACTED] Rd.**

For. Add.....

Occupation..... **[REDACTED] & [REDACTED] [REDACTED]**

FROM	ACCT. OPENED	HIGHEST CREDIT	OWING NOW	FOR MONTHS OF	LAST SOLD	LAST PAID	PAYMENTS
------	--------------	----------------	-----------	---------------	-----------	-----------	----------

Jlry.	12/55	34.95	00		6/56		asagr.- \$5. a mo.
Dept.	st.	81.	76.		8/57	8/57	\$5. to \$10. ev. 30/90 days (limit \$60. - terms \$5. a mo.)
Fin.	12/53	300.	00				8/55 - 20x \$12.4, ok
Bank	3/52	307.	00		4/53		18x \$17.10, good
Fin.	4/54	272.	00		4/54		15x \$22.
Bank	4/54	337.32	00		4/55		12x \$28.11, good
W. Clo.	11/52	19.95	00		12/54	2/55	sat. \$10. a mo.
Jlry.	12/48	100.	00		1/49	1/50	satis.
Furn.	10/49	264.	00		10/49	8/50	\$13.50 a mo. ok
Bank	12/53	425.	00		3/55		15x \$28., good
Furn.	6/55	176.71	00		7/57		\$8. a mo. fair.

FIGURE 13 - RETAIL MERCHANTS CREDIT REPORT ON JAMES C. WALKER, JR.

Analysis of Data. The total debt of Mr. Walker appears high in relation to his income and family status. Little or no equity is indicated in the home he is buying. Payments on regular instalments amount to \$78.46 per month plus \$70 on the mortgage. Payments on the open accounts are not shown.

Credit Decision. This loan was rejected with the recommendation that Mr. Walker reduce his obligations before making additional purchases.

CHAPTER VI

ORGANIZING AN INSTALMENT LOAN DEPARTMENT

PRINCIPLES OF ORGANIZATION

Definition. Webster defines organization as any vitally or systematically organic whole, or the executive structure of a business. Ralph Davis states that an organization may be defined as any group of individuals, large or small, that is cooperating under the direction of executive leadership in the accomplishment of certain common objectives.¹ We can then say that the organization of an instalment loan department is that group cooperating under the guidance of the board of directors to accomplish certain objectives.

The Organizing Process. Prior to the actual execution of the business plan, certain antecedent factors and conditions must be present. These basic factors of performance and conditions must first be studied to see that they conform to the business plan desired. The organizing process is the method of performing the work of organizing.² To provide an effective economical performance, such values

¹Ralph Currier Davis, The Fundamentals of Top Management. (New York: Harper and Brothers, 1951). p. 327.

²Ibid., p. 324.

as the best working conditions, coordination and cooperation of personnel, operative procedures, executive leadership and other values must be predetermined in the organizing process.

Functional Analysis. To properly plan organization structure, knowledge about the factors and functions involved in the particular plan must be related to the objectives. Functional analysis is the process of gathering information concerning the work of organizing. It should provide a basis for the grouping of functions and their relationship for an economical, coordinated performance of the business plan. The principal methods of functional analysis are the organizational analysis and the procedural analysis. Under an organizational analysis, general work assignments are ascertained and time studies made. This deals primarily with personnel requirements. Under a procedural analysis, processes of general requirements are investigated along with time and motion studies. This deals with the physical factors.³ After ascertaining the personnel and physical factors needed, it is possible to begin the organization structure.

³Ibid., p. 234.

THE LINE ORGANIZATION

Definition. The line organization is the hierarchy of executive and operative personnel which extends from the executive head of the entire organization to groups of primary operatives. The primary operatives in most organizations perform services or create values that the customers desire.⁴

Objectives. Organizing cannot be done intelligently without knowledge of the objectives of the mission. An objective may be any value or values that may be needed or desired by individuals or groups provided the latter are willing to make some sacrifice or effort to obtain them.⁵ The basis for organization structure is the objective. The primary form of organization structure is the line structure as discussed thus far in this chapter. The secondary form is the staff organization structure. The staff function deals with the division and specialization of managerial labor.

Characteristics of a Primary Line Organization. The line organization is the result of growth in the business functions with the creation of successive organizational

⁴Ibid., p. 325.

⁵Ibid., p. 90.

service levels. The direction of growth is downward. Primary service values are created or distributed by a line organization. Line growth spreads the load of managerial work but does little for managerial specialization. Thus, without some staff structure the line organization results in line controls that are centralized too highly.⁶

ANTECEDENT FACTORS

IN ORGANIZING AN INSTALMENT LOAN DEPARTMENT

Recognition of Instalment Credit Growth. Instalment lending has established a definite place in the American economy. Because of the proven experience of early finance companies and Morris Plan banks, more and more commercial banks have entered the field. With rising costs, the high income instalment loans have taken their place in the loan portfolio.

Establishing a Need. A careful appraisal of several factors is necessary before a decision is made on whether to organize an instalment loan department. It is necessary to determine if a need exists for such service, the potential volume of such loans and whether the personnel to manage the department is available.

⁶Ibid., p. 363.

Some banks have discovered that while their own customers have little occasion to use an instalment loan department, there exists in the community a real demand for an instalment lending agency. If the bank has a large number of individual customers, an instalment loan department will generally prove useful to the customers and increase the bank's income. Many commercial banks use the instalment lending plan for individual loans without formally setting up a department.

Determining Volume. Since the operating expense of an instalment loan department is greater than the commercial lending department, a bank must be assured of a potential volume sufficient to cover such expense. Greater credit risks are assumed in instalment credit than in the average extension of short term credit to commercial accounts and provision must be made for reasonable bad debt losses. Therefore, sufficient volume must be assured to diversify the risk.

FUNCTIONAL ANALYSIS

Personnel Requirements and Availability. After determining the antecedent factors, an analysis of personnel needs is necessary. If the department is to operate successfully, trained and competent personnel are necessary. Because of the wide difference between commercial lending and

instalment lending and because the average loan officer trained in handling commercial loans tends to be overcautious in making small loans, many banks have obtained their personnel for an instalment loan department from outside sources.

Unless a commercial bank is positive there is a need for a small loan department, that a satisfactory volume is possible, and that trained personnel is available, it is unwise to organize an instalment loan department.

Procedures and Methods. A careful appraisal of the instalment lending process and the most economical method of handling loans should be determined. A study of various commercial banks already engaged in instalment lending provides a basis for establishing a department. The making and handling of instalment loans is altogether different from the average commercial loan. Instalment loans are based largely on the honesty and on the earning power of the borrower, and in many instances the security of pledged collateral is only a secondary consideration. Chapters III and IV have discussed the methods of acquiring credit information and forming the credit decision.

Relation of Functions Sequentially. The proper grouping of the procedures in their sequence is essential to an economical operation. In the instalment loan department the flow of functions is almost natural--from the initial application, to the investigation, to the credit decision.

As the volume of business increases, these functions will tend to be specialized.

AN INSTALMENT LOAN DEPARTMENT LINE ORGANIZATION

Objectives. As stated previously, an objective is the creation of a value for which customers are willing to pay. In establishing an instalment loan department, a bank creates value in the form of cash instalment lending at a given interest price. In addition, the bank is performing one of its basic academic functions of making loans. Being, in a sense, a semi-public institution, any bank establishing an instalment credit department is in part meeting a community need. The major objective of a bank should be to secure maximum loans with minimum losses and minimum expense.

Organization Structure. The primary chain of command would flow as follows: board of directors, president, chief loan officer, instalment credit department head, loan officers and service employees. The grouping of the primary operative functions would be:

1. Interviews
2. Credit and personal investigation
3. Review of data
4. Credit decision
5. Processing loan
6. Collection
7. Final closing of loan

Each of these functions appear repeatedly in the operation of the department. These functions will be performed sequentially and tend to be more specialized as volume increases.

SUMMARY

Prior to establishing an instalment loan department, certain antecedent information such as establishing a need, determining volume and developing sources of personnel must be investigated. By a functional analysis, personnel requirements and procedural methods are determined and related in their proper order. Finally the organizational structure is formed and in the case of instalment lending will be primarily of the line organization type.

CHAPTER VII

POLICIES RELATIVE TO ESTABLISHING AN INSTALMENT LOAN DEPARTMENT

PRINCIPLES OF POLICY

Definition and Importance of Policy. A business policy is essentially a principle or group of related principles, with their consequent rules of action, that condition and govern the successful achievement of certain business objectives toward which they are directed.¹ The management of a bank should formulate sound policies for the safe conduct of the bank in order to protect the depositors' funds, provide adequate employee compensation, serve the community and earn a fair return for the stockholders. A sound policy tends to insure consistency of action, intelligent cooperation and provides a guide for future planning.

Simplicity. In order to avoid misunderstandings, policies should be precise and definite and in simple, understandable terms. Definite written statements of sound policy promote coordinated and cooperative efforts toward desired objectives.

Stability. Policy should remain stable as long as the basic objectives remain unchanged. Policy instability causes loss of respect and confidence in executive leadership.

¹Ibid., p. 173.

It may be the result of improper analysis of objectives, lack of facts concerning the situation involved or snap judgments given under pressure. A satisfactory degree of stability can be achieved by basing policy on sound fundamental principles.

Flexibility. A flexible policy is one that serves effectively as a guide to sound management throughout the normal range of variations in the business cycle. A proper relationship must be developed between stability and flexibility. The ultimate is only achieved in theory. The need for stability develops out of business requirements for continued growth. The need for flexibility develops out of business requirements for prompt adjustments under changing business conditions. Both policy characteristics require as far as possible, that policy statements be made in terms of principles rather than rules.²

Comprehensiveness. In addition to temporary or permanent changes in business volume, certain other changes may result at the bank's own initiative. The policy structure should be sufficiently comprehensive to cover such situations when they arise.

²Ibid., p. 183.

FORMULATION OF DEFINITE POLICIES

Types of Loans to be Handled. In formulating a policy, one of the first matters to be determined is the types of loans to be handled. Some of the principal purposes of borrowing on the instalment plan are: (1) to purchase automobiles and household appliances, (2) to provide home modernization, (3) to refinance existing debts, (4) to finance educational expenses, and (5) to care for unusual or unexpected expenses such as sickness, insurance, interest, and taxes.

The bank should determine whether all loans will be made directly to individuals, whether it will handle trade notes for retail dealers in automobiles and household appliances, and whether it will finance the time sales of manufacturers. Direct loans give the bank the opportunity to appraise each borrower as contrasted with indirect dealer loans. Many banks rediscount customers' instalment notes for dealers in automobiles or household appliances. Dealer financing has more risk than direct financing. The financial condition of the dealer needs careful appraisal by the bank prior to dealer plan financing.

Many banks that have instalment loan departments follow the policy of requiring either satisfactory collateral

or endorsement. Others make unsecured single name loans to the stronger credit risks. Co-maker or endorsed loans are considered by some banks the least satisfactory of all instalment loans. A definite policy should define types of loans, collateral acceptable and the basis for handling loans.³

Interest Rates and Service Charges. A policy should establish a schedule of rates to apply to the various loan types. These rates will be adjusted along with various conditions. Basically, rates are determined by legislation and competition. When instalment lending was first adopted by financial institutions, it was a fairly general practice to charge a 6% discount plus a service fee of 2% for investigation. If a customer borrowed \$300 repayable at twelve instalments of \$25 each, he would receive \$300 less \$18 interest and \$6 investigation fee, or \$276. As competition increased and experience proved satisfactory, the investigation fee was dropped and lower rates were established for loans over \$500. Service or collection charges are now made by most banks for instalments not met properly.

In terms of true interest charges, the annual cost rate is nearly twice the yearly percentage rate quoted.

³Carlisle R. Davis, Credit Administration. (New York: American Institute of Banking, 1949). p. 305.

The formula for computing the actual rate of interest is as follows:

$$AR = \frac{2N \times SR}{N + 1}$$

AR = Actual rate of interest
 N = The number of instalment payments
 SR = Rate of simple interest

Each bank must determine as a policy decision what interest rates and service fees it will charge.

Reserve for Losses. In order to take care of the losses that are bound to occur, a conservative policy will be established to set aside a portion of gross earnings on instalment loans in a reserve account. Experience over the years has shown that losses on this type of lending have been less than $\frac{1}{2}\%$ of the volume discounted. If a department has just been organized, a reserve of 1% of the volume discounted may be set aside until the account equals 5% to 10% of outstanding instalment loans, and thereafter maintain the reserve at that proportion of outstandings.

Maturity and Down Payments. At the inception of the department, a decision should be made regarding the maximum maturity of loans to be accepted. Individual loans vary from six to thirty-six months in various banks. The majority favor the shorter maturities of eighteen months or less. Each bank must decide the maturities it feels necessary.

The question of down payments must be established in automobile and appliance financing. Sound policy should insist that the down payment be sufficiently large for the borrower to have a fair equity at the time of purchase, that the monthly payments be in excess of the depreciation, and that the final maturity not be too distant. Competition and changing conditions will alter these requirements from time to time.

Scope of Investigation. A policy decision should determine what information will be required in the investigation process. It should reveal the amount and purpose of the loan, the plan and source of repayment, the honesty and ability of the borrower and the financial factors of the applicant.⁴

Collection Policy. A significant factor in the successful instalment lending operation is an effective collection policy. Penalty charges should emphasize the importance of the contractual agreement. As volume increases, a separate specialized department should be established. Sometimes the bank must refinance a loan where the customer has suffered some unusual or unexpected expense. An attempt should be made to determine at what point in the collection cycle repossessions will be made in the case of collateral loans and recourse at law in the case of non-collateral loans.

Many losses could be avoided or lessened if a policy were established to cover repossessions and suits. The success of an instalment loan department depends much on the collection policies established.

SUMMARY

If the objectives of the instalment loan department are to be fulfilled, definite policies must be established. These policies, to be effective, must be clear, simple, stable yet flexible, and comprehensive. The determination of sound policies for bank operation is perhaps the most important single function of bank management.

CHAPTER VIII

SUMMARY

The development of instalment credit lending within commercial banks has taken place since the mid-1930's. The successful experience of sales finance companies and Morris Plan banks created an experience record prior to the entry of commercial banks in this field. The development of procedures and methods for a successful instalment loan department operation has necessarily been achieved through trial and error in many cases.

As commercial banks entered this new field, they were not major competitors of sales finance and other instalment lenders. They began in a limited way to establish their own experience records. As the results of instalment lending became known, the commercial banks were desirous of increasing their volume of business. To do this, better methods and procedures of acquisition of new business and handling were needed.

In order to increase volume and determine better credit decisions, new means of evaluating the credit risk had to be developed in contrast to the evaluation of commercial customers. Systems of acquiring better credit information were developed while at the same time the entire process was speeded up due to increased competition.

Since the final credit decision is a personal evaluation and not subject to a definite set of rules, constant improvement is to be desired in the evaluation process. In considering the basic fundamentals of credit--character, capacity, capital, collateral and conditions--too little consideration has often been given to the personal factors primarily because of the difficulty involved in acquiring such information. If further studies could develop methods of evaluating this intangible factor, greater loan volumes could be achieved.

The process and methods of acquiring credit information and forming the credit decision are reviewed in this paper. The case studies outlined give the limitations of present methods and point to a need for further means of evaluating the credit risk.

Since many commercial banks have not as yet established a formal instalment loan department, a review is made of the organizing process. The success of such a department is predetermined to a large extent by the care and diligence in preparation. The formulation of a concise yet simple policy goes hand in hand with the organizing process.

It is concluded from the review and analysis of present instalment lending methods and procedures that instalment lending is an integral part of the commercial bank's

portfolio; and with living standards pressing ever higher and excess funds increasing, newer and more far reaching uses for instalment credit can be anticipated.

BIBLIOGRAPHY

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