1958

Long term loan financing for small business

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Boston University

http://hdl.handle.net/2144/7869

Boston University
BOSTON UNIVERSITY

College of Business Administration

THESIS

LONG TERM LOAN FINANCING FOR SMALL BUSINESS

by

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(B.S. in B.A. Boston University 1952)

Submitted in partial fulfillment of
the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION

1958
Approval:

Noyes Frith, Asst Prof of Engng
April 14, 1857
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INTRODUCTION

This thesis is a study of the long-term loan financing problem which has confronted numerous small business firms since the conclusion of World War II. The thesis will also examine some of the attempts which have been made to overcome partially the problem with special attention directed toward the activities of the Development Credit Corporations in New England.

The Problem

Within the past decade much attention has been focused on the financial difficulties of small business enterprises. Concern over the economic condition of small business has reached even the White House itself, for on May 31, 1956, President Eisenhower created a Cabinet Committee on Small Business to investigate the economic problems of small business. Surveys by public and private groups have shown that long-term credit or capital has been the most difficult type of financing for small business to obtain.

In July, 1956, Mr. Wendell B. Barnes, Administrator of the Small Business Administration and a member of the Cabinet Committee on Small Business stated:

"One of the fundamental problems of small business concerns is difficulty in obtaining, on reasonable terms, medium and long-term financing to purchase equipment and
materials, to expand and modernize operations, or for working capital."*

A study conducted by the Office of Business Economics of the U. S. Department of Commerce reached the conclusion that:

"Despite the growing importance of term borrowing in the postwar period, the availability of long-term funds still constitutes one of the major problems in small business financing. It appears that a considerable unmet demand for long-term borrowed capital exists among small business firms."**

In 1949, the legislature of the State of Maine created an organization known as the Development Credit Corporation of Maine, "to furnish for approved and deserving applicants ready and required money for the carrying on and development of every kind of business or industrial undertaking...."*** Four years later, each New England state had organized a development credit corporation to lend financial assistance to small business firms within the respective states. Knowledge of the activities of the development credit corporations spread rapidly. A study of small

*58, P. 111
**68, P. 20
***71, P. 383-1
business financing problems conducted by the National Association of Manufacturers in 1955 reported:

"In the course of this study it was observed that considerable emphasis was being given to the Credit Development Corporations which had been founded in the New England States during the past five years. These institutions obtain their funds privately and largely from other financial institutions. They are organized primarily to assist concerns that are not in a financial position to borrow from banks. They may under proper conditions provide funds to help existing businesses, to help establish new businesses, or to attract other businesses to their respective states. Despite their limited financial resources, they offer considerable promise for financial help in the future for a large number of small or medium-sized firms."* 

One fundamental problem which will be encountered is that of defining small business and determining a dividing line between small business and "big" business. No specific restriction is outlined in the charters of the development credit corporations that they will extend finan-

*5, P. 6
cial assistance only to small firms. In the past, various criteria have been used to differentiate small and large, such as: (1) the number of employees, (2) total assets, (3) volume of sales, (4) net worth, and (5) net profit, to mention only a few. Section 203 of the Small Business Act of 1953 offered a good general definition of a small business firm. It stated: "A small business concern shall be deemed to be one that is independently owned and operated and which is not dominant in its field of operation."* However, the Small Business Administration also uses the number of employees and the dollar volume of business of the firm in addition to the foregoing criteria.

Prior to 1955, the Small Business Administration defined a manufacturer as small if it employed 100 or fewer employees, and as large if it employed more than 1,000 employees. Between 100 and 1,000 employees, a manufacturer was classified as either small or large depending on its industry and employment size standards in the industry. In 1955, the Small Business Administration changed its definition of a small manufacturer to one having 250 or fewer employees.

In contrast, the Department of Commerce classifies all manufacturers as small if they have fewer than 100 employees.

This same type of problem of classification con-

*61, P. 94
tinually arises in attempting to define a small retailer, a large wholesaler, a large service trade firm, etc.; therefore, the definition of a small business firm must necessarily remain general in this thesis.

After World War II, the number of business firms in this country increased rapidly until about 1950 when the rate of increase slowed. At the start of 1957, the nation's total business population had reached an all-time high of 4,301,000.* There had been a net increase of 53,800 business concerns in 1956 compared with an increase of 58,500 firms in 1955.** It has been estimated that almost ninety-five per cent of these firms would fall within a general definition of a small business concern. The manufacturing industry accounted for about 307,000 members of the business population, and approximately nine per cent of these manufacturers are located in the New England area.

It is the small manufacturing firm that has received the most attention from the development credit corporations in New England.

The Method

Chapter I will attempt to point up the financing problems encountered by small business firms by examining the results of three major surveys completed within the past eight years. Each of these studies was conducted to determine if a genuine problem does exist in small business

*67, P. 11
**ibid., P. 11
financing. The first of these studies was conducted by the Office of Business Economics of the U. S. Department of Commerce in the twelve-month period from June, 1949, to June, 1950. The other two surveys were conducted by the National Association of Manufacturers in 1950 and 1955.

Chapters II and III will be devoted to an examination of some of the reasons this small business financing problem has become discernable in the past few years. Chapter II will point out such government policies as taxation, "tight money", etc., that may have accentuated the problem, and will also show the dependence of small business firms on retained earnings as a primary source of financing expansion. Chapter III will examine the financial position of small business in the national economy, and some peculiarities of the New England economy which have been detrimental to the growth of small business.

Chapter IV will point out the two major attempts by the Federal Government to ease the financing problems of small business, the Reconstruction Finance Corporation prior to 1953, and, more important, the present Small Business Administration.

Chapter V will examine some attempts by private financing organizations to help overcome the problem.

The remaining three Chapters will be devoted to a fairly extensive study of the organization and operations of the development credit corporations in New England in
their attempts to ease the financing problems of small business firms in the New England area.
CHAPTER I
THE SMALL BUSINESS FINANCING PROBLEM

U. S. Department of Commerce, Office of Business Economics Survey

The Office of Business Economics of the U. S. Department of Commerce conducted the first major post-war study of the financing problems encountered by small business firms.

This study was conducted in the period from July 1, 1949, to June 30, 1950, and was confined to 200 established small business concerns. One-half of the firms surveyed were retail establishments and the remaining 100 firms were small manufacturers, the largest having 261 employees. It had originally been planned that the survey would be much larger in scope, but the Korean War interfered with these plans.*

Although this thesis is primarily concerned with the problem of long-term loan funds, it is interesting to note the principal findings of the survey with regard to equity funds for small business firms.

As reported in the Survey of Current Business, there was an "almost total lack of indication that existing small firms were looking for outside equity capital"** at the time of the study. The study revealed that the bulk

*68, P. 17
**68, P. 18
of equity funds used and demanded by small business is obtained from two major sources: (1) the original equity investment of the owners, and (2) the retained earnings of the firm.*

Apparently there are two major aspects of the equity capital question as it pertains to small business which explain why there was this lack of demand for equity funds. First, most small firms feel they are shut out from the organized equity capital market due to the generally localized nature of the business and the high cost of raising small amounts of equity funds, and, second, most small business owners appear reluctant to make use of equity funds, even if available, due to their fear of diluting earnings or control, or both.

However, the survey was primarily concerned with the loan capital financing problems confronting small business firms. The study revealed that "the bulk of the demand for outside funds by small businessmen was in the form of loan capital."** It was noted that term loan financing had become increasingly important in the postwar period, and, as noted in Table I, 24 per cent of the small business loans made in this period had a maturity date of more than one year, and these loans constituted 26 per cent of the

*68, P. 18
**68, P. 20
<table>
<thead>
<tr>
<th>Maturity</th>
<th>No. of Loans</th>
<th>Aggregate Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>90 Days or Less</td>
<td>54</td>
<td>45</td>
</tr>
<tr>
<td>91 Days, But Less Than One Year</td>
<td>22</td>
<td>29</td>
</tr>
<tr>
<td>One Year or More</td>
<td>24</td>
<td>26</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Survey of Current Business, November, 1951, P. 21
total dollar volume of small business loans. Even so, as mentioned in the introductory section, information revealed suggested that "the availability of long-term funds still constitutes one of the major problems in small business financing."

It is interesting to note, however, that 85 per cent of the manufacturers questioned were satisfied with the volume of funds available to them, and only 15 per cent were unable to obtain all the funds they considered necessary for the most efficient operation or expansion of their business.** In any type of industry whether it be farming, retailing, manufacturing, etc., there will likely be a number of marginal operators. The above 15 per cent figure may merely indicate the percentage of marginal operations in the manufacturing industry. It may be questioned whether this relatively low percentage of small business firms unable to obtain adequate long-term financing does constitute "a considerable unmet demand for long-term borrowed capital"*** as stated in the Survey of Current Business. I believe that this question is adequately answered by a single sentence which is found in the Monthly Review of the Federal Reserve Bank of Boston in an article dealing with the unsatisfied need for long-term credit by small business concerns. This sentence states: "The unfilled need exists in only a

*68, P. 20
**ibid., P. 19
***ibid., P. 20
minority of businesses, but these cases are frequent enough to make the problem important."

The U.S. Department of Commerce survey revealed that the only sizable group of unsatisfied borrowers were the small manufacturing firms who had obtained some funds, but felt that they could have used larger amounts. A most unusual fact regarding this finding is that the average size of the additional amounts sought, but not obtained, was actually larger than the average of the amounts actually received.** This probably reflects (1) an unsatisfied desire to obtain longer term financing of major capital expansion programs which were considered necessary or desirable by the firms, and (2) the predominance of corporate manufacturers wishing to borrow more than received since these manufacturers typically borrowed larger sums than the non-corporate manufacturers or the retailers.***

The National Association of Manufacturers Survey - 1950

During 1950, the National Association of Manufacturers conducted a comprehensive survey of its members for two specific purposes: (1) to determine the current financial needs of its members at the time of the survey, and (2) to determine the unmet financial needs during the period from 1939 through 1949. All members of the National Association of Manufacturers were questioned with the ex-

*33, P. 1
**68, P. 19
***ibid., P. 19
ception of the very largest members, and 3,234 replies were tabulated. Emphasis was placed on the number of employees as a measure of size, and, as can be seen from Table II, almost one-half of the number of respondents to the questionnaire had 100 or fewer employees and over 85 per cent had fewer than 500 employees.* From this it can be seen that the survey was primarily directed toward the financing problems of small and medium-sized manufacturers.

Only 225 of the firms, or about 7 per cent, failed to obtain needed funds in the period from 1939-1949. It appears that the smaller firms encountered more difficulty in obtaining funds than the larger. For example, 9 per cent or 80 out of 877 firms with 50 or fewer employees failed to obtain needed funds, while this percentage decreased to only 4 per cent or 32 out of 880 firms with more than 250 employees.** The margin of error in these figures is within ±2 per cent, so the percentage differences noted above are probably statistically significant.

At the time of the survey, these percentages had increased quite noticeably. Of the 3,221 indicating employment size, 395 or 12 per cent were in need of but unable to obtain funds. The percentage increases for the various employment size categories showed comparable increases. Again the smaller firms were encountering the

*4, PP. 7-8  
**ibid., PP. 7-12
TABLE II

CLASSIFICATION OF RESPONDENTS BY NUMBER OF EMPLOYEES TO THE N.A.M. SMALL BUSINESS FINANCING SURVEY OF 1950

<table>
<thead>
<tr>
<th>No. of Employees</th>
<th>No. of Cases</th>
<th>% of Total</th>
<th>Cumulative % from Lowest Class</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 and Under</td>
<td>107</td>
<td>3.3</td>
<td>3.3</td>
</tr>
<tr>
<td>11 - 25</td>
<td>257</td>
<td>8.0</td>
<td>11.3</td>
</tr>
<tr>
<td>26 - 50</td>
<td>513</td>
<td>15.9</td>
<td>27.2</td>
</tr>
<tr>
<td>51 - 75</td>
<td>334</td>
<td>10.4</td>
<td>37.6</td>
</tr>
<tr>
<td>76 - 100</td>
<td>332</td>
<td>10.3</td>
<td>47.9</td>
</tr>
<tr>
<td>101 - 250</td>
<td>798</td>
<td>24.7</td>
<td>72.6</td>
</tr>
<tr>
<td>251 - 500</td>
<td>419</td>
<td>13.0</td>
<td>85.6</td>
</tr>
<tr>
<td>Over 500</td>
<td>461</td>
<td>14.4</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>3,221*</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

*Excludes 13 cases which either did not report employment or reported that employment "varies".

most difficulty with 14 per cent, or 126 of the 877 firms with 50 or fewer employees unable to obtain needed funds. By comparison, only 8 per cent or 72 of 880 firms with more than 250 employees were unable to obtain needed funds at the time of the survey.*

Term loans were the most popular type of funds preferred, being specified by 39 per cent of the firms. Short-term commercial loans were preferred by 27.3 per cent of the firms; bonds and mortgages by 20.4 per cent, and stock sales were preferred by 12.4 per cent.** However, as can be seen from Chart 1, the smaller firms preferred term loans to a much greater degree than larger firms, while the larger firms preferred equity capital and commercial loans in preference to term loans.

Amounts of funds desired were generally not large with two-thirds of the firms needing less than $150,000. Chart 2 outlines the amount of financing desired by the firms in need of funds. These funds were desired for the following purposes: (1) working capital - 47 per cent, (2) plant and equipment modernization, and replacement of fixed assets - 45 per cent, and (3) refinancing - 8 per cent.

National Association of Manufacturers Survey - 1955

Early in 1955, the National Association of Manu-

*4, PP. 9-18
**Ibid., PP. 18-21
CHART 1

TYPE OF FINANCING PREFERRED BY SIZE OF BUSINESS
N.A.M. SURVEY OF 1950

CHART 2

AMOUNT OF FINANCING REQUIRED BY RESPONDENTS
IN NEED OF FUNDS, N.A.M. SURVEY, 1950

facturers conducted a survey of its members to determine if any significant changes had occurred in the small business financing picture since the 1950 survey. This survey was similar to the 1950 survey with a questionnaire being sent to approximately 18,000 members, and 3,500 replies being received. The 1955 survey was designed not only to determine the need for funds by small business firms at the time of the survey, but to determine the unmet needs between 1950 and 1954.

Two significant results were observed in the small business financing problem during the period from 1950 to 1954. First, there had been a considerable increase in the number of firms failing to obtain needed financing, with slightly over 20 per cent of the firms replying, stating they had been unable to obtain all or part of their needs during this period; second, firms in all employment size categories appeared to be having an equally difficult time in obtaining needed funds except that the larger firms with over 250 employees appeared to be having a slightly more difficult time than the smaller firms.* This was an apparent reversal of the results of the earlier survey.

At the time of the 1955 survey, approximately 14 per cent of the firms replying stated that they were in need of funds. As in the 1950 survey the smaller firms with 50

*5, PP. 7-12
or fewer employees appeared in greater need with 16 per cent of this group stating they were unable to obtain needed funds, while those with over 250 employees were in the least need. Chart 3 graphically shows the similarity of need in 1950 and 1955 by all sized groups, with each group showing some increased need in the 1955 survey. Comparison of these figures with those obtained by the Office of Business Economics in its 1949-1950 survey would apparently indicate that the percentage of marginal firms in the manufacturing industry is steadily increasing.

The 1955 survey showed that the preference for term loans had increased to 53.5 per cent of those desiring additional funds, while there was a significant decrease in the desire for equity funds.*

As in the 1950 survey, funds for working capital (43%) and plant and equipment expansion and modernization (39%) were by far the most desired.**

*5, P. 13
**ibid., P. 14
CHART 3

RESPONDENTS IN NEED OF ADDITIONAL FUNDS BY SIZE OF BUSINESS, N.A.M. SURVEYS OF 1950 AND 1955

Number of Employees

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>1950 Survey</th>
<th>1955 Survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>50 or Less</td>
<td>14.0%</td>
<td>15.8%</td>
</tr>
<tr>
<td>51 to 100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>101 to 250</td>
<td></td>
<td></td>
</tr>
<tr>
<td>251 and Over</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All Firms</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: Financing Small Business, National Association of Manufacturers, New York, 1950, P. 15
CHAPTER II
GOVERNMENT POLICIES WHICH MAY HAVE ACCENTUATED THE PROBLEM

Taxes

As was pointed out in the previous chapter, recent studies have shown an unsatisfied need for long-term loan and equity capital by approximately 15 per cent of the small business population, and although this percentage is not high, it appears to have shown a steady upward trend. Many factors have contributed to this shortage of medium and long-term funds, but the effects of taxes have been most severe.

Within the past 25 years there has been an enormous increase in the burden of federal taxation on small business firms. These tax burdens have been one major obstruction to survival and growth of small business firms, and in many cases have prevented them from plowing back earnings into the growth of the firm.

The present federal income tax rate takes 30 per cent of a corporation's profits up to $25,000, and 52 per cent of all earnings above that amount. These rates become important when it is considered that 47 per cent of all corporations have a net annual income, before taxes, of less than $5,000 and only 2 per cent of all corporations earn more than $375,000 annually.*

*56, P. 7
The death of the excess profits tax in 1953, under which a new business became subject to an 82 per cent levy on every additional dollar of income after passing the $25,000 mark was of considerable help to the business population.

However, the effect of the present tax rate on internal financing of growth is well illustrated by the following example:

"Today the internal financing of growth is a slow process. The cumulative effect of successive 52 per cent corporate income-tax bites year after year has seriously reduced internal growing power. Consider two firms, each with $100,000 of initial capital and a capacity for earning a 100 per cent return on its capital annually. Prior to 1913 when corporation taxes were first levied, a company beginning with $100,000 could accumulate $1,600,000 in capital and surplus in four years. At today's tax rates it would accumulate only $524,000 in four years."*

It has also been recognized that corporation income taxes, in addition to being an effective barrier to small business growth, have given impetus to the concentra-

*28, P. 120
tion of economic power in the hands of the larger corporations which have available to them not only a big percentage of their heavy profits, but also sources of capital other than retained earnings. Professors Butters and Lintner have commented that:

"The high rates of corporate income tax during recent years appear to have been by far the most important feature of the tax structure tending to increase the level of concentration. To the extent that this tax has not been shifted, it has restricted the growth of successful small companies much more severely than that of larger concerns. This conclusion applies to the effects of the tax on the availability of outside capital as well as on internally financed growth, although the latter is of greater importance. This restrictive effect of the tax has been especially marked with respect to the growth and growth potential of the more vigorous and promising concerns with the best chance of effectively challenging the established positions of their dominant competitors."*

Many proposals have been put forth in recent years

*2, PP. 274-275
to ease the income tax and other tax burdens on small business. For example, the Senate Select Committee on Small Business conducted a study during the 82nd and 83rd Congresses and recommended five specific means to ease the tax burden on small business:

1. To end the excess profits tax.
2. To establish more reasonable policies on depreciation.
3. To establish more easily understood criteria dealing with unreasonable accumulation of corporate profits.
4. To lessen the impact of death levies on small, privately-held firms.
5. To increase the exemption from the surtax rate on corporate income from the present $25,000 to $50,000 or $100,000.*

Subsequent legislative or administrative action has permitted some progress on these recommendations, and the excess profits tax has been ended. However, the surtax rate still remains at $25,000.

On August 7, 1956, the Cabinet Committee on Small Business presented 14 proposals to President Eisenhower to help formulate "a constructive program, both legislative and administrative, for expanding the opportunities of small business to prosper and grow."** The Cabinet Committee

*56, P. 35
**54, P. 1
recognized the tax burden on small business and stated:

"In the past quarter century an enormous increase has occurred in the burden of federal taxation. The impact of this development has been especially severe on small business. Such concerns have little or no access to public markets for capital. If they are to grow, they must have the wherewithal to expand plant, equipment, and markets. But the burden of taxes nowadays sharply reduces the ability of small enterprises to plough profits back into their businesses."*

The Cabinet Committee made four specific recommendations to improve the tax picture for small firms:

"1. That the taxes imposed on business corporations be modified by reducing the tax rate from 30 per cent to 20 per cent on incomes up to $25,000."**

The Cabinet Committee felt that the benefits from such a tax reduction would be concentrated progressively on the corporations with the smallest net incomes, and would help them to retain earnings to finance expansion or give them some advantage in pricing.

"2. That businesses be given the right to utilize, for purchases of used property

*54, PP. 1-2
**ibid., P. 4
not exceeding $50,000 in any one year, the formulas of accelerated depreciation that were made available to purchasers of new property by the Internal Revenue Code of 1954."

The Committee felt that this measure would benefit small and new businesses whether or not incorporated. The members felt that most small businesses begin operations by buying an old building, used machinery, or used display equipment, due to their limited capital. Emergency amortization provisions of the 1950 Revenue Act allowed corporations to write off, over a five-year period, roughly three-fifths of the costs of new plant and equipment certified as necessary for defense purposes. The 1954 revenue laws were revised to make possible on a permanent basis more rapid depreciation than had been previously allowed, but not nearly so rapid as under the five-year program. However, these provisions applied only to new plant and equipment.

"3. That corporations with, say, ten or fewer stockholders be given the option of being taxed as if they were partnerships."**

Already certain partnerships are offered the option of being taxed as corporations. This proposal would particularly benefit small firms having stockholders with modest incomes.

*54, P. 4
**ibid., P. 5
"4. That the taxpayer be given the option of paying the estate tax over a period of up to ten years in cases where the estate consists largely of investments in closely-held business concerns."*

The present method of payment of heavy estate taxes in small firms leads many to dissolution or at least the disruption of the management. This proposal would allow installment payments over a period of ten years whenever an estate consisted largely of investments in closely-held business concerns.

On the surface, these appear to be sound proposals. However, the Cabinet Committee estimated revenue loss to the Federal Government from these changes in corporate taxation would be about $600 million in the first year, $740 million in the second year, and somewhat reduced figures in later years.** The major portion of this loss of revenue would result from Proposal 1, which lowers the normal tax rate.

In a statement to the Senate Select Committee on Small Business, Professor Friedland, discussing proposed changes in corporation taxation, said:

"If the aim of these changes is to encourage small business, the change should meet the following general criteria. First, since expenditure requirements are

*54, P. 5
**ibid., P. 11
to remain unchanged presumably, there should be no reduction in tax revenue flow to the Treasury. Second, within the narrow framework of corporate taxation, it would be unwise to shift tax burdens from the corporate universe to other sectors of the economy. Third, if the aim is to help small business, we should be suspicious of suggestions which also help larger enterprises. On the basis of these criteria, the only acceptable type of bill would be one which introduces progressivity into the tax structure without reducing the flow of tax revenues."*

It is of interest to note three proposed revisions in the corporate tax laws which were introduced to the Senate in the 85th Congress.

Senator Fulbright introduced a bill (S.3128) which would reverse the normal and surtax rates, so that the normal tax rate on corporate income would become 22 per cent (now 30 per cent), and the surtax rate would become 30 per cent (now 22 per cent). Although this bill would benefit all sizes of business, it would result in a revenue loss of over $300 million.** Table I compares this proposal with the

*99, PP. 1-2
**57, PP. 36-37
### TABLE I

COMPARISON OF PRESENT CORPORATION INCOME TAX LAWS WITH CHANGES PROPOSED BY FULBRIGHT BILL (S.3128)

<table>
<thead>
<tr>
<th>Income Subject to Normal Tax and Surtax</th>
<th>Present tax liability (Normal Rate 30%, Surtax Rate 22%)</th>
<th>Proposed tax liability (Normal Rate 22%, Surtax Rate 30%)</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000,000</td>
<td>$51,994,500</td>
<td>$51,992,500</td>
<td>-$2,000 - .004</td>
</tr>
<tr>
<td>100,000</td>
<td>7,500</td>
<td>5,500</td>
<td>-2,000 - 4.3</td>
</tr>
<tr>
<td>25,000</td>
<td>3,000</td>
<td>2,200</td>
<td>-1,800 - 26.7</td>
</tr>
<tr>
<td>10,000</td>
<td>1,500</td>
<td>1,100</td>
<td>-400 - 26.7</td>
</tr>
<tr>
<td>$5,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td>0</td>
</tr>
<tr>
<td>Note: Estimated revenue loss is between $300 million and $400 million</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

present corporate income tax laws.

As an alternative, Senator Fulbright introduced a bill (S.3129) which would increase the surtax rate prescribed in S.3128 to 31 per cent. This would make the corporate income tax structure mildly progressive and would not reduce the flow of tax revenues.* Table II compares this proposal with the present corporate income tax laws.

A third proposal introduced by Senator Sparkman (S.4138) would reduce the income taxes of all corporations earning less than $375,000 annual net income. This bill would substitute a graduated rate of taxes for the present normal and surtax rates. The new rates would range from 5% up to 55% and would result in a slight revenue increase to the Treasury.** Table III outlines these proposed graduated rates in comparison with present laws.

These few examples give some idea of the tax problems facing small business firms, thus restricting their retained earnings and their capacity for growth. Many, many ideas have been put forth to ease these tax burdens.

It should also be mentioned that the progressive personal income tax has lessened the amounts individuals have available to invest as equity and loan capital in small business firms. Risk-taking has become less profitable for wealthy individuals.***

*57, P. 37
**ibid., PP. 37-38
***33, P. 1
**TABLE II**

**COMPARISON OF PRESENT CORPORATION INCOME TAX LAWS WITH CHANGES PROPOSED BY FULBRIGHT BILL (S.3129)**

<table>
<thead>
<tr>
<th>Income subject to Normal Tax and Surtax</th>
<th>Present tax liability (Normal Rate 30%, Surtax Rate 22%)</th>
<th>Proposed tax liability (Normal Rate 30%, Surtax Rate 31%)</th>
<th>Change</th>
<th>Amount</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,000</td>
<td>$1,500</td>
<td>$1,100</td>
<td>-$400</td>
<td>-26.7</td>
<td></td>
</tr>
<tr>
<td>10,000</td>
<td>3,000</td>
<td>2,200</td>
<td>-800</td>
<td>-25.7</td>
<td></td>
</tr>
<tr>
<td>25,000</td>
<td>7,500</td>
<td>5,500</td>
<td>-1,000</td>
<td>-25.7</td>
<td></td>
</tr>
<tr>
<td>100,000</td>
<td>45,500</td>
<td>45,250</td>
<td>-1,250</td>
<td>-2.7</td>
<td></td>
</tr>
<tr>
<td>1,000,000</td>
<td>514,500</td>
<td>522,250</td>
<td>+7,750</td>
<td>+1.5</td>
<td></td>
</tr>
<tr>
<td>100,000,000</td>
<td>51,994,500</td>
<td>52,992,250</td>
<td>+997,750</td>
<td>+1.9</td>
<td></td>
</tr>
</tbody>
</table>

Note: Estimated Revenue increase is $20 million.

### TABLE III

**COMPARISON OF PRESENT CORPORATE INCOME TAX LAWS WITH CHANGES PROPOSED BY SPARKMAN BILL (S.4138)**

<table>
<thead>
<tr>
<th>Income Subject To Tax</th>
<th>Effective Rate(%)</th>
<th>Present Tax Liability</th>
<th>Proposed Tax Liability</th>
<th>Change Amount</th>
<th>Change Per Cent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Present Law</td>
<td>Proposed Law</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$ 5,000</td>
<td>30.0</td>
<td>5.0</td>
<td>$ 1,500</td>
<td>$ 250</td>
<td>-$ 1,250</td>
</tr>
<tr>
<td>10,000</td>
<td>30.0</td>
<td>7.5</td>
<td>3,000</td>
<td>1,500</td>
<td>-2,250</td>
</tr>
<tr>
<td>15,000</td>
<td>30.0</td>
<td>10.0</td>
<td>4,500</td>
<td>2,750</td>
<td>-3,000</td>
</tr>
<tr>
<td>20,000</td>
<td>30.0</td>
<td>13.75</td>
<td>6,000</td>
<td>4,500</td>
<td>-3,000</td>
</tr>
<tr>
<td>25,000</td>
<td>30.0</td>
<td>18.0</td>
<td>7,500</td>
<td>7,500</td>
<td>-3,000</td>
</tr>
<tr>
<td>50,000</td>
<td>41.0</td>
<td>31.5</td>
<td>20,500</td>
<td>15,750</td>
<td>-4,750</td>
</tr>
<tr>
<td>100,000</td>
<td>46.5</td>
<td>38.25</td>
<td>46,500</td>
<td>38,250</td>
<td>-8,250</td>
</tr>
<tr>
<td>250,000</td>
<td>49.8</td>
<td>47.7</td>
<td>124,500</td>
<td>120,750</td>
<td>-3,750</td>
</tr>
<tr>
<td>375,000</td>
<td>50.53</td>
<td>50.53</td>
<td>189,500</td>
<td>189,500</td>
<td>None</td>
</tr>
<tr>
<td>500,000</td>
<td>50.9</td>
<td>51.65</td>
<td>254,500</td>
<td>258,250</td>
<td>+ 3,750</td>
</tr>
<tr>
<td>1,000,000</td>
<td>51.4</td>
<td>53.33</td>
<td>514,500</td>
<td>533,250</td>
<td>+ 18,750</td>
</tr>
<tr>
<td>5,000,000</td>
<td>51.9</td>
<td>54.68</td>
<td>2,594,500</td>
<td>2,733,250</td>
<td>+ 138,750</td>
</tr>
<tr>
<td>10,000,000</td>
<td>51.95</td>
<td>54.83</td>
<td>5,194,500</td>
<td>5,483,250</td>
<td>+ 288,750</td>
</tr>
</tbody>
</table>

**Note:** Estimated Revenue increase is $45 million.

Changes to assist small business firms have also been proposed in the laws regarding tax loss carry-back and loss carry-forward. Prior to 1954 the loss carry-back period was one year. This one-year carry-back of losses was often insufficient for a company which experienced a loss year, and the Internal Revenue Code of 1954 increased the net loss carry-back from one year to two years.* However, the five-year period for carry-forward of losses was not modified. This provision of the tax law is designed to permit new businesses to offset their early losses against later profits, and extension of the present five-year terms of this provision to seven or even ten years would be of considerable assistance to many new, small firms which encounter early losses. By extension of the loss carry-forward term and by allowing losses to be written off by use of a formula similar to the rapid depreciation formula, increased investment could be expected and the working capital problem of many new, small firms might be eased.

**Securities and Exchange Laws**

Generally, small business firms do not resort to the securities market as a source of external financing due to the prohibitive cost of flotation of relatively small issues.

"A recent study made by the Securities and Exchange Commission showed that the average

*61, P. 25
flotation costs of debt issues under $500,000 publicly offered was 10.21 per cent, and even for issues of $500,000 to $1,000,000 was 8.72 per cent. The S.E.C. study shows that publicly-offered preferred and common stocks of under $500,000 entailed an average flotation cost of 19 per cent."*

Since 1945, the Securities and Exchange Commission has been authorized to accept a simple notification statement in lieu of the full registration statement on issues of securities that do not exceed $300,000 in amount. This notification statement substantially reduces the legal, engineering, and accounting costs that are involved in filing a registration statement.**

Even if a small business firm is willing to absorb the high flotation cost of a small securities issue, there appears to be a reluctance of securities houses to market such issues. Investment banking houses ordinarily pass up any flotation of less than a million dollars as unprofitable.

Within recent years, securities issued under Regulation A (notification statement) have averaged approximately two per cent of total securities issues, as can be seen from Table IV. It has been proposed that the registration exemption limit under Regulation A be raised to

*83, P. 3
**54, P. 8
## TABLE IV

**CORPORATE SECURITIES OFFERINGS, 1954, 1955, AND 1956**

*(Dollars in Millions)*

<table>
<thead>
<tr>
<th></th>
<th>1954</th>
<th>1955</th>
<th>1956</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Corporate Securities Offerings</strong></td>
<td>$9,516</td>
<td>$10,240</td>
<td>$10,939</td>
</tr>
<tr>
<td><strong>Equity Securities (Common and Preferred Stocks)</strong></td>
<td>2,028</td>
<td>2,828</td>
<td>2,937</td>
</tr>
<tr>
<td><strong>Bonds</strong></td>
<td>7,448</td>
<td>7,420</td>
<td>8,002</td>
</tr>
<tr>
<td><strong>Securities Between $100,000 and $300,000 (Regulation A)</strong></td>
<td>195</td>
<td>269</td>
<td>176</td>
</tr>
<tr>
<td><strong>Securities under Regulation A as Per Cent of Total Corporate Securities Offerings</strong></td>
<td>2.0</td>
<td>2.6</td>
<td>1.6</td>
</tr>
</tbody>
</table>

**Sources:**

- Sixth Semi-Annual Report, Small Business Administration, Washington, D.C. September 21, 1956, P. 31
$500,000 to allow small firms greater opportunity to utilize the public markets for capital.

The Securities and Exchange Commission has recently established a new Branch of Small Issues within the Corporate Finance Division. This branch will co-ordinate and supervise examination of exempt offerings under $300,000. It should also help in establishing and maintaining uniform procedures since the processing of Regulation A filings is now decentralized to the nine regional offices of the Securities and Exchange Commission.*

"Tight Money" Policy

It has been difficult to determine the effects that the tightening of credit by the Board of Governors of the Federal Reserve System has had on small business during the past few years. However, it is widely suspected that this policy has had a heavier impact on small business than on large borrowers. In May, 1956, Mr. Allan Sproul, formerly President of the Federal Reserve Bank of New York, stated:

"I suspect that the impact of a policy of credit restraint is greater on 'small business' than on big business... it seems fairly clear that 'small business' has less access to alternative sources of funds when bank credit is not readily available, and only less clear that its access to bank

*56, P. 44
credit is likely to be more difficult under such circumstances. Access to bank credit is achieved primarily by the credit worthiness of the borrower, long-established customer relationships with the lender, and the profitability of the transaction. It may well be that big business has an edge in these respects, which becomes apparent when not everyone can get all of the credit that everyone wants.*

One month before this statement by Mr. Sproul, the Standard Factors Corporation released a report of a survey which it had conducted of 727 manufacturers and 127 banks throughout this country, dealing with credit controls. The report concluded that:

"Despite the apparent fairness of the Federal Reserve bank's method of holding down credit expansion, we have found that the tightening of the money supply has not affected all businesses in the same fashion.. Smaller business has felt the tightness worst; medium-sized corporations have been next in complaining about the money situation; large business has had little to worry about."**

*65, P. 29  
**56, P. 32
Two recent surveys may not be truly indicative of conditions since they both involved larger banks which might be expected to make larger loans than small banks.

The Credit Policy Commission of the American Bankers Association survey of the period from September 1, 1955, to August 31, 1956, showed that loans of less than $100,000 in size by 78 leading banks increased 5 per cent in number and 14.2 per cent in amount, while during this same period the volume of commercial, industrial and agricultural loans reported to the Federal Reserve System by its 379 weekly-reporting banks increased 20.6 per cent.*

A Federal Reserve survey of new business loans of 91 large banks showed that loans of less than $10,000 in size made in the first two weeks of June, 1956, equaled the comparable 1955 period, but loans of over $200,000 increased from $1.5 billion to $2.3 billion.**

In the March, 1957, issue of Business Conditions,*** published by the Federal Reserve Bank of Chicago, an article entitled "The Price of Business Loans" showed that there were relatively fewer loans by commercial banks at high risk rates in December, 1956, than in September, 1955. This was a period of credit restraint and the supply of funds could not expand sufficiently to satisfy all would-be borrowers. Money became "tight" relative to the demand for it,

*66, P. 33
**ibid., P. 33
***102, P. 14
and the price rose. From 3 per cent in mid-1955, the prime rate moved up four times in steps of one-quarter per cent to a level of 4 per cent in October, 1956.

Among possible explanations of the relatively fewer loans at high risk rates in December, 1956, than in September, 1955, are included such factors as: (1) the greater demand for credit by prime rate borrowers, (2) the improvement in the credit standing of some firms over this period, and (3) the postulate that some screening of loans on a quality basis undoubtedly took place. It is possible that many previously marginal borrowers were squeezed entirely out of the bank credit market.
CHAPTER III
OTHER FACTORS ACCENTUATING THE PROBLEM

Personal Savings

Within recent years there has been a great increase in total and per capital personal savings. A large proportion of this savings has come from the middle and lower income groups. These savers appear to prefer safety to risk investments, and an increased proportion of the funds saved by this group has gone into Government bonds and such financial institutions as savings bank deposits, savings and loan associations, commercial bank deposits, and life insurance equities.

By mid-1955 total liquid savings in New England approximated $18.5 billion. In November, 1955, the Federal Reserve Bank of Boston reported:

"The growth in the volume of savings in New England from the end of 1954 to mid-1955 was 3.0 per cent, whereas in the United States it was 3.4 per cent. The national growth reflects a greater population increase than New England has experienced. On a per capita basis the increase in savings in New England was larger than in the nation....

"Liquid savings per person in New England rose from $1,858 in December, 1954,
to about $1,895 by mid-1955. Nationwide figures revealed that savings per person rose from $1,296 at the end of December, 1954, to $1,307 in mid-1955. Unfortunately there are no regional figures available to show investments in other types of saving. It appears probable that people in other parts of the country, especially the faster growing areas, are more inclined to put their savings into other types of investments."*

Table I compares the investment in selected types of liquid assets of accumulated per capital savings in New England and the United States in 1955. As can be seen, mutual savings bank deposits are New Englanders' preferred medium for liquid savings.

Savings channeled into these types of financial institutions may be less effective in aiding small business. These institutions have legal limits imposed on their lending procedures and also have a fiduciary relationship to maintain with their depositors.

Mr. Sherwin C. Badger, Financial Vice President of New England Mutual Life Insurance Company, summed up the problem in his letter to the Board of Directors of the Massachusetts Business Development Corporation when he stated:

*36, P. 7
<table>
<thead>
<tr>
<th>Type of Liquid Asset</th>
<th>Per Capita Saving New England</th>
<th>Per Capita Saving United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual Savings Bank Deposits</td>
<td>$765</td>
<td>$171</td>
</tr>
<tr>
<td>Life Insurance Equities</td>
<td>509</td>
<td>446</td>
</tr>
<tr>
<td>U.S. Bonds, E and H Series</td>
<td>263</td>
<td>242</td>
</tr>
<tr>
<td>Commercial Bank Time Deposits</td>
<td>209</td>
<td>296</td>
</tr>
<tr>
<td>Savings and Loan Association Shares, Including Cooperative Banks</td>
<td>205</td>
<td>195</td>
</tr>
<tr>
<td>Per Capita Total</td>
<td>$1,951</td>
<td>$1,350</td>
</tr>
</tbody>
</table>

"As we look at private sources of funds today, where can small or medium-sized, or even an off-the-top-grade large corporation get long-term capital...to expand or even to stay in business...

"It is not the business of commercial banks to supply medium or long-term capital in the form of loans. While 'term loans' running from three to sometimes ten years are made by many commercial banks, they are almost invariably confined to concerns with top credit ratings and with long and well established earnings records. Short-term loans which are the typical loans of commercial banks should not serve as permanent or semi-permanent capital because the borrower is always faced with the possibility that his loan may be called for payment. Hence he cannot utilize a bank line or short-term loans for long-term planning.

"Similarly, savings banks can rarely lend (except on mortgages) to corporations for long term unless the bonds which they buy are readily marketable and liquid, the reason being of course that savings bank deposits are close to a demand liability."
"Life insurance companies to an increasing extent, through what is known as a 'Direct Placement', have been lending 10-20 year money to corporations. However, from the nature of their trustee responsibilities they must necessarily confine their investment activities pretty much to the demonstrably strong credit risks."*

Because of legal restrictions and fiduciary relationships, these increased personal savings, flowing into conventional financial institutions, have not generally been made available to small business firms seeking long-term credit.

Financial Position of Small Business

Small business firms have three basic ways in which to finance growth: (1) retained earnings, (2) borrowing, or (3) equity capital.

Equity capital would eliminate the burden on income that interest charges and repayment of loans make on many small concerns. However, for a small firm to get equity financing it is necessary to have a good earnings record, some atmosphere of "glamor", and favorable prospects for growth and expansion. Even if a small firm can fulfill these requirements, the costs of raising equity capital are still large, and, as mentioned previously, most small business

*83, PP. 2-3
entrepreneurs prefer not to dilute their control of the business or their share of the profits. Charts 1 and 2 show that the annual rate of earnings on stockholders' equity, both before and after taxes, have been continually lower since 1947 for small manufacturing corporations than for large concerns. Because these charts are based on data from reports of the Federal Trade Commission and the Securities and Exchange Commission which receive wide circulation, this fact in itself has lessened the enthusiasm for small business investment.

There has been a notable shift to retained earnings as a source of equity capital. During the 1920's stock financing provided almost one-half of the new equity funds obtained by corporations while retained profits amounted to less than 30 per cent of all earnings.* By 1954 undistributed profits amounted to 39.0 per cent of total corporate profits after taxes, and by 1955 this percentage had risen to 46.9. Retained profits have remained at approximately the 1955 level.** The Senate Select Committee on Small Business reported in 1957 that:

"The traditional way for small companies to grow is to finance their expansion by the use of retained earnings. Thus, for the years 1947-1950, about 80 per cent of physical expansion of nonfinancial corporations,

*63, P. 22
**65, P. 29
U. S. MANUFACTURING CORPORATIONS, EARNINGS ON STOCKHOLDERS' EQUITY BEFORE TAXES, BY ASSET SIZE, ANNALLY 1947-1956

Annual Rate (Per Cent)

*Rate for 1956 based on new sample

CHART 2

U. S. MANUFACTURING CORPORATIONS, EARNINGS ON STOCKHOLDERS' EQUITY AFTER TAXES, BY ASSET SIZE, ANNULARLY 1947-1956

Annual Rate (Per Cent)

<table>
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<tr>
<th></th>
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<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

*Rate for 1956 based on new sample

including inventories, was paid for with retained profits. From 1953 to 1955, this proportion increased to 87 per cent."*
The Small Business Administration reports:

"This high ratio of retained earnings has been attributable to the reluctance of owners of companies to raise money through security issues, as well as a desire to enhance the capital value of the companies by reinvesting the earnings instead of paying them out in dividends. Small companies have been less able than large companies to retain earnings to plow back for expansion because their earnings have been smaller and because they have relatively less left after taxes."**

Charts 3 through 5 indicate the less favorable position of small manufacturing corporations in net sales and earnings from data based on Statistics of Income 1947-1953. Charts 6 through 8 indicate the same information through 1956 based on data from Federal Trade Commission and Securities and Exchange Commission Reports. It can be seen that sales and earnings of small firms have not

*56, P. 6
**63, P. 22
CHART 3

U. S. MANUFACTURING CORPORATIONS
NET SALES BY ASSET SIZE
1947-1953

Index: 1947-1949 = 100

CHART 4

U. S. MANUFACTURING CORPORATIONS
EARNINGS BEFORE TAXES, 1947-1953

Index: 1947-1949 = 100

CHART 5

U. S. MANUFACTURING CORPORATIONS
EARNINGS AFTER TAXES BY ASSET SIZE, 1947-1953

Index: 1947-1949 = 100

Assets over $1 Million

Assets under $1 Million

CHART 6

U. S. MANUFACTURING CORPORATIONS
NET SALES BY ASSET SIZE, 1951-1956

Index: 1951 = 100

*Index for 1956 based on new sample

CHART 7

U. S. MANUFACTURING CORPORATIONS
EARNINGS BEFORE TAXES BY ASSET SIZE, 1951-1956

Index: 1951 = 100

Assets over $1 Million

*Index for 1956 based on new sample

CHART 8

U. S. MANUFACTURING CORPORATIONS
EARNINGS AFTER TAXES BY ASSET SIZE, 1951-1956

Index: 1951 = 100

Assets over $1 Million

Assets under $1 Million

*Index for 1956 based on new sample

maintained the pace set by the larger corporations in the period from 1947-1956.

For these reasons small business firms have turned to borrowing and term loans as a source of financing expansion.

Peculiarities of the New England Region

The New England region is one of the oldest and most highly developed industrial regions in the country. This fact in itself has tended to aggravate the problem of small firms in obtaining long-term loan funds in this area. In his article on the Massachusetts Business Development Corporation in the Boston University Business Review, Professor Friedland pointed out that:

"A highly developed economic area will contain large, established firms which provide severe competition in the funds market for smaller, newer firms. At any time, there is available a supply of loanable funds. In allocating these funds among potential borrowers, lenders will be concerned not only with the promised rate of interest, but with the likelihood of repayment. At a given rate of interest, a firm with a history of good earnings will have an advantage over a firm whose future earnings are somewhat uncertain. A large firm,
whose balance sheet is loaded with marketable assets, will be favored over a small firm. In an underdeveloped area, the handicap of being new and/or small will be slight, since there will be few old or large firms. However, as the economy develops, the new and small firms must compete with a growing number of older and larger firms in the funds market."

For many years New England financial institutions have been considered highly conservative in their outlook and their lending procedures and policies. This may be partially true and may be partially explained by the above statement of Professor Friedland. However, New England bankers were instrumental in formation of the development credit corporations in New England, although one writer apparently questioned their intentions in formation of the organizations when he stated an "important objective, though rarely publicly stressed, is to get existing lending institutions 'off the hook' in the matter of political propaganda which says that they won't lend to small business."**

*99, P. 29
**12, P. 33
CHAPTER IV
TWO MAJOR ATTEMPTS BY THE FEDERAL GOVERNMENT TO
OVERCOME THE PROBLEM

The Reconstruction Finance Corporation

The Reconstruction Finance Corporation was es­
tablished by the federal government during the depression
year of 1932. The R.F.C. was a government lending agency
that was designed to make loan funds available to busi­
nesses that were unable to obtain their financing needs
from private sources.

The lending power of the R.F.C. was quite broad.
Loans by the R.F.C. were not restricted to the area of
small business enterprise, but were available to all sized
businesses in need of funds. The R.F.C. was restricted
from lending funds if satisfactory arrangements for loans
could be made through ordinary banking and business channels.
Prospective borrowers from the R.F.C. were required to show
evidence that an attempt had been made to borrow through
ordinary business channels and that such borrowing attempts
were unsuccessful. The R.F.C. also required that adequate
security be posted to secure each loan. There were various
other minor considerations for loans from the R.F.C. For
example, the economic value of the enterprise both to its
locale and the nation as a whole was taken into considera­
tion. The value of the potential loan in increasing em­
ployment was determined. In that period of depression and
high unemployment, loans which tended to increase employ­
ment were given first priority. Another consideration in
granting a loan was in determining what other favorable
effects the loan would make on the economic life of the
community.

Some example of the lending activities of the
Reconstruction Finance Corporation would be helpful in de­
monstrating the broad lending power that the organization
had even until 1953. In the New England area from
January, 1948, through March, 1952, the R.F.C. made loans
totaling $164 million. On a nationwide basis, during the
two-year period of 1948 and 1949, the R.F.C. received over
18,000 loan applications. The total amount of funds in­
volved in these applications was $2.7 billion.* As can be
seen from the preceding figures, the average loan requested
from the R.F.C. during this period was about $150,000, but
it should be remembered that a few very large loans re­
quested tend to overbalance this figure to the high side.

Of these 18,000 loan requests, approximately
4,000 were withdrawn before action could be taken. Some
firms were able to secure financing through ordinary
channels before their applications for R.F.C. loans were
acted upon, and many businesses had reached the failing
stage before appropriate action could be taken on their
requests. Therefore, final action was taken on 13,479 loan

*68, P. 22
requests during the years of 1948 and 1949.* Of these 13,479 requests, the R.F.C. approved 8,100 for an aggregate amount of $1 billion. The average approved loan was slightly over $125,000. 5,379 requests for $863 million were declined. Table I outlines these figures.

In its 1950 survey of small business financing problems, the Office of Business Economics of the U.S. Department of Commerce sampled 300 loans declined by banks, but eventually approved by the Reconstruction Finance Corporation, to determine the reasons for bank rejection.** This survey disclosed that the average loan declined ran from two to ten years' maturity, with the typical term being five years. The banks listed 445 reasons for declining the 300 loan applications, more than one reason being given in most cases. The reason most often mentioned was the length of maturity of the loan. In almost one-half of the cases, the banks felt that the requested maturity of the loan impaired its safety. Other reasons listed and their frequency in being mentioned will be found in Table II.***

"It is clear from this table that the largest credit gap for small business in the private financing situation was for long-term loans. Practically half of the banks which the borrowers approached refused the loan

*68, P. 22
**ibid., P. 22
***61, P. 23
**TABLE I**

**ACTION TAKEN BY THE RECONSTRUCTION FINANCE CORPORATION ON 13,479 LOAN APPLICATIONS, 1948 AND 1949**

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>%</th>
<th>$ Amount</th>
<th>%</th>
<th>Average Size $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans Approved</td>
<td>8,100</td>
<td>60</td>
<td>1,000,000,000</td>
<td>54</td>
<td>125,000</td>
</tr>
<tr>
<td>Loans Declined</td>
<td>5,379</td>
<td>40</td>
<td>863,000,000</td>
<td>46</td>
<td>160,000</td>
</tr>
<tr>
<td>Totals</td>
<td>13,479</td>
<td>100</td>
<td>1,863,000,000</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

### TABLE II

**Why Banks Declined 300 Small Business Loans**

**Authorized by R.F.C., 1948-1949**

<table>
<thead>
<tr>
<th>Reason</th>
<th>No. of Banks</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maturity too long</td>
<td>207</td>
<td>46.5</td>
</tr>
<tr>
<td>Bank Policy</td>
<td>62</td>
<td>13.9</td>
</tr>
<tr>
<td>Unacceptable or insufficient collateral</td>
<td>56</td>
<td>12.6</td>
</tr>
<tr>
<td>Financial Condition of Borrower</td>
<td>31</td>
<td>7.0</td>
</tr>
<tr>
<td>&quot;Brush off&quot; or Miscellaneous</td>
<td>89</td>
<td>20.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>445</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

**Sources:** R.F.C. with regrouping of reasons by the U. S. Department of Commerce, Office of Business Economics
because of its long maturity."

Lending authority of the R.F.C. was terminated on September 28, 1953.

The Small Business Administration

The Small Business Administration came into existence by virtue of Public Law 163 of the 83rd Congress. The law was known as the Small Business Act of 1953 and was enacted on July 30, 1953. President Eisenhower signed the Act into law on the same day. Public Law 163 established the Small Business Administration for a two-year period. Section 202 of the law stated:

"It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect insofar as is possible the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts for supplies and services for the Government be placed with small-business enterprises, and to maintain and strengthen the overall economy of the Nation."**

Public Law 268 of the 84th Congress continued the life of the Small Business Administration for another two-
year period. This law was known as the Small Business Act of 1955 and was signed by President Eisenhower on August 9, 1955. The most recent session of Congress has given the Small Business Administration an indeterminate life.

The Small Business Administration was set up by the Government for three major purposes.* Most important to this study is the authority of the Small Business Administration to make business loans to small business concerns. The S.B.A. also has the power to make loans to assist victims of floods and other disasters. Both of these powers were formerly held by the Reconstruction Finance Corporation.

A second major purpose of the Small Business Administration is to assist small business firms in Government procurement. This responsibility was formerly held by the Small Defense Plants Administration.**

The Small Business Administration was also established to help small business firms obtain management, technical, and production counsel. This has developed into one of the more important functions of the S.B.A., second only to the lending function.

"For many small businesses, the lack of many necessary managerial skills and technical and production 'know-how' are serious impediments to progress. In the growing

*61, P. 2
**61, P. 1
complexity of business operations, businessmen can rely less and less on native talent and trial and error to make a success of their businesses. They must be alert, well informed, and conversant with daily changes in their particular fields, if they are to survive. And yet all too frequently small concerns cannot afford to engage expert counsel to set up, for example, efficient accounting systems, or to advise them as to the most advanced business methods. Often, too, small firms cannot afford to hire engineers or other technicians to help them solve their technical problems."

The S.B.A. has provided individual counseling on management and financial problems and has co-sponsored administrative management courses with more than 100 educational institutions. In addition, the Small Business Administration issues four series of publications: Small Marketers Aids, Management Aids for Small Manufacturers, Technical Aids for Small Manufacturers, and the Small Business Management Series. All except the Small Business Management Series are distributed without charge."

*61, PP. 3-4
**67, PP. 87-90
small entrepreneurs increase their managerial skills and operate their establishments more skillfully. The Lending Function of the Small Business Administration

As mentioned previously, one of the major functions of the S.B.A., and the one most important to this study, is the lending function. The lending policy of the S.B.A. is determined by its Loan Policy Board. The Small Business Act of 1953 designated the administrator of the Small Business Administration as Chairman of the Loan Policy Board. The board is composed of only two other members, the Secretary of the Treasury and the Secretary of Commerce.

An August, 1953, decision of the Loan Policy Board was made to defer acceptance of loan applications to the Small Business Administration until after September 28, 1953, when the lending authority of the Reconstruction Finance Company terminated. The first policy statement was issued by the board on September 16, 1953, and since that time there have been numerous revisions and amendments to fit the basic changes which occur in the economy.*

The Small Business Administration makes three basic types of business loans.** Under the deferred participation loan plan a bank or other private credit institution advances the capital needed by the small business firm that has been granted a loan. The Small Business Administration

*61, P. 56
**60, PP. 4-5
agrees to purchase upon notice by the bank an agreed percentage of the unpaid balance of the loan. Under the immediate participation loan plan the Small Business Administration or a private lending institution agrees to purchase from the other immediately upon disbursement of a loan, an agreed percentage of each disbursement made on account of a loan approved by both. By statute, S.B.A. participation is limited to 90% of an immediate participation loan. Of the 7,096 business loans approved by the Small Business Administration through June 30, 1957, 4,941 were participation loans.*

The S.B.A. will also make direct loans to small business firms. Such loans are made wholly by the Small Business Administration with no private participation. The 2,155 direct loans approved by the S.B.A. through June 30, 1957, have been authorized only as a last resort.

The following steps must be followed by a prospective borrower from the S.B.A.:

"(1) The applicant must show that he has been refused private financing on reasonable terms. (2) The applicant must seek deferred participation in which the bank or other lending institution provides the entire amount but has an agreement with S.B.A. under which it will purchase part of the loan on demand at any time.

*67, P. 45
(3) The applicant must seek an immediate participation in which S.B.A. agrees to take a portion of the loan from the start.

(4) S.B.A. grants a direct loan. According to S.B.A. loan policy, in return for S.B.A. participation in a loan the bank pays the agency a small fee, which varies with the extent of S.B.A. participation.*

Late in 1955, the Small Business Administration began a Limited Loan Participation Program, designed especially to aid small retailers, wholesale distributors and service establishments.** This type of concern may have good management and earnings but little tangible collateral to pledge for a term loan.

"Under this plan, the Small Business Administration will participate with a bank in a loan to a small retailer, wholesaler, service establishment or other business up to a maximum of $15,000 or 75 per cent of the total amount of the loan, whichever is the lesser."***

The Limited Loan Participation Program has provided an increased opportunity for these types of businesses to obtain loans.

*67, P. 57
**64, P. 38
***64, P. 39
The Loan Policy Board of the Small Business Administration has set forth in its policy statements certain basic requirements which must be met by a small business concern to be eligible for a loan from the agency. Most important, of course, is the fact that the loan applicant must meet the small business criteria; in other words, the concern must be one that is "independently owned and operated and which is not dominant in its field of operation."* Manufacturing concerns are considered small if they have fewer than 250 employees, and certain industries may be considered small if they have between 250 and 1,000 employees. No manufacturing firm is eligible to borrow from the Small Business Administration if it has more than 1,000 employees.

Most wholesale concerns are considered to be small if they have annual sales of less than $5,000,000. "Any wholesale concern also engaged in manufacturing shall not be designated as a 'small business concern' unless it so qualifies under both manufacturing and wholesaling standards."**

Retailers and service trade firms are considered small if their annual sales or receipts are $1,000,000 or less, with a few exceptions such as department stores and automobile dealers.

The loan applicant must also meet certain practical credit requirements.

*61, P. 94
**61, P. 9
"a. An applicant must be of good character.
b. There must be evidence he has the ability
to operate his business successfully.
c. He must have enough capital in the busi-
ness so that, with loan assistance from
the S.B.A., it will be possible for him
to operate on a sound financial basis.
d. As required by the Small Business Act,
the proposed loan must be 'of such sound
value or so secured as reasonably to
assure repayment.'
e. The past earnings record and future
prospects of the firm must indicate
ability to repay a loan out of income
from the business.'*

The Small Business Act of 1953 limited the maximum
amount of loan funds which could be committed or outstanding
to any one borrower to $150,000. However, the Small Busi-
ness Act of 1955, in recognition of the increasing costs of
carrying on a business, raised this maximum amount to
$250,000. With certain minor exceptions, the maximum
maturity of any loan is ten years and the maximum interest
rate is 6%. The most notable exception to the above is
loans made under the Limited Loan Participation Program.
Such loans have a maximum maturity of five years.

*58, P. 2
"The S.B.A. will not make certain types of loans or loans under certain circumstances. Loans will not be granted:

1. If the funds are otherwise available on reasonable terms (a) from a financial institution, (b) from the disposal at a fair price of assets not required by the applicant in the conduct of its business or not reasonably necessary to its potential growth, (c) through use of the personal credit and/or resources of the owner, partners, management, or principal stockholders of the applicant, (d) from other Government agencies which provide credit specifically for the applicant's type of business or (e) from other known sources of credit;

2. If the loan would be for the purpose of (a) paying off a creditor or creditors of the applicant who are inadequately secured or in a position to sustain a loss, (b) providing funds for distribution or payment to the owner, partners, or shareholders of the applicant, or (c) replenishing working capital funds previously used for either of such purposes;

3. If the purpose of the applicant in applying for such assistance is to effect a change
in ownership of the business;
4. If the loan will provide or free funds for speculation in any kind of property, real or personal, tangible or intangible;
5. If the applicant is an eleemosynary institution;
6. If the purpose of the loan is to finance the construction, acquisition, conversion, or operation of facilities which are or will be used for recreational or amusement purposes; however, this does not prohibit financial assistance for such facilities when they are or will be incidental and appropriate to the business of the applicant;
7. If the applicant is a newspaper, magazine, radio broadcasting or television broadcasting company, or similar enterprise;
8. If a substantial portion of the gross income of the applicant (or any of its principal owners) is derived from the sale of alcoholic beverages;
9. If any part of the gross income of the applicant (or any of its principal owners) is derived from gambling purposes;
10. If the loan is to provide capital to
an enterprise primarily engaged in the business of lending or investment;

11. If the effect of the granting of the financial assistance will be to encourage monopoly or will be inconsistent with the accepted standards of the American system of free competitive enterprise."*

Lending Operations of the Small Business Administration

Since acceptance of the first business loan application on October 2, 1953, the Small Business Administration had received 16,552 applications for loans through June 30, 1957. The number of loan applications has surged noticeably since January, 1955, as the activities of the S.B.A. have become more widely known. For example, during the six-month period ending June 30, 1955, the S.B.A. received 1,499 business loan applications; during the corresponding six-month period ending June 30, 1957, the S.B.A. received 3,527 business loan applications.** This upward trend in loan applications can be graphically seen by observing Chart 1.

Of these 16,552 applications, 1,994 were withdrawn before the S.B.A. took any action. Of the remaining 14,558 applications processed, 7,096 were approved for a total dollar volume of $324,785,615. Table III breaks down these approvals by loan types.

*58, PP. 2-3
**67, P. 44
BUSINESS LOAN APPLICATIONS RECEIVED BY THE S.B.A. JANUARY, 1955 THROUGH JUNE, 1957

### TABLE III

**BUSINESS LOANS APPROVED BY THE S.B.A. BY TYPE OF LOAN**

**SEPTEMBER, 1953 THROUGH JUNE, 1957**

<table>
<thead>
<tr>
<th>Type of Loan</th>
<th>Total Number</th>
<th>Total Amount</th>
<th>S.B.A. Share</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>7,096</td>
<td>$324,785,615</td>
<td>$269,975,800</td>
</tr>
<tr>
<td>Direct Loans</td>
<td>2,155</td>
<td>$91,017,700</td>
<td>$91,017,700</td>
</tr>
<tr>
<td>Participation Loans</td>
<td>4,941</td>
<td>233,767,915</td>
<td>178,958,100</td>
</tr>
<tr>
<td>Deferred</td>
<td>2,160</td>
<td>95,216,137</td>
<td>70,475,552</td>
</tr>
<tr>
<td>Immediate</td>
<td>2,781</td>
<td>138,551,778</td>
<td>108,482,548</td>
</tr>
</tbody>
</table>

Although manufacturers constitute less than ten per cent of the total business population, they have received almost forty per cent (2,752 of 7,096) of the number of loans approved and over fifty per cent of the total dollar volume ($167,710,572 of $324,785,615). "Furthermore, loans to small manufacturers may continue to be a higher percentage of business loan approvals than the number of manufacturers would suggest because of their relatively greater need for funds required to make the capital expenditures essential to expansion and growth."*

Table IV outlines the business loans approved by the S.B.A. by industry. As can be seen, almost every conceivable type of manufacturing industry is included in the table. The average manufacturing loan approved amounted to $60,000, while the average non-manufacturing loan was about $35,000.

The percentage of loans approved by the Small Business Administration has steadily increased to a point where almost 60% of all applications received are now approved. In the period from January 1, 1956, to June 30, 1956, 60.2% of the applications for loans were approved; from July 1, 1956, to December 31, 1956, the approval rate was 58.5%; and for the first six months of 1957, the approval rate was 58.8%.** "Through June 30, 1957, about 51.2% of the business loan applications on which final action had been taken had been approved."***

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*67, P. 52
**67, P. 47
***67, P. 46
<table>
<thead>
<tr>
<th>Industry</th>
<th>Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grand Total</td>
<td>7,096</td>
<td>$324,785,615</td>
</tr>
<tr>
<td>Manufacturing Industries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2,752</td>
<td>$167,710,572</td>
</tr>
<tr>
<td>Ordnance and Accessories</td>
<td>4</td>
<td>$112,800</td>
</tr>
<tr>
<td>Food and Kindred Products</td>
<td>449</td>
<td>$31,539,725</td>
</tr>
<tr>
<td>Tobacco Manufactures</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Textile Mill Products</td>
<td>67</td>
<td>$5,508,000</td>
</tr>
<tr>
<td>Apparel and Other Finished Products, etc.</td>
<td>75</td>
<td>$2,570,167</td>
</tr>
<tr>
<td>Lumber and Wood Products (except Furniture)</td>
<td>302</td>
<td>$17,930,574</td>
</tr>
<tr>
<td>Furniture and Fixtures</td>
<td>48</td>
<td>$3,449,350</td>
</tr>
<tr>
<td>Paper and Allied Products</td>
<td>136</td>
<td>$5,157,125</td>
</tr>
<tr>
<td>Printing, Publishing, and Allied Industries</td>
<td>107</td>
<td>$6,516,755</td>
</tr>
<tr>
<td>Chemicals and Allied Products</td>
<td>21</td>
<td>$1,495,200</td>
</tr>
<tr>
<td>Petroleum and Coal Products</td>
<td>21</td>
<td>$1,681,232</td>
</tr>
<tr>
<td>Rubber Products</td>
<td>21</td>
<td>$574,000</td>
</tr>
<tr>
<td>Leather and Leather Products</td>
<td>216</td>
<td>$13,672,351</td>
</tr>
<tr>
<td>Stone, glass and clay products</td>
<td>105</td>
<td>$7,838,766</td>
</tr>
<tr>
<td>Fabricated Metal Products (except ordnance, machinery, and transportation equipment)</td>
<td>290</td>
<td>$16,582,747</td>
</tr>
<tr>
<td>Machinery (except electrical)</td>
<td>405</td>
<td>$24,550,581</td>
</tr>
<tr>
<td>Electrical Machinery, Equipment and Supplies</td>
<td>103</td>
<td>$7,049,248</td>
</tr>
<tr>
<td>Transportation Equipment</td>
<td>105</td>
<td>$6,938,678</td>
</tr>
<tr>
<td>Professional, Scientific and Controlling Instruments; Photographic and Optical Goods; Watches and Clocks</td>
<td>26</td>
<td>$1,370,250</td>
</tr>
<tr>
<td>Miscellaneous manufacturing industries</td>
<td>130</td>
<td>$6,782,923</td>
</tr>
</tbody>
</table>
Table IV (Continued)

<table>
<thead>
<tr>
<th>Nonmanufacturing Industries</th>
<th>Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>4,344</td>
<td>$157,075,043</td>
</tr>
<tr>
<td>Poultry Hatcheries, Greenhouses, Crop Specialties, Fisheries, etc.</td>
<td>147</td>
<td>$5,834,553</td>
</tr>
<tr>
<td>Mining</td>
<td>102</td>
<td>6,714,325</td>
</tr>
<tr>
<td>Construction</td>
<td>412</td>
<td>18,019,460</td>
</tr>
<tr>
<td>Transportation, Communication and Other Public Utilities</td>
<td>359</td>
<td>22,830,109</td>
</tr>
<tr>
<td>Wholesale and Retail Trade</td>
<td>2,615</td>
<td>78,597,611</td>
</tr>
<tr>
<td>Services, etc.</td>
<td>709</td>
<td>25,078,985</td>
</tr>
</tbody>
</table>

The Small Business Administration has given many reasons for declining loan applications. The reasons most often listed in their approximate order of importance are: (1) The earning ability of the concern has not been demonstrated in the past or is not reasonably assured for the future; (2) sufficient collateral is not available to secure the loan; (3) there is an insufficient equity investment in the business concern; (4) the business is in unsatisfactory financial condition; and (5) the business is unable to demonstrate a need for loan funds.*

"Analysis of the proposed uses of business loans approved through June 30, 1957, shows that small businesses intended to use the funds for these purposes: 36.9 per cent for working capital; 27.6 per cent for consolidation of obligations; 24.4 per cent for construction of facilities; and 11.1 per cent for purchases of equipment."**

A summary of these proposed uses is found in Table V.

*67, p. 50
**67, p. 55
### TABLE V

**PROPOSED USES OF S.B.A. BUSINESS LOANS APPROVED**

**SEPTEMBER, 1953, THROUGH JUNE, 1957**

<table>
<thead>
<tr>
<th>Use</th>
<th>Amount</th>
<th>Per Cent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>$324,785,615</td>
<td>100.0</td>
</tr>
<tr>
<td>Working Capital</td>
<td>119,881,802</td>
<td>36.9</td>
</tr>
<tr>
<td>Facilities</td>
<td>79,240,760</td>
<td>24.4</td>
</tr>
<tr>
<td>Consolidation of Obligations</td>
<td>89,772,805</td>
<td>27.6</td>
</tr>
<tr>
<td>Equipment</td>
<td>35,890,248</td>
<td>11.1</td>
</tr>
</tbody>
</table>

CHAPTER V

SOME PRIVATE ATTEMPTS TO OVERCOME THE PROBLEM

The First National Bank of Chicago

In the late 1940's, with Congressional investigators agitating over the "plight" of small business, and suggestions for semi-public credit banks for small business being advocated, there was some awakening by established financial institutions to the specific needs of small business concerns.

The directors of the First National Bank of Chicago realized after the end of World War II, that small business firms were experiencing difficulty in obtaining capital funds to begin peace-time work. With this thought in mind, the bank established a small business loan program in 1947, primarily to assist manufacturers.* Loans were to be made to small manufacturers for two purposes only: (1) the procurement of new machinery and/or buildings, and (2) working capital purposes. The maximum maturity of any loan is five years and loans can be made in amounts ranging from $50,000 to $250,000. Loans are repaid to the bank in monthly or quarterly installments.**

The bank has made some general statements regarding the success of the program, but no figures are available. The First National states that it has found that the

*22, P. 88
**ibid., P. 89
lending program meets the needs of some small businesses. With regard to the bank itself, the First National feels that the program has built good will for the bank and has created additional business for the bank in the form of deposits by successful loan negotiators.

Expected losses from the program "have been almost zero.* The bank requires certain reports with the installment payments by the borrowers, and these reports have enabled the bank to spot unfavorable developments before losses begin to mount. When trouble occurs, bank officers work with the small business management to go over the company's operations and spot the major difficulties.**

No doubt, the program has enjoyed considerable success as far as the First National is concerned, but its limited scope and area of operation have been of little benefit to small business in general. Even so, the First National Bank of Chicago should be given recognition for its assistance to small business concerns in its area.

**Similar Bank Plans for Long-Term Lending to Small Business**

Early in 1950, the Chase National Bank of New York established a loan plan for small business firms. The bank set aside $10 million in order to join with its 3,700 correspondent banks in extending intermediate term credit (approximately five-year maximum maturity) to small local concerns.***

*22, P. 88
**Ibid., P. 88
***Ibid., P. 88
The Pennsylvania Company for Banking and Trusts of Philadelphia also established a small business loan plan early in 1950. Under this plan, the maximum loan which the bank will make to any one business firm is $25,000. Loans are made for capital purposes only and the maximum term of any loan is three years.*

In May, 1950, the National City Bank of New York established a loan plan for small businesses. The maximum loan under this plan is $10,000, and the maximum term of any loan is five years. "As of the end of 1953, 38,000 such loans, totaling $46,000,000, were outstanding and...loss experience...was less than one-fourth of 1 per cent."**

All of these programs have probably been of some local benefit to small business concerns, but it would take a great many more of such programs to benefit truly small business on a national scale.

Other Private Credit for Small Business

"Insurance companies, such as Prudential and Metropolitan also have small business loan programs in operation. Life insurance companies have been able to invest in small business primarily through the mortgage loan route."***

*22, P. 88
**61, P. 27
***ibid., PP.27-28
In 1950 the Metropolitan Life Insurance Company set up a division to experiment with small business loans. This plan was to be in cooperation with local banks that were willing to take at least ten per cent of each loan.* Unfortunately, it must be said that the program has been notable only for its lack of success.

Many cities and towns throughout the country have established industrial foundations, both as a means to attract new business and industries, and to aid existing firms.

"An industrial foundation is a community finance corporation set up to carry on and extend the services customarily provided by chambers of commerce in the industrial development of their communities. The primary purpose of the industrial foundation is to bring new industrial enterprises into the community, although it may also be interested in assisting local manufacturing firms. It achieves its purpose primarily by financing requirements for factory space. It may also furnish other aid by leasing or selling industrial sites at or below cost, by loans or other financial aid, and by providing managerial assistance, 

*22, P. 88
subsidies such as free rent or land, and exemption from property taxation."*

Because industrial foundations are local in nature and operate with limited funds, they generally cater to small manufacturing concerns.

The Louisville, Kentucky, Industrial Foundation provides an excellent example of the action of an industrial foundation outside the New England area.

The Louisville Industrial Foundation was established in 1916 and is now one of the oldest active foundations in the country. Total paid-in capital of the foundation from the sale of stock has reached nearly $900,000. The foundation has authority to make loans or invest in manufacturing establishments in Louisville and its vicinity.** The maximum loan to any one concern is $100,000 and loans may be made for construction or enlargement of plant facilities, for equipment modernization, or for other purposes usually associated with equity capital. Two-thirds of the directors of the foundation must approve any loan or investment. "The Foundation may not invest more than 10% of its capital in any one concern, nor may it advance financial aid that will exceed one-third of the total paid-in capitalization."***

Capital advances had been made to 44 new or established manufacturing firms through 1944 and 36 of these

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*32, P. 1
**ibid., P. 4
***ibid, P. 4
firms were still in operation in 1950.* Thirteen of the firms aided by loans or equity investment were completely new establishments; eight of those aided were recently founded firms in need of capital for expansion purposes; twelve firms were relocations from other cities, and eleven firms assisted were old established concerns in need of financial aid.**

"As it grew in experience, the Foundation developed the following policies that contributed materially to the success with which it attained its objectives: (1) it sponsored diversified types of industries; (2) it agreed to liberal financial arrangements; (3) it arranged flexible repayment schedules, adapted to the client's ability to pay; (4) it maintained close and personal relationships with its client concerns; (5) it operated as a quasi-public institution; (6) it avoided competition with existing lending institutions.

"The Foundation in 1944 had liquid assets of $400,000 and a reserve against possible losses amounting to $90,000, in addition to industrial investments of $567,698."***

*32, P. 1
**Ibid., P. 4
***Ibid., P. 4
New England now has an abundance of industrial foundations, the oldest dating back to 1912. A survey by the Federal Reserve Bank of Boston in 1952 disclosed that thirty-six New England communities had industrial development corporations whose primary function was indirectly assisting small New England manufacturers with venture capital problems by providing plant space on a rental or long-term purchase basis.* Since completion of that survey, the number of industrial foundations has increased rapidly.

Of the local industrial development foundations located in New England in June, 1952, twelve stated they would make loans to manufacturers, and six stated they would invest equity capital.**

At the time of the survey, the Federal Reserve Bank stated:

"Seven have actually loaned money. Only three have purchased stock.

"All of the foundations that will make loans except one require bank rejection of loan requests before they will handle them. The seven groups have had about fifty applications for loans and approved nineteen. They have loaned an estimated $1,281,700. Most of the loans were of the long-term amortizing type. Complete

*35, P. 1
**ibid., P. 4
figures on repayments are not yet available, but most of the loans have either been repaid or are being repaid satisfactorily. There have been defaults in a few cases. Interest rates have ranged from 2 to 6 per cent, with an average rate of 4\% per cent."

Within recent years, industrial foundations have worked with conventional financial institutions and development credit corporations, by providing considerable third mortgage money for new plant construction for small manufacturers.

A more recent survey by the Federal Reserve Bank of Boston disclosed that at least seventy-five local industrial development corporations had been organized in New England through 1955.** Twenty-three of these corporations had made 82 loans aggregating $3,190,900. From May, 1952, through December, 1955, eighteen corporations made 42 loans aggregating $1,909,200.***

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*35, P. 4
**31, P. 6
***ibid., P. 6
CHAPTER VI
PRELIMINARY STEPS TO ORGANIZATION OF THE DEVELOPMENT CREDIT CORPORATIONS OF THE NEW ENGLAND STATES

The Development Credit Corporation of Maine

Maine was the first of the New England states to form a development credit corporation. The Development Credit Corporation of Maine was created by an act of the state legislature in 1949. Primary credit for leadership in the formation of the corporation is given to Arthur F. Maxwell, President of the First National Bank of Biddeford, Maine. Early in 1949 Mr. Maxwell organized the members of the Maine Bankers Association, leading public utility executives and industrialists in Maine to work together to devise some form of private financial institution that would be able to extend financial assistance to the numerous small industrial firms in the state that were unable to obtain financing from existing institutions. Like the other New England states, Maine had seen many of its industries move off to the South in search of cheaper labor and raw materials immediately after World War II. Rather than request government aid, this group of Maine bankers and businessmen decided to solve the problem for themselves. It was decided to set up a banker-businessman "co-op" lending group to provide loans to small businesses unable to obtain bank loans.

"The formulators of the plan recognized that conventional financial institutions have a
primary concern for the safety of the funds entrusted to them and are not able to enter the risk capital field to any great extent. By pooling the small part of their resources which they can risk, however, these institutions could provide a considerable amount of venture capital and still avoid serious risk to any one institution. The sponsors founded the Development Credit Corporation of Maine to channel some of the funds of Maine's financial institutions to new ventures and to facilitate to expansion of promising smaller concerns."

As mentioned above, the organizers recognized that two distinct advantages could be realized from this pooling of funds of conventional financial institutions: (1) A considerable amount of risk capital could be provided by such a pool, and (2) serious risk to any single financial institution would be avoided.

The organizers decided that the Development Credit Corporation of Maine would make loans to three groups of businesses. It was recognized that the majority of loans would go to small business firms that were already operating in the state but were in need of funds for working capital or expansion purposes. In order to encourage new business

*37, P. 1
firms to locate in Maine and expand the economy of the state, loans were authorized to be made to small business firms needing money to begin operations and also to small businesses already in operation in other states that desired to relocate in Maine.

Certain objections had to be overcome by Mr. Maxwell and his group before the Development Credit Corporation of Maine could become a reality. After enthusiasm had been generated among the bankers and businessmen of the state, it was necessary to generate political enthusiasm for the organization. This was necessary because the sponsors chose to seek a special charter from the legislature instead of a charter under the general laws.

Another problem was obtaining the approval of the state banking commissioner to allow Maine banks to become members of the corporation. Two concessions were made to obtain such approval. First, it was agreed that stock in the Development Credit Corporation of Maine would be sold only to non-bank subscribers. Second, the corporation was to be subject to the examination, supervision and control of the bank commissioner and was to make reports of its condition to him as he might require.

After these problems had been overcome, the Development Credit Corporation of Maine became a reality in late 1949 and began operations early in 1950. This was the first such organization of its type in the country.
The New Hampshire Business Development Corporation

The beginning of the New Hampshire Business Development Corporation was similar to that of the Development Credit Corporation of Maine. By 1951, it was recognized that an additional source of long-term credit was needed by the small business concerns of New Hampshire. Two separate studies, one conducted by the Governor's Industrial Advisory Committee, the other by the New Hampshire Bankers' Association, determined that a development credit corporation such as existed in Maine was the answer to the problem.*

As in Maine, approval of the state banking commissioner had to be obtained. The same procedure was followed in New Hampshire with one exception. The New Hampshire Business Development Corporation is not considered a banking institution and does not pay a fee for examination by the state banking commissioner. However, it is subject to his supervision and examination, and must report to him as he requires.

An act creating the New Hampshire Business Development Corporation was passed as House Bill No. 417 by the legislature of the State of New Hampshire on July 10, 1951.

The Massachusetts Business Development Corporation

Preliminary plans for some type of development credit corporation for Massachusetts began as early as 1951. By that time indications were that the Development Credit

* 33, P. 3
Corporation of Maine was a distinct asset to the industry of that state, and it was thought such a corporation might also prove beneficial to Massachusetts industry.

The first plan for a development corporation for Massachusetts was introduced to the state legislature in 1951 by Sumner Whittier, then a state senator. Mr. Whittier plugged hard for his bill for a corporation modeled after that already in operation in Maine, but was unsuccessful in his efforts to obtain financial and legislative approval. The Republican State Committee then took up the idea as a part of its Republican legislative program for 1952. Even this strategy failed to work as financial concerns, rather than showing interest in the plan, exhibited open hostility.* Representative Charles Gibbons, then House minority leader, led the drive in the 1952 legislature for passage of the bill, but was unable to bring forth sufficient support to gain passage.

Also in 1952, Governor Dever proposed "a grandiose plan to provide $250,000,000 in capital funds for new and existing industries."** This plan went far beyond those developed in Maine and New Hampshire, and found little favor among financial and business interests in Massachusetts.

By 1953 it appeared that financial interests had become more favorable toward a development corporation.

*24
**25
*Perhaps an indication of this reversal of thinking is the report of the Committee of New England of the National Planning Association which pointed up the need for long-term credit for New England business. Furthermore, the Blanchard Report also proposed the development credit idea for Bay State industry."

The Committee of New England, in its report on the region's financial resources, warned that neither a development corporation nor any other single device could be counted on as a panacea, but it strongly endorsed the corporation idea as part of an over-all program of development.

"Perhaps one of the more important functions which such an agency can perform is to help show prospective manufacturers that the community or state is vitally interested in their welfare. To dispel the instinctive fears or antagonisms which some businessmen have toward any government helps to develop the healthy optimism which is necessary for investment."

In his campaign for Governor in 1952, Christian Herter stated that the major need of the state was to build
up its industrial capacity and provide more job opportunities. He recognized that the government's role in such a build-up must be an indirect one, in that it can provide the conditions under which industry thrives but it must not enter the industrial field itself. It was thought that Mr. Herter was thinking of a development corporation when he made such statements.

In his inaugural message in January, 1953, Governor Herter mentioned "the difficulty of obtaining venture capital for new firms or expansion of old ones" was one of the disadvantages facing Massachusetts industry, but at that time he gave no specific plan for correcting this disadvantage.*

However, on May 14, 1953, Governor Herter called together a large group of leading businessmen and financiers from all parts of the state and outlined his plans for the formation of a privately-financed Massachusetts Business Development Corporation designed to attract new industries to the state, rehabilitate and expand existing companies and establish a source of credit not otherwise readily available for economic development of the state. This group was almost unanimous in its approval of the plan he had outlined. Governor Herter recognized that Maine, New Hampshire, Rhode Island, and Vermont had already passed bills establishing development corporations, and that it was "essential that

*25
the competitive position of Massachusetts in relation to other states be strengthened by the creation of such a private corporation for Massachusetts."*

On this same day, May 14, 1953, the Boston Chamber of Commerce fully endorsed Governor Herter's plan. Mr. Paul T. Rothwell, President of the Chamber, said: "We believe the plan is a constructive approach to our current economic problems."** Mr. Rothwell said the Chamber felt that the need for such a corporation had already been established as shown by surveys conducted by the Federal Reserve Bank and the Massachusetts Development and Industrial Commission, and that such a corporation would be a valuable weapon in Massachusetts' fight to maintain a strong position in the industrial competition between the states. It was thought that a business development corporation in Massachusetts would advertise to the country that Massachusetts "not only wants industry to locate and expand here but we are willing to lend a helping hand to the right kind of enterprises."***

At this meeting Governor Herter appointed a committee of seven business leaders, headed by Irwin L. Moore, President of the New England Electric System, to determine the extent to which financial institutions would support

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**23  
***23
the plan. The Governor recognized that "success depends on the willingness of business to invest in it and the cooperation of Massachusetts financial institutions in making loans to it."* When the committee reported that there appeared to be strong support among the financial and business interests in the state, Governor Herter presented the measure to the state legislature in a special message in June, 1953. After some delays, the Massachusetts Business Development Corporation was established by the legislature on July 3, 1953.

The Rhode Island Development Company

A development credit corporation for Rhode Island was first proposed in 1952. Governor Roberts strongly supported a bill for formation of the Rhode Island Development Company which was introduced in the 1952 legislature. However, political, business, and financial support failed to appear and the bill was defeated in the closing hours of the legislature.

Greater support for the proposal developed in 1953, and a subcommittee of the Industrial Development Committee of the Providence Chamber of Commerce led to the formation of the Rhode Island Development Company which was approved by the Rhode Island legislature in 1953.**

The Vermont Development Credit Corporation

The Vermont legislature passed an act enabling

*26
**33, P. 3
formation of the Vermont Development Credit Corporation in 1953. However, there has been very little support for the Corporation in Vermont, and it was not until 1957 that the corporation had sold the $50,000 worth of stock that was necessary before it could begin business. An editorial appeared in the Rutland (Vermont) Herald in the summer of 1957 pointing out that Vermont was the only one of the New England states without an active and functioning development credit corporation, and "one cannot help wondering if there is a connection between that fact and the other fact that Vermont is the least industrialized of any state in the Northeast."*

The Connecticut Development Credit Corporation

Connecticut was the sixth and final New England state to form a development credit corporation. The Connecticut Light and Power Company was the driving force in establishing the Connecticut Development Credit Corporation.** Legislation creating the corporation was passed by the Connecticut legislature late in 1953.

*47, P. 6
**33, P. 3
CHAPTER VII
FORMATION OF THE DEVELOPMENT CREDIT CORPORATIONS OF THE NEW ENGLAND STATES

Special Charters of the Corporations

All of the New England development credit corporations were chartered under special legislation rather than under the general incorporation laws of the various states. These charters are all quite similar, but vary in slight details to meet local needs and conditions.

The most important reason for being chartered under special legislation is that a special charter specifically made participation legal for state chartered financial institutions, public utilities, and others. For example, Section 6 of the Charter of the Massachusetts Business Development Corporation states:

"Notwithstanding any rule at common law or any provision of any general or special law or any provision in their respective charters, agreements of association, articles of organization or trust indentures: (1) all domestic corporations organized for the purpose of carrying on business within this commonwealth, including without implied limitation any electric or gas company.... any railroad corporation....and all trusts, are hereby authorized to acquire, purchase,
hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of any bonds, securities or other evidences of indebtedness created by, or the shares of the capital stock of, the corporation, and while owners of said stock to exercise all the rights, powers and privileges of ownership, including the right to vote thereon, all without the approval of any regulatory authority of the commonwealth."

This thought is carried somewhat further in Section 6 of the charter of the Rhode Island Development Company. In addition to allowing public utilities in Rhode Island the above powers, the charter states:

"The charters of all corporations subject to regulation by the public utility administrator are hereby amended to the extent necessary to authorize the purchase, sale, or other disposition of the bonds, securities, or other evidences of indebtedness created by, or the shares of the capital stock of this corporation..."**

Special charters also made stock of the development corporations "legal investments" for certain types of
fiduciaries who otherwise could not purchase it due to the risk element involved. The Massachusetts charter does not allow any financial institution to purchase stock of the Massachusetts Business Development Corporation unless the institution becomes a member of the corporation, but the charter states:

"Each financial institution which becomes a member of the corporation is hereby authorized to acquire, purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of, any bonds, securities or other evidences of indebtedness created by, or the shares of the capital stock of the corporation, and while owners of said stock to exercise all the rights, powers and privileges of ownership, including the right to vote thereon, all without the approval of any regulatory authority of the commonwealth."*

In addition to making public utility participation possible and making development credit corporation stock purchases "legal", the special charters also serve the purpose of showing that legislative and executive branches of the various state governments favored the plans and lent their support to the corporations.

*79, P. 4
The special charters also have certain public relations and educational values. They exhibit to business interests that the state has an interest in growth and expansion of industrial facilities, rather than oppression of business. The publicity given to the legislative Acts by newspapers and magazines offered the people of the states an opportunity to know and understand the purposes for which the corporations were established.

Although the charters give the corporations a wide possible field of operations, the basic purpose for establishment of the corporations was to make medium and long-term loan funds available to small and medium-sized businesses, which could not obtain bank loans. Mr. Sherwin C. Badger, a member of the executive committee and a director of the Massachusetts Business Development Corporation, stated in a letter dated January 11, 1954, which was sent to all members of the Board of Directors:

"Our primary function, I firmly believe, is going to be the furnishing of semi-permanent, medium-term financing to perfectly sound enterprises that through no fault of their own have no other financial institutions to turn to."*

"The Massachusetts Business Development Corporation is the only type of agency

*83, P. 1
(other than a Government financed tax
exempt corporation) which can possibly
meet the legitimate needs of perfectly
sound small or medium-sized businesses,
for semi-permanent capital in the form
of medium-term loans or equity."

"By all the above, I do not mean to
belittle the opportunities of the Corpo-
ration to aid in community development,
etc., etc., and helping to start new
business enterprises, etc..."**

The general purposes as stated in the charters
actually envision a much wider field of operations than mak-
ing loans. Section 3 of the Act creating the New Hampshire
Business Development Corporation states:

"The purposes of this corporation shall be
to promote, assist, encourage and through the
cooperative efforts of the institutions and
corporations which shall from time to time
become members thereof, develop and advance
the business prosperity and economy of the
state of New Hampshire; to encourage new indus-
tries and to rehabilitate existing indus-
tries in the state of New Hampshire; to

*83, P. 5
**ibid., P. 5
promote and stimulate the expansion of New Hampshire business ventures which tend to increase the growth and thrift of the state; to cooperate and act in conjunction with other organizations, the objects of which are the promotion of industrial, agricultural and recreational developments within the state; and to loan to approved and deserving applicants money for the carrying on and development of all kinds of business undertakings in the state of New Hampshire, thereby establishing a medium of credit not otherwise readily available...."*

The Rhode Island Development Company is the only one of the New England corporations that has extended its activities beyond the lending function. The company financed a study by a consulting firm to determine promising industrial opportunities in Rhode Island. The development company also purchased a large building formerly used by a textile manufacturer who needed funds and only about half the space in the plant. The corporation leased space back to the manufacturer and is renovating the remaining space to make it suitable for a number of small business concerns.**

*91, PP. 1-2
**34, PP. 4-5
As the financial positions of the corporations improve, there will probably be an increasing amount of activity of this type.

Capital Stock

Each development credit corporation has been authorized to issue capital stock as an equity base for the corporation and its operations. Funds realized from stock sales were used mainly to finance initial operations and to provide some cushion against any losses incurred in the early life of the corporations.*

The Massachusetts Business Development Corporation has the largest capital stock authorization; four million shares of common stock with a par value of one dollar each.** This common stock has been sold to the public at a price of ten dollars per share in order to create a capital surplus.

The Development Credit Corporation of Maine originally had authority to issue five hundred shares of one hundred dollar par value stock. However, less than two years after operation of the corporation became active, it was realized that income from the original stock issue was an insufficient equity capital base. On August 20, 1951, the charter of the corporation was amended to allow the corporation to issue 1,500 shares of $100 par value stock.***

Because the New Hampshire Business Development

*33, P. 1
**79, P. 4
***71, P. 383-2
Corporation was organized soon after the Development Credit Corporation of Maine, the charter of the New Hampshire Corporation also authorized an insufficient original capital stock issue of 1,000 shares of no par value stock at $100 per share. On October 26, 1955, the original charter was amended to authorize the corporation to increase the capital stock to 2,500 shares of no par stock to be issued for $100 per share.*

The other three New England corporations have various amounts of stock authorized. The capital stock of the Vermont Development Credit Corporation consists of 50,000 shares of common stock with a par value of five dollars per share**; the Rhode Island Development Company has been authorized to issue 200,000 shares of one dollar par value stock***; the Connecticut Development Credit Corporation has an authorized capital stock issue of 5,000 shares of no par value stock which is issued at $100 per share****.

The number of stockholders in each corporation is quite small at the present time. For example, as of June 30, 1957, the Massachusetts Business Development Corporation had the largest number of stockholders, 236, and had sold the most stock, $763,510, of any New England corporation.*****

The Rhode Island Development Company had only 18 stockholders,

*91, P.2
**100, P. 2
***97, P. 3
****69, P. 3
*****78, P. 3
as of the same date.* Chart 1 shows the amount of stock sold and the number of shareholders in each New England corporation as of June 30, 1957.

"No corporation has yet made a determined effort to sell stock to the general public. The advantages of selling stock in fairly sizable lots to a relatively small number of stockholders seem to outweigh whatever advantages may be gained through obtaining a broader base of support from the general public, at least in the initial stage.

"Although the number of stockholders in each credit corporation is quite small, they represent a wide variety of interests. Manufacturing firms, utilities, railroads, merchants, brokers, lawyers, contractors, newspapers, chambers of commerce, service concerns, trucking companies, and other types of businesses and individuals are included among the stockholders."**

For example, the Massachusetts Business Development Corporation lists such diversified stockholders as:
The Carter's Ink Company, United Shoe Machinery Corpora-

*78, P. 3
**33, P. 3
CHART 1

STOCK SOLD AND NUMBER OF STOCKHOLDERS OF THE DEVELOPMENT CREDIT CORPORATIONS OF NEW ENGLAND AS OF JUNE 30, 1957

$800

STOCK SOLD IN THOUSANDS

TOTAL AMOUNT OF STOCK SOLD $1,275,710

TOTAL NUMBER OF STOCKHOLDERS 758

Source: Data obtained from Northeastern Development Credit Corporation's Report, Six Months Ending June 30, 1957. PP. 1-4

By-laws of the Rhode Island Development Company, the Connecticut Development Credit Corporation, and the New Hampshire Business Development Corporation have established similar restrictions on ownership and transfer of capital stock. Article VI of the By-laws of the New Hampshire Business Development Corporation states:

"At least a majority of the capital stock shall at all times be held by residents of New Hampshire or by persons, firms or corporations engaged in doing business therein. A stockholder desiring to transfer stock shall inform the Treasurer in advance if the proposed transferee is a non-resident and is not engaged in doing business in New Hampshire; and the proposed transfer shall not be allowed or registered upon the books of the corporation, if to do so would violate the foregoing provision."**

The other three corporations have not established such restrictions.

*87, PP. 15-18
**92, P. 4
Institutional Members

The major source of the loan funds of the development credit corporation is derived from loans to the corporations by the member financial institutions. As mentioned previously, the charters allow financial institutions to become members of the corporations and lend funds to the corporations. These loans are "accepted by regulatory authorities to be carried at full value on the balance sheets of the lending financial institutions."* Loans to the corporations are evidenced by bonds or notes of the corporations and bear interest at varying rates. In Maine and New Hampshire, the corporations determine the rate of interest to be paid; in Massachusetts the rate is fixed at one-quarter of one per cent above the prime rate by the charter, and in Rhode Island the member financial institutions determine the rate of interest to be paid on their loans. The Development Credit Corporation of Maine and the New Hampshire Business Development Corporation have been paying interest at the rate of 2% for member loans. This is considerably under the rate paid by the other corporations. The Seventh Annual Report of the Development Credit Corporation of Maine recognized this fact and reported:

"A pioneering development, such as the Development Credit Corporation, requires a rather flexible policy and a large degree of open-mindedness. As

*10, P. 36
conditions change, we have to alter our thinking. One matter, which our Loan Committee has been discussing seriously, is the matter of interest rates. We all know that a radical change in interest rates has occurred in the last year. In the beginning a 2% payment on advances by member banks seemed to be fair and in line with existing conditions. We feel that eventually we must increase this rate."

Each member is limited as to the amount that it can lend to the corporation. These loan limits vary from state to state. For example, the Rhode Island Development Company charter has established the following limits:

(1) Commercial Banks and Trust Companies - $2\%$ of the capital and surplus.

(2) Savings Banks - $2\%$ of one-half of the total surplus accounts.

(3) Building and Loan Associations and Cooperative Banks - $2\%$ of the guaranty funds, surplus and undivided profits.

(4) Stock Insurance, Surety, Fire, Marine or Casualty Companies - $2\%$ of the capital and surplus.

(5) Mutual Insurance Companies - $2\%$ of the guaranty funds or of the surplus, whichever is applicable.

*74, P. 3
(6) Comparable limits for other types of institutions.*

In all states, the loan limits are established to the thousand dollar amounts nearest the amounts computed from the percentages. In all states, calls by the corporations on members for loans are prorated in approximately the same proportion that the maximum lending limit of each bears to the aggregate maximum lending limit of all members.

As of June 30, 1957, the five active New England corporations had acquired 305 institutional members who had pledged a total of $16,229,310 in loan funds.** A state by state breakdown of the members and amounts pledged will be found in Table I.

If all financial institutions eligible to become members were to become members, the five active development credit corporations would have potentially over $40,000,000 in loan funds available for their call.*** For this reason, the corporations are making an active effort to get all eligible members to join.

**Directors and Staff**

The corporate powers are exercised by boards of directors which may vary between three and thirty-three members. In some states, the directors must be residents and stockholders, and there is usually some requirement that representation be given to all parts of the state on

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*97, P. 4  
**78, PP. 1-4  
***33, P. 3
TABLE I

NUMBER OF MEMBERS AND AMOUNTS PLEDGED BY MEMBERS OF THE ACTIVE NEW ENGLAND DEVELOPMENT CREDIT CORPORATIONS - JUNE 30, 1957

<table>
<thead>
<tr>
<th>Corporation</th>
<th>No. of Members</th>
<th>Amounts Pledged</th>
</tr>
</thead>
<tbody>
<tr>
<td>Massachusetts Business Development Corporation</td>
<td>90</td>
<td>$5,508,260</td>
</tr>
<tr>
<td>National Banks &amp; Trust Companies</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td>Savings Banks</td>
<td>31</td>
<td>$1,483,000</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>11</td>
<td>$3,585,000</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>133</td>
<td>$10,577,260</td>
</tr>
<tr>
<td>Amounts Called</td>
<td></td>
<td>$3,500,000</td>
</tr>
<tr>
<td>Amounts Available to Call</td>
<td></td>
<td>$7,077,260</td>
</tr>
<tr>
<td>Rhode Island Development Company</td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Banks &amp; Trust Companies</td>
<td>6</td>
<td>$1,247,000</td>
</tr>
<tr>
<td>Savings Banks</td>
<td>3</td>
<td>$135,000</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>3</td>
<td>$225,000</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
<td>$50,000</td>
</tr>
<tr>
<td>Totals</td>
<td>13</td>
<td>$1,647,000</td>
</tr>
<tr>
<td>Amounts Called</td>
<td></td>
<td>$704,000</td>
</tr>
<tr>
<td>Amounts Available to Call</td>
<td></td>
<td>$953,000</td>
</tr>
<tr>
<td>Connecticut Development Credit Corporation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Banks &amp; Trust Companies</td>
<td>26</td>
<td>$1,805,000</td>
</tr>
<tr>
<td>(No other members)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amounts Called</td>
<td></td>
<td>$1,204,900</td>
</tr>
<tr>
<td>Amounts Available to Call</td>
<td></td>
<td>$600,100</td>
</tr>
<tr>
<td>Development Credit Corporation of Maine</td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Banks &amp; Trust Companies</td>
<td>41</td>
<td>$783,000</td>
</tr>
<tr>
<td>Savings Banks</td>
<td>5</td>
<td>$151,000</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td></td>
<td>$2</td>
</tr>
<tr>
<td>Others</td>
<td></td>
<td>$4,000</td>
</tr>
<tr>
<td>Totals</td>
<td>48</td>
<td>$938,000</td>
</tr>
<tr>
<td>Amounts Called</td>
<td></td>
<td>$768,700</td>
</tr>
<tr>
<td>Amounts Available to Call</td>
<td></td>
<td>$169,300</td>
</tr>
</tbody>
</table>
Table I (Continued)

<table>
<thead>
<tr>
<th>New Hampshire Business Development Corporation</th>
<th>No. of Members</th>
<th>Amounts Pledged</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Banks &amp; Trust Companies</td>
<td>45</td>
<td>$507,000</td>
</tr>
<tr>
<td>Savings Banks</td>
<td>34</td>
<td>717,000</td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>1</td>
<td>8,000</td>
</tr>
<tr>
<td>Others</td>
<td>5</td>
<td>20,050</td>
</tr>
<tr>
<td>Totals</td>
<td>85</td>
<td>$1,252,050</td>
</tr>
</tbody>
</table>

Amounts Called: 607,870
Amounts Available to Call: 644,180

Source: Figures compiled from Northeastern Development Credit Corporation's Report, Six Months Ending June 30, 1957.
the board of directors. Directors and officers serve without financial compensation. Because members supply the major portion of the financial resources, they elect a majority or two-thirds of the directors of each development credit corporation.

Paid staffs are very small. In some states the entire paid staff consists of a manager to handle the day-to-day affairs of the corporation, and his secretary. The Massachusetts Business Development Company has the largest staff of any New England corporation.
Lending Authority

The lending power of each New England development credit corporation has been specifically spelled out in its corporate charter. For example, Section 3(b) of the charter of the Rhode Island Development Company states that the corporation shall have the power:

"To lend money to and to guarantee, endorse, or act as surety on the bonds, notes, contracts or other obligations of, or otherwise assist financially, any person, firm, corporation or association, and to establish and regulate the terms and conditions with respect to any such loans or financial assistance and the charges for interest and service connected therewith. It is not the intention hereof to take from the banking or financial institutions within this state those loans or commitments which may be desired by such institutions generally in the course of their business and which may generally pertain to such business."

*97, P. 2
All of the corporations with the exception of the Vermont Development Credit Corporation and the Massachusetts Business Development Corporation have established some restrictions in their by-laws regarding loans made by the corporation. Article VII of the New Hampshire Business Development Corporation By-Laws states:

"The corporation shall loan money only when credit is not elsewhere readily available. Before granting loans, the Board of Directors shall endeavor so far as is reasonably possible to ascertain that the first opportunity to grant the loan has been given to the savings banks, trust companies, national banks, building and loan associations, and insurance companies of the state, with preference given to members.

"No one person, firm or corporation shall at any time be granted loans by this corporation aggregating in principal amount, more than thirty (30) per cent of the maximum call privilege of the corporation and its paid-in capital.

"As a condition to the granting to a corporation of a loan or loans, said corporation shall include among its Board of Directors at
least one representative of the Board of Directors of this corporation, if the Directors of this corporation deem the same to be advisable. He may or may not be a member of the Board of Directors of this corporation.

"As a condition to the granting to a corporation of a loan or loans, said corporation shall issue to or cause to be transferred to this corporation such number of shares of its capital stock as the Directors of this corporation may determine, if they deem such requirement to be advisable.

"The Board of Directors shall have the power to fix interest rates upon loans made, to determine service charges and fees, and to superintend all investments of the corporation's funds and all loans to be made and to fix the terms and conditions thereof. The surplus of the corporation....shall be invested, at the direction of the Board of Directors, solely in accordance with the requirements governing trustees of estates under state law.
"The Board of Directors shall have the power to appoint local advisory boards to advise and consult regarding loans made or to be made."*

As previously mentioned, all development credit corporations require bank rejection of a proposed loan, before they will handle an application for financing. In many cases, banks rejecting loans recommend to the applicant that he apply to his development credit corporation for the loan. Detailed information is required from the prospective loan applicant. The Application for Financing with the Massachusetts Business Development Corporation requires such information as a breakdown of the major purposes for the use of the requested loan; collateral available to secure the loan such as fixed assets and life insurance; a complete business history of the company including details of any receiverships, bankruptcies, or compromises with creditors and any financial embarrassments of officers, directors, or principal stockholders; names and addresses of principal trade suppliers, customers, and competitors; applications for credit with banks or other lending institutions in the previous five years; and detailed financial statements for the last five years including a balance sheet and profit and loss statement dated within 30 days of the application.**

*92, P. 4
**80, PP. 1-6
Various procedures are followed in processing loan applications. A good example of the careful scrutiny of the applications is the process followed by the Development Credit Corporation of Maine.

(1) The manager screens applications and investigates and evaluates information presented by each applicant such as his reasons for seeking funds, his plant facilities, production techniques, and related matters.

(2) Regional advisory boards of bankers and businessmen further investigate the character, reliability, and financial responsibility of applicants from their areas. These advisory boards also try to determine if any financial institution in the region is interested in assuming the loan.

(3) A Credit Committee then reviews the reports from the manager and the Regional Advisory Board, works out terms with the borrower, and then recommends to the Board of Directors whether to accept or decline the application.

(4) The full Board of Directors then passes on the loan, and if the application is accepted the Board makes arrangements for a nearby bank to service the loans.*

Most loans have been made at a 6 per cent rate of interest, and some states have also imposed a 1 per cent service charge. Some of the development credit corporations have accepted common stock of the borrower in lieu of the customary service charge.

*37, P. 2
Lending Operations Through June 30, 1957

Since the Development Credit Corporation of Maine began operations early in 1950, the five active New England corporations had received 799 formal loan applications through June 30, 1957.*

The Development Credit Corporation of Maine has received 238 loan requests and has approved 71 for a total of $1,879,799. As can be seen from the above figures, the approval rate of requests has been about 30 per cent. However, this average has been steadily rising and in the 18-month period from January 1, 1956 through June 30, 1957, the corporation approved 13 of 26 applications processed.**

Mr. M. Herrick Randall, manager of the Development Credit Corporation of Maine has summarized the accomplishments of the corporation and its loans as follows:

"The borrowers to whom these loans have been made are currently responsible for over 4,500 jobs with an aggregate annual payroll of $10,300,000. While claim is not made to having created all of these as new jobs, a considerable number are, and a large percentage would not exist today if the financial aid supplied had not been available.

*78, PP. 1-4
**ibid., P. 2
"Its loans are made principally to small business concerns. Only two of its borrowers employ more than 500, and only eight of its loans have been for the maximum of $75,000. Loans run from $2,000 to $75,000, with an average loan disbursed of $29,524. Over 64 per cent of its loans are under $35,000 with maturities running from five months to 14 years with an average of approximately six years.

"Loans have been made to a broad segment of Maine industries with 14 different types represented.

"It has participated in the financing of ten new buildings encompassing over 400,000 square feet of space.

"Eight hundred and seventy thousand dollars of Development Credit Corporation of Maine's loans have made possible the use of $1,437,749 in first mortgage money which might not otherwise have been available.

"Four loans have resulted in the utilization of 103,000 square feet of formerly vacant buildings, now housing over 515 employees.

"It has assisted in the establishment of
two new concerns not previously in existence.

"Ten loans have been made directly for industrial development, resulting in a sizable job increase.

"Loans of $254,000 have been made to assist in moving six concerns into Maine."*

These are a few of the accomplishments claimed by the Development Credit Corporation of Maine.

The Massachusetts Business Development Corporation has received 204 requests for financial assistance and has approved 94 of these applications for a total of $13,409,500. The average size loan granted by the Massachusetts corporation has been slightly over $142,500, an average far above that of the other corporations.** Some examples of loans made by the Massachusetts Business Development Corporation should be of interest.

The corporation loaned $30,000 to a spring manufacturer for working capital purposes and to replenish funds utilized in construction of an addition to the manufacturer's plant; $25,000 to a plastics manufacturer to provide working capital for an increased volume of business; $13,000 to a tool and die company to supplement first mortgage financing and company investment to provide for construction of a new plant; $300,000 to a fish processing

*6, PP. 10-12

**37, P. 3
company for construction of a new modern production facility; and $150,000 to an industrial development project to finance completion of four new buildings and future development of the project.*

One outstanding example of the cooperation of the M.B.D.C. with a local industrial development foundation is illustrated in the 1955 annual report of the M.B.D.C.

"In 1954 a group of Lawrence businessmen raised $100,000 and agreed to supply an additional like amount if needed, for the purpose of bringing new diversified industries to the City. The Arlington Mills, comprising 1,800,000 square feet of manufacturing space, which had been idle for some years, were purchased by the aid of a mortgage loan of $325,000 from the Massachusetts Business Development Corporation. Within less than one year new industries employing 3,500 people, with an aggregate payroll of $12,000,000 were brought to Lawrence. Our loan was paid in full in eight months, and we have recently loaned this same group $200,000 for the purpose of renovating one of the remaining buildings to be occupied by a Federal Unit.*

*87, PP. 18-19
with about 500 new workers for the Lawrence area under a long-time lease."*

Of the 94 loans approved by the Massachusetts Business Development Corporation, six have been made to assist firms to relocate in Massachusetts, and four have been made to assist in establishing new businesses.** Nine loans totaling $1,232,500 have already been repaid in full to the corporation.***

Through 1955 the Massachusetts Business Development Corporation had assisted in the financing of 12 new modern industrial buildings generally by taking second mortgages to fill the gap between the money available on first mortgages and on equity money.****

The Rhode Island Development Company had received 96 requests for loans totaling $5,208,500 through June 30, 1957. The company has approved 21 of these requests for a total of $1,169,750, an average loan being about $55,000. Unfortunately the approval rate is low, but as with the Development Credit Corporation of Maine, the rate has shown a definite upward trend during the 18 month period ending June 30, 1957, and during the year from July 1, 1956 to June 30, 1957, the Rhode Island Development Company approved 10 loans out of 27 requests, an approval rate near 40 per

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*89, P. 8
**78, P. 3
***ibid., P. 3
****89, P. 9
As mentioned previously, the Rhode Island Development Company has expanded its operations beyond the lending field and has expended $491,000 toward the purchase of industrial property and the financing of a survey of the industrial potential of Rhode Island.

The New Hampshire Business Development Corporation has approved more than one-half of the requests that it has received for financial assistance. Of the 89 loan requests received by the corporation, 46 have been approved for a total of $1,102,800 or an average loan of near $25,000.** A few typical loans that have been authorized by the New Hampshire Business Development Corporation are:

On July 14, 1955, a five-year loan for $12,000 was approved to assist a wooden case manufacturing concern to move into New Hampshire from out-of-state. This loan helped to purchase a plant being vacated because the former business was moving to another location in New Hampshire.***

On August 10, 1955, a $125,000 loan for ten years was authorized to an out-of-state tanning corporation that was moving to a northern New Hampshire town. This company was planning to build a new $600,000 plant, install $250,000 worth of machinery, and employ between 200 and 300 people. A first mortgage of $375,000 has been provided by New Hampshire banks and an insurance company and a local

*78, P. 3
**78, P. 2
***95, P. 2
industrial foundation has provided a third mortgage of $100,000.*

On October 6, 1955, a five-year loan for $5,000 was approved to a forest industries corporation located in New Hampshire which wished to expand its operations and add about ten new employees.**

On April 20, 1956, a ten-year loan for $75,000 was extended to an industrial realty company in northern New Hampshire. This loan was to help finance the construction of a new plant for a rubber manufacturer that was expanding operations and contemplated adding 150 new employees.***

The New Hampshire Business Development Corporation claims that its loan commitments have helped to bring about the following results:

"A yearly payroll of over $5,000,000 distributed in 33 New Hampshire communities. The building of 18 new modern industrial plants. The moving into New Hampshire of seven new industries. The creation of six new businesses in the state. Expansion of 22 existing industries operating in New Hampshire. The enabling of seven concerns to continue operations in the State.

*95, P. 2
**ibid., P. 2
***ibid., P. 3
Making more secure the 2,000 jobs involved in the above industries. Loans to 20 different types of industry. Participation in above authorized loans of over $2,000,000 of first mortgage money."* 

The Connecticut Development Credit Corporation has approved 34 loans for $1,607,900 out of 154 applications processed. The average loan approved has been near $50,000 by the corporation, but the approval rate is very low, barely over 20 per cent.**

Complete lending operations of the various corporations are summarized in Tables I through VI.

A study conducted by the Federal Reserve Bank of Boston showed that loans made through June, 1954, had been used for the following purposes:

(1) Working capital 45.1%
(2) Purchase of equipment 18.3%
(3) Construction of buildings 15.4%
(4) Refinancing 12.5%
(5) New Product Development 3.6%
(6) Aid Industrial Foundation 2.9%
(7) Purchase of Real Estate 2.0%***

Most development credit corporations have operated at a loss for the first few years because organizational

*96, P. 1  
**78, P. 4  
***34, P. 8
TABLE I

LENDING OPERATIONS OF THE DEVELOPMENT CREDIT CORPORATION OF MAINE THROUGH JUNE 30, 1957

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal loan applications received</td>
<td>238</td>
<td>$4,675,399</td>
</tr>
<tr>
<td>Formal applications rejected</td>
<td>167</td>
<td>2,795,600</td>
</tr>
<tr>
<td>Loans approved</td>
<td>71</td>
<td>1,879,799</td>
</tr>
<tr>
<td>Loans disbursed</td>
<td>53</td>
<td>1,564,783</td>
</tr>
<tr>
<td>Loan repayments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In full</td>
<td>30</td>
<td>602,728</td>
</tr>
<tr>
<td>On Outstanding loans</td>
<td></td>
<td>144,239</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>746,967</td>
</tr>
<tr>
<td>Losses incurred</td>
<td>3</td>
<td>22,913</td>
</tr>
<tr>
<td>Balance of loans outstanding</td>
<td></td>
<td>794,903</td>
</tr>
<tr>
<td>Types of concerns receiving assistance:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entirely new businesses</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Already established in state</td>
<td>45</td>
<td></td>
</tr>
<tr>
<td>Relocations from out of state</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>Financial commitments other than loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial commitments repaid</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Table II

**LENDING OPERATIONS OF THE NEW HAMPSHIRE BUSINESS DEVELOPMENT CORPORATION THROUGH JUNE 30, 1957**

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal loan applications received</td>
<td>89</td>
<td>$2,422,500</td>
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<tr>
<td>Formal applications rejected</td>
<td>42</td>
<td>$1,314,700</td>
</tr>
<tr>
<td>Loans approved</td>
<td>46</td>
<td>$1,102,800</td>
</tr>
<tr>
<td>Loans disbursed</td>
<td>40</td>
<td>$897,800</td>
</tr>
<tr>
<td>Loans repayments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In full</td>
<td>6</td>
<td>79,000</td>
</tr>
<tr>
<td>On outstanding loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>142,090</td>
</tr>
<tr>
<td>Losses incurred</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Balance of loans outstanding</td>
<td></td>
<td>676,710</td>
</tr>
<tr>
<td>Types of concerns receiving assistance:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entirely new businesses</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Already established in state</td>
<td>31</td>
<td></td>
</tr>
<tr>
<td>Relocations from out of state</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Financial commitments other than loans</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Financial commitments repaid</td>
<td>--</td>
<td>--</td>
</tr>
</tbody>
</table>

**Source:** Northeastern Development Credit Corporation's Report, Six Months Ending June 30, 1957. P. 2
TABLE III

LENDING OPERATIONS OF THE MASSACHUSETTS BUSINESS DEVELOPMENT CORPORATION THROUGH JUNE 30, 1957

<table>
<thead>
<tr>
<th>Description</th>
<th>Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal loan applications received</td>
<td>204</td>
<td>$20,368,500</td>
</tr>
<tr>
<td>Formal applications rejected</td>
<td>110</td>
<td>$6,959,000</td>
</tr>
<tr>
<td>Loans approved</td>
<td>94</td>
<td>13,409,500</td>
</tr>
<tr>
<td>Loans disbursed</td>
<td>62</td>
<td>8,123,716</td>
</tr>
<tr>
<td>Loan repayments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In full</td>
<td>9</td>
<td>1,232,500</td>
</tr>
<tr>
<td>On outstanding loans</td>
<td></td>
<td>1,368,254</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>2,600,754</td>
</tr>
<tr>
<td>Losses incurred</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Balance of loans outstanding</td>
<td></td>
<td>5,522,962</td>
</tr>
<tr>
<td>Types of concerns receiving assistance:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entirely new businesses</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Already established in state</td>
<td>84</td>
<td></td>
</tr>
<tr>
<td>Relocations from out of state</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>Financial commitments other than loans</td>
<td>--</td>
<td></td>
</tr>
<tr>
<td>Financial commitments repaid</td>
<td>--</td>
<td></td>
</tr>
</tbody>
</table>

### TABLE IV

**LENDING OPERATIONS OF THE RHODE ISLAND DEVELOPMENT COMPANY THROUGH JUNE 30, 1957**

<table>
<thead>
<tr>
<th>Category</th>
<th>Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal loan applications received</td>
<td>96</td>
<td>$5,208,500</td>
</tr>
<tr>
<td>Formal applications rejected</td>
<td>75</td>
<td>4,038,750</td>
</tr>
<tr>
<td>Loans approved</td>
<td>21</td>
<td>1,169,750</td>
</tr>
<tr>
<td>Loans disbursed</td>
<td>18</td>
<td>1,082,750</td>
</tr>
<tr>
<td>Loan repayments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In full</td>
<td>1</td>
<td>30,000</td>
</tr>
<tr>
<td>On outstanding loans</td>
<td></td>
<td>452,587</td>
</tr>
<tr>
<td>Total</td>
<td>--</td>
<td>482,587</td>
</tr>
<tr>
<td>Losses incurred</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Balance of loans outstanding</td>
<td></td>
<td>600,163</td>
</tr>
<tr>
<td>Types of concerns receiving assistance:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entirely new businesses</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Already established in state</td>
<td>17</td>
<td></td>
</tr>
<tr>
<td>Relocations from out of state</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Financial commitments other than loans</td>
<td>2</td>
<td>491,000</td>
</tr>
<tr>
<td>Financial commitments repaid</td>
<td>1</td>
<td>225,000</td>
</tr>
</tbody>
</table>

**Source:** Northeastern Development Credit Corporation's Report, Six Months Ending June 30, 1957. P. 3
**TABLE V**

LENDING OPERATIONS OF THE CONNECTICUT DEVELOPMENT CREDIT CORPORATION THROUGH JUNE 30, 1957

<table>
<thead>
<tr>
<th>Description</th>
<th>Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal loan applications received</td>
<td>172</td>
<td>$10,799,768</td>
</tr>
<tr>
<td>Formal applications rejected</td>
<td>120</td>
<td>8,892,368</td>
</tr>
<tr>
<td>Loans approved</td>
<td>34</td>
<td>1,607,900</td>
</tr>
<tr>
<td>Loans disbursed</td>
<td>31</td>
<td>1,300,900</td>
</tr>
<tr>
<td>Loan repayments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In full</td>
<td>4</td>
<td>120,000</td>
</tr>
<tr>
<td>On outstanding loans</td>
<td></td>
<td>309,669</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>429,669</td>
</tr>
<tr>
<td>Losses incurred</td>
<td>1</td>
<td>17,536</td>
</tr>
<tr>
<td>Balance of loans outstanding</td>
<td></td>
<td>853,695</td>
</tr>
<tr>
<td>Types of concerns receiving assistance:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entirely new businesses</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Already established in state</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Relocations from out of state</td>
<td>--</td>
<td></td>
</tr>
<tr>
<td>Financial commitments other than loans</td>
<td>2</td>
<td>47,625</td>
</tr>
<tr>
<td>Financial commitments repaid</td>
<td>1</td>
<td>20,000</td>
</tr>
</tbody>
</table>

Source: Northeastern Development Credit Corporation's Report, Six Months Ending June 30, 1957. P. 4
## TABLE VI

TOTAL LENDING OPERATIONS OF THE FIVE ACTIVE NEW ENGLAND DEVELOPMENT CREDIT CORPORATIONS THROUGH JUNE 30, 1957

<table>
<thead>
<tr>
<th>Description</th>
<th>Number</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal loan applications received</td>
<td>799</td>
<td>$43,474,667</td>
</tr>
<tr>
<td>Formal applications rejected</td>
<td>514</td>
<td>$24,000,418</td>
</tr>
<tr>
<td>Loans approved</td>
<td>266</td>
<td>$19,169,749</td>
</tr>
<tr>
<td>Loans pending June 30, 1957</td>
<td>19</td>
<td>$304,500</td>
</tr>
<tr>
<td>Loans disbursed</td>
<td>204</td>
<td>$12,969,949</td>
</tr>
<tr>
<td>Loans approved but not disbursed, June 30, 1957</td>
<td>62</td>
<td>$6,199,800</td>
</tr>
<tr>
<td>Loan repayments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In full</td>
<td>50</td>
<td>$2,064,228</td>
</tr>
<tr>
<td>On outstanding loans</td>
<td></td>
<td>$2,416,839</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$4,481,067</td>
</tr>
<tr>
<td>Losses incurred</td>
<td>4</td>
<td>$40,449</td>
</tr>
<tr>
<td>Balance of loans outstanding</td>
<td></td>
<td>$8,448,433</td>
</tr>
<tr>
<td>Types of concerns receiving assistance:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entirely new businesses</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>Already established in state</td>
<td>207</td>
<td></td>
</tr>
<tr>
<td>Relocations from out of state</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td>Financial commitments other than loans</td>
<td>4</td>
<td>$538,625</td>
</tr>
<tr>
<td>Financial commitments repaid</td>
<td>2</td>
<td>$245,000</td>
</tr>
</tbody>
</table>

Source: Information compiled from Northeastern Development Credit Corporation's Report, Six Months Ending June 30, 1957. PP. 1-4
expenses are large and because it takes time to build up a sizable volume of income from interest on loans. Each New England Development Credit Corporation, with the exception of the Connecticut corporation, is required by charter to set aside as a surplus not less than 10 per cent of its net earnings every year until such surplus along with any paid-in surplus amounts to one-half of the amount of capital stock outstanding. Section 7 of the charter of the Connecticut Development Credit Corporation states:

"Said corporation shall set apart as an earned surplus all of its net earnings in each and every year until such earned surplus shall equal the total of the paid-in capital and paid-in surplus then outstanding. Said earned surplus shall be held in cash or invested in United States Government bonds, and shall be kept and used to meet losses and contingencies of the corporation...."

Each corporation is required to rebuild its earned surplus in the same manner that it is accumulated, whenever the earned surplus becomes impaired.

Some question has been injected as to the legality of accumulating such large reserves because of the Federal income tax problem. A special tax committee of the Northeastern Conference of Development Credit Corporations,

*69, P. 4
representing the New England corporations and the Development Credit Corporation of New York, has approved filing of a bill in Congress to permit development credit corporations to set aside a reserve for bad debts similar to that in effect for mutual savings banks. This would allow the corporations to establish reserves up to 20 per cent of outstanding loans. The filing of this bill has been deferred while a Presidential sub-cabinet committee is studying Federal assistance to development credit corporations, including special tax treatment.*

*96, P. 1
SUMMARY AND CONCLUSIONS

Although the development credit corporations in New England have only been in existence a relatively few years, they are now beyond the experimental stage, and many authorities believe that this novel method of financing has already achieved sufficient growth to indicate that it has an important and lasting place in the economy.

The spread of the development credit corporation idea has been notable in the past few years. Besides the five active corporations in New England, development credit corporations are now active in New York and North Carolina and have been authorized but are not currently engaged in lending operations in Arkansas, Georgia, Michigan, South Dakota, Wisconsin and Vermont. Seven other states are now considering specific legislative proposals for establishment of development credit corporations: Florida, Minnesota, Mississippi, Montana, New Jersey, South Carolina and West Virginia. In addition, six other states are considering formation of such corporations, but the proposals have not yet reached the legislative stage. These are Arizona, Illinois, New Mexico, Oregon, Virginia and Washington. Kansas has a corporation which is on a regional basis, and Pennsylvania has a credit corporation which differs from the others in that it uses State rather than private funds.*

*67, PP. 37-38
The development credit corporations in New England have grown up together with the Small Business Administration. Neither considers the other a direct competitor. In New England, the Small Business Administration has been a recourse for wholesalers, retailers, etc., who at present have not been able to borrow from the development credit corporations. For example, in 1956, the Small Business Administration approved 157 loans for $5,619,038 in the five New England States having active development corporations, while the corporations themselves in this same period approved 62 loans for $5,437,850. State by State comparisons may be of interest. In Maine, the S.B.A. approved 19 loans for $506,200 in 1956, while the Development Credit Corporation of Maine approved eight loans for $312,000; in New Hampshire, the S.B.A. approved nine loans for $436,000, while the N.H.B.D.C. approved eleven loans for $357,000; in Rhode Island, the S.B.A. approved thirteen loans for $340,200 and the R.I.D.C. seven loans for $227,250; in Massachusetts, the S.B.A. approved 94 loans for $3,585,725 and the M.B.D.C. 24 for $4,085,000; and in Connecticut, the S.B.A. approved 22 loans in the amount of $754,913, while the C.D.C.C. approved twelve loans for $455,600. As can be seen, there is considerable State by State similarity in number and dollar amounts of loans. However, the 157 loans made by the S.B.A. represent only 5.5% of the national total for 1956, while the $5,619,038 is only 4.5% of the total amount loaned.
There are some outstanding differences in the operation of the Small Business Administration in comparison with the development credit corporations. The Government agency has established a maximum loan limit of $250,000 to any one borrower, whereas most development corporations have not established a specific loan limit. In fact, the Massachusetts Business Development Corporation has made a number of loans approaching the $1 million mark. The Small Business Administration does not like second mortgages as collateral for loans; the development corporations do. Of course, the Small Business Administration cannot ethically loan funds to finance a state-to-state transfer for a small business firm. The Small Business Administration prefers to lend to established firms, while the development corporations can and have extended financial assistance to new businesses in need of aid to begin operations. The most outstanding difference arises in cost of operation. For the fiscal year 1957, the Small Business Administration showed a net loss of $5,066,713.76 not including non-lending operating costs of $1,850,229.93, whereas all development corporations showed operating profits. The development corporations have been able to operate at an expense ratio inconceivable to any conventional corporation. The staffs are small, and the directors are willing to devote their services without compensation as a matter of broad public policy. Most directors are ranking officers in conventional financial
institutions, and they bring to the development credit corporations a wide experience in screening loan applications.

The capitalization ratios of the development credit corporations would be unthinkable in a conventional corporation. The debt/equity ratio of the Massachusetts Business Development Corporation is 8 to 1, and the ratio runs as high as 12 to 1 in some states. These capitalization ratios have allowed the corporations to borrow large sums from their members and have allowed a substantial leverage for earnings. Fortunately, the development corporations have been operating in a period of rising economy, have been able to accumulate some loss reserves, and have somewhat lessened the dangerous reverse leverage effects the capital structures allow.

Certain lending policies appear to have developed from the lending experience of the corporations.

No loans are made to concerns who can reasonably obtain financing from regular financial sources. Many loan applicants have been directed to the corporations by commercial banks who feel that the applicant is worthy of financial assistance, but normal bank financing is not practicable. In many cases banks have taken token positions prior to the corporations, and in some cases the information obtained by the corporations in their investigations shows that the applicant is eligible to obtain financing through normal channels.
No restrictions have been placed on the type of industry to which loans will be made, although practically all loans have been made to manufacturing concerns or local industrial development groups. Loans of this type tend to encourage greater employment than would an equivalent loan to a retailer or a wholesaler. However, manufacturing concerns are more closely tied to cyclical swings in the economy and the policy of concentrating loans in the manufacturing area has its dangers. If the present late 1957-early 1958 downturn in the economy should continue for a prolonged period, it is possible that the development corporations would find many of their loans delinquent or defaulted. Losses so far have been moderate, and as the corporations strengthen their financial positions, it is quite possible they will expand their lending operations beyond the manufacturing area.

Most loans have been confined to companies or individuals who have already demonstrated their business ability and who afford reasonable probability of eventual repayment. A number of loans have been made, however, to new businesses just beginning operations, and this type of activity may increase as the corporations strengthen their reserves.

Although the development credit corporations have eased the long-term loan fund problem for many small business firms, they have done little to furnish equity capital
which is possible under the charters. The basic reason why such action has not been taken is that in most cases over 90 per cent of the funds available to the development corporations is derived by borrowing from member financial institutions. These loans must be paid at some future time which would hardly be possible if the funds were tied up in equities with a very limited and uncertain market.
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