

Summer 1963

A Study of the Procedures and Policies Used by Kansas Banks in Establishing Lines of Credit

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A STUDY OF THE PROCEDURES AND POLICIES
USED BY KANSAS BANKS
IN ESTABLISHING LINES OF CREDIT

A Thesis Presented to the Graduate Faculty
of the Fort Hays Kansas State College in
Partial Fulfillment of the Requirements for
the Degree of Master of Science

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Date

7/29/63

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Chairman, Graduate Council

ACKNOWLEDGMENT

The writer wishes to express his appreciation for the assistance given by Mr. Richard Levitt of Fort Hays Kansas State College in the formulation and preparation of this study. Appreciation is also extended to Dr. Leonard W. Thompson, Dr. Archie Thomas, and Mr. E. J. Spomer for their constructive suggestions.

The cooperation of the bankers of Kansas in making available certain pertinent information merits special recognition.

ABSTRACT OF THESIS

Student: Kerry S. Cain, 508 West 21st Street, Hays, Kansas

Thesis Title: A Study of the Procedures and Policies used by Kansas Banks in Establishing Lines of Credit

THE PROBLEM:

The major purpose of this study was to analyze the status of extension of lines of credit by Kansas banks. The examination involved a study of the extent to which banks granted lines of credit, methods by which banks delegated authority in extending lines of credit, how loan policies and practices differed among banks surveyed, methods by which the smaller banks might adopt the policies of larger banks in granting lines of credit.

METHODS AND PROCEDURES EMPLOYED:

A questionnaire was prepared to obtain information on the practices of banks in granting lines of credit. The questionnaire was sent to 300 banks selected at random from those in operation in Kansas as of June 24, 1963. There were 136 questionnaires returned, as requested, and the information for this status study was obtained from the information provided.

SUMMARY AND FINDINGS:

A high percentage of the banks investigated were granting lines of credit. Lines were granted primarily at the initiative of the banks and were utilized only to a limited extent as a means of increasing loan activities. The number of lines granted was generally small and represented a limited portion of the loan activities of the banks. Approximately one third of the banks had established a department to handle this type of loan. A large number of the banks established a definite repayment schedule. The most common repayment period was on a monthly basis. Some of the banks specialized in extending credit to certain types of operations. Farming and manufacturing were most commonly mentioned. A portion of the banks required line of credit borrowers to maintain compensatory balances and based requirements to varying degrees on the type of business, the size of the business, and the security provided. Some of the banks related requirements to the use of the line of credit. The most commonly mentioned factor limiting the extension of lines of credit was lack of demand. The legal limit was the most frequently mentioned factor in setting upper limits on lines of credit.

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CHAPTER I

INTRODUCTION

Many banks do a substantial part of their business lending to borrowers who have prearranged lines of credit. In a survey of Member Bank Loans for Commercial and Industrial Purposes conducted by the Federal Reserve System as of October 5, 1955, it was found that more than half of the banks investigated indicated that they were extending lines of credit in the fall of 1955. The sample taken for the survey conducted by the Federal Reserve included all member banks with deposits of \$50 million and over and a declining proportion of the smaller banks throughout the country.¹

The proportion of banks extending lines of credit varied directly with the size of the bank, and ranged from almost all of the banks with deposits of \$100 million and over to somewhat less than 20 per cent of the banks with deposits of less than \$20 million.²

A line of credit is generally thought of as an understanding between the borrower and the bank as to the maximum amount, or upper limit, which the firm or person is entitled to borrow from the bank.

The understanding is that the business could borrow and pay off loans as need dictate, but the maximum amount that could be borrowed at any one time would be set by the limits established by the line of credit.

¹"Credit Lines and Minimum Balance Requirements," The Federal Reserve Bulletin, June 1956, pp. 573-579.

²Ibid.

The exact amount of the line is seldom fixed and depends to a great extent upon the financial statement of the borrower, the loanable resources of the bank, and the general trade and money conditions existing in the bank's territory. In most cases the bank is unwilling to make a firm commitment as to the extent of the line of credit because the changing conditions in the affairs of the customer and the bank may make it inadvisable to lend a specified amount. For these reasons, whenever a line of credit is established it is predicated upon the continuance of the conditions under which it was granted.

Businessmen who anticipate the necessity of having to finance operations through the use of bank loans customarily ask their bank for a line of credit so that they may know in advance how much they will be able to borrow when the need arises. The bank will usually establish a line of credit for the firm up to a limit that it feels commensurable to the conditions of the business. In most cases the business is expected to keep the bank informed of any changes in its affairs so that its credit needs may be more accurately evaluated.

Statement of the Problem

The purpose of this study was to analyze the procedures and policies employed by Kansas banks in granting lines of credit. The definition of a line of credit, as used in this research, was an advance commitment, expressed by a bank, of the maximum amount of credit which it is willing to extend to a borrower during a given period of time.

More specifically, this investigation was concerned with

determining the extent to which lines of credit are granted, and how this affected the relationship between the bank and the borrower.

The problem was further concerned with methods by which the Kansas banks delegated authority in granting lines of credit with specific regard to the delegation of duties, how loan policy is determined, how loans are administered, what affects loan policy, and limitations encountered in granting lines of credit.

Delimitations

The analysis was restricted to the study of Kansas banks that were in operation as of June 24, 1963.

Significance of the Study

Many banks over the United States do a substantial part of their business lending to borrowers who have prearranged lines of credit.³

This study attempted to determine the extent to which Kansas banks engage in this type of loan activity, and the factors which influence this type of credit extension.

The information derived from this study may point out areas where modifications of existing policy might result in an improved employment of existing banking facilities.

³Ibid., p. 573.

Sources of Data

The data for the investigation were derived from a study of the banks in Kansas. Banks chosen for the study were those that were in operation as of June 24, 1963. The investigation was restricted to the current practices of these banks in granting lines of credit.

PROCEDURES IN GATHERING DATA

Selection of the Group. A directory of banks was used to obtain the names and locations of all of the banks that were in operation at the time of the study.⁴ A list of these banks was coded and a Table of Random Numbers was used to compile a 50 per cent random sample.⁵

Development of the Instrument. A questionnaire was developed as a device for procuring information pertinent to the study. Determination of the major items included in the questionnaire was made following an inquiry to the Board of Governors of the Federal Reserve System and a study of material available in Forsyth Library at Fort Hays Kansas State College concerning various aspects of granting lines of credit.

Collection of Data. A letter containing the questionnaire was sent to the banks selected through the use of the Table of Random Numbers. A self-addressed stamped envelope was provided for the return of

⁴Polk's Bank Directory (Nashville, Tennessee: R. L. Polk and Company, 1960), pp. 815-869.

⁵Sir Ronald Fischer, and Frank A. Yates Statistical Tables for Biological, Agricultural, and Medical Research (New York: Hafner Publishing Company, Inc., 1957) pp. 126-132.

the questionnaire and any additional comments the respondents wished to make concerning the questions asked.

Examination of the forms returned by bank officials revealed that 149 of the 300 banks selected did not return the material sent them. There were 151 questionnaires returned and of these 136 were taken for the study. One of the questionnaires was rejected because one bank had consolidated with another, and the other 14 were rejected because they were not filled out as requested. Revision of the master list gave a total of 136 banks to be included in the study.

A chart was made of the number of banks in different groups arranged by total resources. There were two distinct breaks in the groupings. These fell at the level of \$1 million and \$4 million respectively. A division of banks into three classes was made. This division placed 17 banks in the first group, 77 in the second, and 42 in the third. The resulting groups were called the 'A', 'B', and 'C' groups respectively. The groups represented banks having total resources of \$0 to \$1 million, \$1 million to \$4 million, and above \$4 million dollars, in that order. The data recorded on the questionnaires was then transferred to master sheets for subsequent tabulation and analysis.

REVIEW OF RELATED LITERATURE

In his discussion of lines of credit Davis made the statement that:

Generally speaking, a line of credit is an indication, expressed by a bank, of the maximum amount of loans which it is willing to extend to a borrower within a given period of time, normally twelve months.⁶

Prather stated that a line of credit is usually set up at the borrower's request, but there are some cases where lines are established by the bank in order to build up its loan business or to serve as a guide for its loan officers.⁷

Beckhart felt that lines of credit provided certain advantages to the bank. He indicated that through the practice of establishing seasonal lines of credit the bank is able to establish permanent relations with valued business customers, and to retain the type of account and loan business in which it has the greatest interest. In addition, he mentioned that ordinarily business concerns rarely change banks with which they have lines of credit, other than to add to existing lines as loan needs grow, in the absence of materially adverse developments or serious misunderstandings.⁸

⁶Carlisle R. Davis, Credit Administration (New York: American Institute of Banking Section of American Bankers Association), p. 18.

⁷Charles L. Prather, Money and Banking (Homewood, Illinois: Richard D. Erwin, Inc., 1961) p. 221.

⁸Benjamin H. Beckhart, Business Loans of American Commercial Banks (New York: Ronald Press, 1936), p. 137.

Davis maintained that the expression of the bank's willingness to extend a line of credit may or may not specify the conditions under which the line will continue. Under certain circumstances the line may be a legal binding agreement on the part of the bank to lend, while under other conditions it may only constitute a moral obligation.⁹

Gerstenberg stated that many businessmen who anticipate having to finance current operations by bank loans may ask their bank for a line of credit so that they may know in advance how much they can borrow at a particular bank, without collateral, should the need arise. He indicated that the bank would establish a line of credit up to an amount in keeping with the firm's strength. While the line is in force, the corporation keeps the bank informed of its operations and financial condition. In addition, the firm must continue to maintain its deposit account at the bank. Furthermore, to keep the line open, the corporation must make some use of the line. The bank cannot afford to maintain unused loan commitments indefinitely.¹⁰

Munn indicated that the line of credit is the maximum amount which a person or concern is entitled to borrow from a bank at any given time or the normal limit of accomodation. It is the total credit force or potential credit balance at the disposal of a borrowing customer, in return for which the customer is required to maintain a proportional balance,

⁹Davis, loc. cit.

¹⁰Charles W. Gerstenberg, Financial Organization and Management of Business (New York: Prentice-Hall, Inc., 1951), p. 374.

prove to be an acceptable credit risk, and otherwise prove satisfactory as a borrower.¹¹

An American Bankers Association report on lines of credit stated that a businessman with a temporary need of funds might apply for a loan and leave the possibility of renewal open. If his needs are likely to reoccur, however, the bank and the borrower will frequently arrange for a so-called 'confirmed line of credit.' Under this type of relationship, the businessman could borrow up to a certain limit, pay the loan off, and then borrow again up to the limit of the line of credit. It was further indicated in the monograph that the lines are extended for a certain use and that they are not a contractual obligation. The borrower is normally expected to maintain a deposit account at the bank. In some cases agreements are made as to the amount of the balance that is required of the borrower. In most cases the line is in effect for a year. This provides an opportunity for yearly review. The writers called attention to the fact that most lines were extended to large and well established firms. Informal relationships possible between smaller banks and local businessmen lessen the need for more formally arranged lines of credit.¹²

Kent maintained that a line of credit was a commitment on the part of a bank to lend a borrower any amount that he requested up to a specified maximum. Customers who have lines of credit do not need to

¹¹Glen G. Munn Encyclopedia of Banking and Finance (Cambridge, Massachusetts: The Bankers Publishing Company, 1949), pp. 367-368.

¹²The American Bankers Association, The Commercial Banking Industry (Englewood Cliffs: Prentice-Hall, Inc., 1962)

enter into long negotiations with their bank each time that they wish to increase their loans. It was mentioned that while lines of credit are advantageous from the viewpoint of the borrower, they could restrict the bank's freedom. At the time when the bank may be trying to strengthen primary reserves, it may be obligated to grant new loans because of outstanding commitments. During the period of the second World War, large lines of credit were arranged by many of our leading industrial corporations with many participating banks. The reason for the negotiations of these huge loans was an uncertainty as to the expenditures that would be required in the completion of war contracts.¹³

Steiner and Shapiro stated that banks commonly extend lines of credit to their better customers, thus agreeing in advance of a customer's borrowing season to lend up to a stipulated maximum if the borrower's credit position remains fundamentally unchanged. They further indicated that the device of extending lines of credit has arisen to some extent to protect bank directors, since they are thereby able to control the bank's loans by specifying conditions under which advances to particular borrowers may be made. In this way they may delegate responsibility in making loans and discounts. The authors mentioned two conditions that are often imposed upon the borrower. First, the borrower may be required to maintain compensating, reciprocal, or proportionate balances. City banks have insisted upon this requirement more frequently than have country banks;

¹³Raymond P. Kent, Money and Banking (New York: Rinehart and Company, Inc., 1947)

the usual figure is a deposit balance of 20 per cent of the loan. The bankers feel that the balances represent, to some degree, the cost of keeping the line of credit in force. The second condition imposed is that the borrower must liquidate his indebtedness to the bank annually.¹⁴

In Money and Banking, edited by Foster and Rogers, the discussion of lines of credit concerned the conditions prevailing when a borrower is granted a line of credit by more than one bank. Under these circumstances a firm may borrow from one bank to pay off loans at another. While satisfying the requirements of cleaning up his loan at one bank, he remains in debt to the others. If the condition of the business is good, the borrower has a certain amount of permanent capital furnished by the banks. But if there is a decline, one or more of the banks may not continue their line of credit, making the remainder assume the whole burden and risk among themselves. These multiple or rotating bank lines are an outgrowth of the credit needs of business units requiring more bank accommodation than any one bank in the community can provide. They must arrange multiple lines of credit or deal with larger banks. In hard times banks take steps to eradicate this situation--often with drastic results. In succeeding periods of prosperity and optimistic lending there is usually a revival of the multiple credit line practice.¹⁵

¹⁴William Howard Steiner and Eli Shapiro, Money and Banking (New York: Henry Holt and Company, 1941)

¹⁵Major B. Foster and Raymond Rogers (ed.), Money and Banking (New York: Prentice -Hall, Inc., 1947)

CHAPTER II

FINDINGS

The data presented in this chapter provide specific information regarding current practices of Kansas banks with regard to the extension of lines of credit.

Responses to 26 major items included in the questionnaire were obtained from 136 banks. These data were organized and treated as the findings of the study.

The data have been presented under the following major headings: (a) the extent of use of lines of credit, (b) delegation of authority in granting lines of credit, and (c) loan policy modifications.

The first few tables which follow are included to acquaint the reader with the division of the investigated banks into different classes, their activities in relationship to the extension of lines of credit in the past, and their future plans along this line.

Table I shows the division of the 136 banks into three classes as determined by their total resources.

TABLE I
DISTRIBUTION OF INVESTIGATED BANKS ACCORDING TO TOTAL RESOURCES

Total resources in millions of dollars	Number in Group	Per cent of Total
0 to 1	17	12.5
1 to 4	77	47.0
4 and above	42	40.5
Total	136	100.0

Table I reveals that a high percentage of the banks investigated had total resources in the range of one to four million dollars. Approximately one-quarter of the banks had total resources of less than one million dollars.

Table II shows the number and distribution of banks between groups that were extending lines of credit in June of 1963.

TABLE II
STATUS OF EXTENSION OF LINES OF CREDIT BY KANSAS BANKS

Extension of lines of credit	Group A (17)		Group B (77)		Group C (42)		Total (136)	
	No.	%	No.	%	No.	%	No.	%
Banks extending lines of credit	14	82.4	58	75.3	37	88.0	109	80.2
Banks not extending lines of credit	3	17.6	19	24.7	4	9.5	26	19.1
Did not answer					1	2.5	1	0.7

Table II reveals that a high percentage of the investigated banks indicated that they were extending lines of credit. This is illustrated by the fact that 109, or 80.2 per cent, of the 136 respondents stated that they were granting lines of credit. It may be noted that more banks in the group having resources equal to, or greater than, four million dollars were granting lines of credit than in the other two classifications.

The data in Table III are provided in order to show the number of lines of credit granted by the banks in the three different groups.

TABLE III
NUMBER OF LINES OF CREDIT GRANTED

Number of lines	Group A (14)	Group B (58)	Group C (38)	Total (110)
Unknown		1		1
0-5	2	7	4	13
5-10	2	9	5	16
10-20	2	1	4	7
20-30	1	2		3
30-40		2	5	7
40-50		5	1	6
50-100			2	2
100-200	4	3	3	10
Above 200	1	11	2	14
Did not answer	2	6	12	20

From the information in Table III it may be seen that most of the banks granted a fairly small number of lines of credit. Where indications were made that the number of lines granted was well up into the hundreds a misunderstanding of the meaning of the term as used in this survey may have existed.

Table IV presents information concerning the extent to which granted lines of credit constituted the loan business of banks granting lines of credit.

TABLE IV

EXTENT TO WHICH LINES OF CREDIT CONSTITUTED BANKS' LOAN BUSINESS

Per cent of loan business in lines of credit	Group A (14)	Group B (58)	Group C (38)	Total (110)
Not known			2	2
0-5	3	7	6	16
5-10	1	4	6	11
10-20	1	6	6	13
20-30		2	2	4
30-40	2	1	6	9
40-50	1	5	2	8
50 and above		3		3
No answer	6	30	8	44

The findings in Table IV reveal that 44 of the banks granting credit did not indicate what portion of their loan business is in this type of credit extension. Of the banks that answered the questionnaire it was apparent that these banks did less than 20 per cent of their credit business by extending lines of credit. The data revealed, however, that in the second group one respondent indicated that three lines of credit made up 80 per cent of the bank's loan business.

Table V relates to the number and percentage of the respondents in each case who indicated past consideration of the extension of lines of credit but who had decided against doing so.

TABLE V
CONSIDERATION OF EXTENSION OF CREDIT

Bank's consideration of granting lines of credit	Group A (3)		Group B (16)		Group C (4)	
	No.	%	No.	%	No.	%
Had considered			3	18.7	3	75.0
Had not considered	3	100.0	13	81.3		
Did not answer					1	25.5
Total	3	100.0	16	100.0	4	100.0

From an inspection of Table V it may be observed that none of the officials of the banks in the 'A' group indicated past consideration of extending lines of credit. In the second and third groups three, or 18.7 and 75 per cent, respectively, indicated that they had considered doing so.

Table VI provides detailed information regarding the reasons indicated by the banks for not extending lines of credit.

TABLE VI

REASONS INDICATED BY THE BANKS FOR NOT EXTENDING LINES OF CREDIT

Reasons	Group A (3)		Group B (19)		Group C (4)		Total (26)	
	No.	%	No.	%	No.	%	No.	%
Adequate collateral					1	25.0	1	3.8
Bank policy			5	26.2	2	50.0	7	27.2
Difficult to extend loan in agricultural community			1	5.3			1	3.8
Limited capital and surplus			1	5.3			1	3.8
Loan area limited	1	33.4					1	3.8
No demand	2	66.6	11	57.9			13	50.0
Personal merit			1	5.3			1	3.8
Repayment uncertain					1	25.0	1	3.8

The data in Table VI show that a lack of demand for lines of credit was the most frequently mentioned reason for not extending lines of credit in the first two classifications. In the third group bank policy, adequate collateral, and problems of repayment were the reasons listed for not extending lines of credit. In the third classification bank policy was the reason indicated in two out of four cases where a decision was made to refrain from extending lines of credit.

Information concerning factors that limit the extension of lines of credit is presented in Table VII.

TABLE VII

GENERAL FACTORS LIMITING EXTENSION OF LINES OF CREDIT

Limitations	Group A (17)	Group B (77)	Group C (42)	Total (136)
Bank policy	7	27	18	52
Economic conditions		15	8	23
Legal limit			1	1
Limited capital and surplus	8	24	7	39
No demand	6	15	8	29
Repayment ability			2	2
Stability of firm			1	1
No answer	3	22		25

The data contained in Table VII indicate that the most frequently mentioned factor limiting the extension of lines of credit was bank policy. The next factors, in order of frequency, were limited capital and surplus, lack of demand, and economic conditions.

Table VIII was included in order to show the number and percentage of investigated banks having a separate department dealing with lines of credit.

TABLE VIII

BANKS HAVING A DEPARTMENT DEALING WITH LINES OF CREDIT

Line of credit facility	Group A (14)		Group B (58)		Group C (38)		Total (110)	
	No.	%	No.	%	No.	%	No.	%
Separate department	4	28.6	5	8.5	11	28.9	20	18.1
No separate department	10	71.4	53	91.5	27	71.1	90	81.7

An examination of the data presented in Table VIII reveals that in approximately one out of every three cases banks in the first and third classification had a separate department set up to deal with lines of credit. In the second classification the ratio fell to roughly one in ten. The relatively high percentage of banks in the 'A' group indicating a separate department possibly reflects a situation in which the bank's business constituted a fairly small operation in which the president, vice president, or cashier administered lines of credit.

Table IX shows the maximum amount that may be granted by a single bank officer.

TABLE IX

MAXIMUM AMOUNT THAT MAY BE GRANTED BY A SINGLE OFFICER
OF THE BANKS INVESTIGATED

Amount	Group A (14)	Group B (58)	Group C (38)	Total (110)
Legal limit	4	19	6	29
No limit set	2	10	11	23
0 dollars to \$1,000		1	1	2
\$1,000 to \$5,000		5	2	7
\$5,000 to \$10,000	5	2	1	8
\$10,000 to \$20,000	2	6	3	11
\$20,000 to \$30,000		5	1	6
\$30,000 to \$40,000		3	1	4
\$40,000 to \$50,000		2	1	3
Above \$50,000		2	4	6
Did not answer		3	4	7
Takes two officers	1		3	4

As shown in Table IX, at least one-quarter of the banks allowed a single officer to lend up to the legal limit of the bank. In approximately 20 per cent of the cases no limit had been established. It may be noted that four of the banks had established a ruling that required at least two officers to approve all loans. In general, the larger the bank the greater the amount that could be loaned by a single officer.

The information presented in Table X concerns the number and percentage of the banks in each group that have an upper limit established on lines of credit set by bank policy.

TABLE X

BANKS WITH LIMITS ON LINES OF CREDIT SET BY BANK POLICY

Status of limitation	Group A (15)		Group B (58)		Group C (38)		Total (111)	
	No.	%	No.	%	No.	%	No.	%
Set by bank policy	8	53.4	33	57.0	21	55.3	62	55.9
Not formally established	6	40.0	25	43.0	16	43.2	47	42.4
Did not answer	1	6.6			1	1.5	2	1.7

The information presented in Table X indicates a similarity among the banks investigated with respect to bank policy concerning the limits of lines of credit. In all three groups the percentage of banks reporting an upper limit on the amount of lines of credit set by bank policy ranged between 53 per cent and 57 per cent.

Data presented in Table XI concerns the reasons given for setting an upper limit on lines of credit.

TABLE XI

REASONS GIVEN FOR SETTING AN UPPER LIMIT ON LINES OF CREDIT

Reason	Group A (14)	Group B (58)	Group C (38)	Total (110)
Avoid concentration			2	2
Legal limit	9	35	18	62
Limited capital and surplus	1			1
Security		1	3	4
No answer given	4	22	15	41

From the data in Table XI it may be observed that the most frequently listed reason for setting a limit on lines of credit is the legal limit.

Table XII indicates the number and percentage of the respondents reporting whether or not lines of credit were granted primarily at the initiative of the bank.

TABLE XII

BANK INITIATIVE IN GRANTING LINES OF CREDIT

Method of granting lines of credit	Group A (15)		Group B (58)		Group C (38)		Total (111)	
	No.	%	No.	%	No.	%	No.	%
Bank initiative	9	60.0	33	76.8	13	34.2	55	49.5
Request of borrower	6	40.0	25	23.2	25	65.8	56	50.5

An inspection of the data contained in Table XII reveals that in the 'C' group a high percentage of the requests for lines of credit came from the customer, while the largest percentage of loans granted in the 'A' group were granted at the initiative of the bank. The information presented may indicate less emphasis exists on granting lines of credit at the initiative of the bank as the size of the bank increases. More than half of the banks in the first group granted lines primarily at the bank's initiative, while roughly one-third of the credit lines were granted at the initiative of the bank in the 'C' group.

The number and percentage of banks in each group granting lines of credit as a means of increasing loan activities is shown by the information contained in Table XIII.

TABLE XIII

BANKS GRANTING LINES TO INCREASE LOAN ACTIVITIES

Loan activities	Group A (15)		Group B (58)		Group C (36)		Total (109)	
	No.	%	No.	%	No.	%	No.	%
Granted for increase	5	33.3	15	38.6	10	26.3	30	27.6
Not granted for increase	10	66.7	43	61.4	26	73.7	79	72.4

The data in Table XIII show that slightly more than one-quarter of the banks did grant lines of credit in order to increase loan activities. A slightly higher percentage of banks in groups 'A' and 'B' granted lines for this reason than did those in group 'C'.

Tables XIV, XV, and XVI were included to show the origin of requests for lines of credit listed by the respondents who indicated that lines were not granted primarily at the initiative of the bank. Three borrower relationships were investigated: (a) past customers who had not used lines of credit in their relationships with the bank, (b) customers granted lines of credit in the past, and (c) new customers of the bank.

TABLE XIV

STATUS OF REQUESTS FOR LINES OF CREDIT FROM BORROWERS
DEALT WITH IN OTHER CAPACITIES

Requests from past customers not granted credit lines	Group A (6)		Group B (25)		Group C (25)		Total (56)	
	No.	%	No.	%	No.	%	No.	%
Many requests	6	100.0	16	64.0	20	80.0	42	75.0
Few requests			1	4.0	1	4.0	2	3.6
Did not answer			8	32.0	4	16.0	12	21.4

The information contained in Table XIV reveals that the highest percentage of requests for lines of credit in the 'B' and 'C' groups came from past customers, while in the 'A' group all requests were

from past customers.

Data concerning the requests from prospective bank customers in relationship to lines of credit are presented in Table XV.

TABLE XV
REQUESTS FOR A LINE OF CREDIT FROM PROSPECTIVE
BORROWERS FROM THE BANK

Requests	Group A (6)		Group B (25)		Group C (25)		Total (56)	
	No.	%	No.	%	No.	%	No.	%
Most requests			4	16.0	4	16.0	8	14.2
Few requests	1	16.6	6	24.0	7	28.0	14	25.0
Did not answer	5	83.4	15	60.0	14	56.0	34	60.8

It may be observed from the data in Table XV that only one of the banks in the 'A' group reported requests for lines of credit from borrowers who were prospective customers. In the second and third groups it is apparent that few requests came from this source.

Information pertaining to requests from past line of credit borrowers is contained in Table XVI.

TABLE XVI
SOURCE OF REQUESTS FOR LINES OF CREDIT

Source	Group A (6)		Group B (25)		Group C (25)		Total (56)	
	No.	%	No.	%	No.	%	No.	%
Previous line of credit borrower	5	83.4	19	76.0	20	80.0	44	78.5
Did not answer	1	16.6	6	24.0	5	20.0	12	21.5
Other sources	none		none		none		none	

An examination of Table XVI reveals that all requests for a line of credit were received from borrowers who had been previously granted a line of credit.

An examination of the three previous tables shows that the frequency of requests for a line of credit was greater from borrowers who had previously been granted a line than from borrowers with whom the bank had dealt in other capacities. Fewer requests for lines of credit were received from borrowers who had not dealt with the bank in the past.

Table XVII provides information concerning the number and percentage of banks requiring a repayment schedule for their line of credit commitments.

TABLE XVII
 REPAYMENT SCHEDULES ON LINES OF CREDIT

Schedule status	Group A (15)		Group B (38)		Group C (38)		Total (111)	
	No.	%	No.	%	No.	%	No.	%
Definitely established	13	86.6	53	91.5	26	68.5	92	83.0
Remains flexible	2	13.4	5	8.5	10	26.4	17	15.3
No answer					2	5.1	2	1.7

The data in Table XVII show that 83 per cent of the banks had established a definite repayment schedule on lines of credit. A higher percentage of the banks in the 'B' group established a schedule than in the other two groups. The division indicating the smallest percentage was the 'C' group in which 26, or approximately 69 per cent, of the banks had established a definite repayment schedule.

Table XVIII is provided to give information concerning the repayment schedules specified by banks reporting that a definite schedule had been set up for their lines of credit.

TABLE XVIII
REPAYMENT SCHEDULES ESTABLISHED BY BANKS

Repayment time allotment	Group A (13)	Group B (53)	Group C (26)	Total (92)
Monthly	8	30	8	46
Quarterly	1	10	4	15
Annually	3	11	2	16
Semi-annually	7	20	10	37
Seasonally		1	1	2
Varies	2	7	13	22

The findings in Table XVIII reveal that most of the banks had more than one period of repayment established. A monthly schedule was mentioned most frequently in the first two groups while in group 'C' the semi-annual period predominated. Forty-six banks established monthly schedules while 37 banks reported semi-annual schedules.

Table XIX calls attention to the frequency with which lines of credit were reviewed by the banks which had granted or were currently granting lines of credit.

TABLE XIX

FREQUENCY WITH WHICH LINES OF CREDIT WERE REVIEWED

Period of review	Group A (14)	Group B (58)	Group C (38)	Total (110)
Daily	1	2		3
Weekly	1	6		7
Bi-weekly		2		2
Monthly	5	18	5	28
Every two months	3			3
Every three months	3	3		6
Quarterly	4	8	7	19
Every six months		9	2	11
Annually		4	13	17
Did not answer		6	5	11

The data in Table XIX show that there was a wide variation in the frequency with which lines of credit were reviewed by the investigated banks. All of the banks in the first group indicated that the lines were reviewed at least on a quarterly basis. In the second group the monthly period of review was indicated most frequently, while in the third group an annual repayment period was reported. It may be noted that most of the respondents reported that more than one time period was customarily established for review. In some cases it was mentioned that the period established for review was related to the nature of the business activities of the borrower.

Table XX calls attention to the number and percentage of banks that required their line of credit borrowers to maintain compensatory balances.

TABLE XX
 NUMBER AND PERCENTAGE OF BANKS REQUIRING
 COMPENSATORY BALANCES

Compensatory balance	Group A (14)		Group B (58)		Group C (38)		Total (110)	
	No.	%	No.	%	No.	%	No.	%
Required	5	35.1	12	20.7	16	42.1	33	30.0
Not required	2	14.3	46	79.3	21	55.2	64	62.5
Did not answer	7	50.0			1	2.7	8	7.5

The data contained in Table XX show that 30 per cent of the banks granting lines of credit required compensating balances. A higher percentage of the banks in the 'C' group required such balances than the banks in the other groups.

Only 21 per cent of the banks required compensatory balances of all line of credit borrowers. It is of interest that none of the banks in the 'A' group required balances of all customers. At least one-third of the banks in the second group always required such a balance while less than a fourth of the banks in the third group established such a balance as a requirement.

Slightly more than 30 per cent of the banks set balance requirements according to a division of borrowers into classes or types. The banks that did not set balance requirements according to such a division did so on the basis of size and type of business. In the first group

requirements were set according to the type of business. In the second group the size of the company was a major factor in every case, while in two instances the type of business was also important. In the third group most of the banks considered the type of business important while in two instances the size of the business was an important factor.

The data in Table XXI are provided in order to show the number and percentage of investigated banks specializing in the extension of lines of credit to certain types of businesses.

TABLE XXI
STATUS OF BANKS IN EXTENDING LINES OF CREDIT
TO CERTAIN TYPES OF BUSINESSES

Status of specialization	Group A (14)		Group B (58)		Group C (38)		Total (110)	
	No.	%	No.	%	No.	%	No.	%
Did specialize	3	21.4	18	45.0	10	27.0	31	28.2
Did not specialize	11	78.6	40	55.0	25	65.8	76	69.0
Did not answer					3	7.2	3	2.8

From the data contained in Table XXI it may be seen that slightly less than half of the banks in the 'B' group specialize in extending lines of credit to certain types of businesses. In the other two groups the ratio was about one in four, with the banks in the 'A' group indicating the least degree of specialization.

Table XXII points out the different types of firms which were

granted lines of credit by the banks that specialize in extending lines of credit to certain kinds of businesses.

TABLE XXII

TYPES OF BUSINESS OPERATIONS GRANTED A LINE OF CREDIT

Type of business	Group A (3)	Group B (18)	Group C (10)	Total (31)
Construction	1			1
Consumer credit		3	3	6
Farming	2	18	6	26
Finance company			2	2
Manufacturing	1	10	7	18
Real estate		2		2

The information presented in Table XXII shows that in at least one out of every two cases farming was the type of business operation granted a line of credit by banks in the first two groups. In the third classification manufacturing and farming were mentioned most frequently. It may be noted that none of the banks in the 'B' and 'C' groups extended lines of credit to construction companies. In addition, two respondents reported that they granted lines of credit to finance companies. Both of these banks were in the 'C' group which included all of the investigated banks with total resources greater than four million dollars.

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CHAPTER III

INTERPRETATION OF FINDINGS

A high percentage of the banks investigated had resources in the range of one to four million dollars. One-eighth of the banks had less than one million dollars, while more than one-half reported a range of one to four million.

In a survey made by the Federal Reserve in 1955 it was found that 56 per cent of the banks, in a sample which included all member banks with deposits of \$50 million and over, and a declining proportion of each smaller size, were granting lines of credit.¹⁶

In the Kansas City Federal Reserve District 43 per cent of the banks surveyed were extending lines of credit as of October 5, 1955. For the district as a whole, it was found that all banks with deposits of \$100 million and over extended lines of credit. Eighty per cent of the banks with deposits of \$50 million to \$100 million granted lines, as did 73 per cent of the banks with deposits of \$20 to \$50 million, and 19 per cent of the banks with deposits of less than \$20 million.¹⁷

Eighty per cent of the banks investigated in this study were extending lines of credit as of June 24, 1963. It was found that 82 per cent of the banks with total resources of less than one million dollars, investigated in this survey, were extending lines of credit. In

¹⁶The Federal Reserve Bulletin, op. cit., p. 574.

¹⁷Ibid.

the group that included banks with \$1 to \$4 million, slightly more than 75 per cent indicated that they extended lines of credit, and in the group of banks with resources of more than four million dollars, 88 per cent were extending lines.

A comparison of the data obtained by the Federal Reserve in 1955 with the findings of this study indicates that the percentage of Kansas banks granting lines of credit as of June 24, 1963 is much higher than might be expected.

This difference becomes even more apparent when it is noted that: (a) the figure listed by the Federal Reserve for banks with less than 20 million dollars in deposits was 19 per cent; (b) only 6, or about 4 per cent of the banks investigated in this survey had total resources greater than 20 million dollars, a classification in which the Federal Reserve found that 73 per cent of the banks in the 10th Federal Reserve District were extending lines of credit.¹⁸ The figures are comparable on a percentage basis even though one classification used by the Federal Reserve was based on total deposits while this study used total resources. A check of the questionnaires returned showed that total deposits and total resources were closely related and did not differ more than 5 to 10 per cent. The difference in the classification basis between this study and the 1955 survey would have been significant only in cases where the banks had resources or total deposits close to 20 million dollars, and no bank in this study was near the borderline.

¹⁸Ibid.

On a comparable classification basis, this study found that 80 per cent of the banks in the less than 20 million dollar category were granting lines of credit as of June 24, 1963 while the Federal Reserve indicated in 1955 that only 19 per cent of the banks throughout the district, in the less than \$20 million group, were extending lines of credit.¹⁹ The number of banks included in this survey in the 20 to 50 million dollar group was too small to comprise an adequate sample, but here also the percentage of banks granting lines of credit was higher than that found in the Federal Reserve Study. In summation, a comparison of the results obtained as of June 1963 with the study of the Kansas City Federal Reserve District shows that the percentage of Kansas banks with less than \$20 million granting lines of credit increased from 19 per cent in 1955 to 80 per cent in June of 1963.

Care must be taken in interpreting the deviations mentioned above because of variations in the number of banks in each size group throughout the district, and the time lapse between studies. In addition, the Federal Reserve included all banks with deposits of \$100 million and over and a limited sampling of the banks with lower deposit totals in computing their figures for the overall percentages of banks granting lines of credit in 1955. However, there are a number of factors other than the above that might well have a bearing upon the differences noted between the studies.

¹⁹The Federal Reserve Bulletin, op. cit., p. 573.

A "stand-by" commitment is often erroneously called a line of credit. Under this type of arrangement, the banks and the borrower enter into a formal and binding contract in which the bank agrees to lend a certain amount of money within a stated period of time, the funds to be loaned for a specific period, and the borrower agrees to pay the bank a fee if he does not use the funds provided. The borrower also agrees to live up to certain conditions and terms that are incorporated in the agreement.²⁰

Agri-business is a very important part of the Kansas economy and it accounts for a substantial portion of the output of the state. The commercial banks have always been the principal suppliers of credit to farmers especially in short term loans.²¹ There has been a surge in the agricultural productivity over the past two decades requiring substantial outlays of capital to obtain the specialized equipment that characterizes modern-day agriculture. The greater portion of these funds have been obtained from commercial banks. This increase in the credit needs of the modern-day farmer may to some extent account for a portion of the increased use of lines of credit noted in this study.

In addition, bankers are able to finance farmers indirectly by advancing credit to businesses that are related to agricultural needs. In the business community, banks have been increasingly involved in providing large amounts of short-term credit to businesses of all types.

²⁰Davis, op. cit., p. 23

²¹The American Bankers Association, op. cit., p. 5.

At present, business loans comprise about one-fourth of the total bank earning assets.²²

This increase in business loans may be a significant factor in explaining the increased use of lines of credit indicated in this study.

Approximately the same number of banks that are currently extending lines of credit plan to continue the practice. One of the banks in the 'A' group planned to discontinue the use of credit lines in the future. This might reflect a lack of demand for this type of credit extension.

Eighty per cent of the banks investigated in this study granted lines of credit before 1963. At least two of the banks in the 'B' group began granting lines in 1963.

In the first two groups, the majority of the banks that were not extending lines of credit indicated that they had not considered doing so. To some degree this might be due to practices established in granting other types of loans. Some banks may have found that stand-by commitments, revolving credit arrangements, or other types of loans are capable of providing the banks borrowers with sufficient credit in the form desired.

In a number of cases the respondents stated that it had not been necessary to work out credit needs for extended periods. Instead, they worked out the credit needs of borrowers once a year. In at least one case the discussion with the borrower was a commitment by the bank to

²²Ibid., p. 5.

help, and to some degree, constituted an expression of the bank's faith in the individual. At other times, the meeting was used as a brake on borrowers who customarily over-extended themselves.

In the first two groups the most frequently listed reason leading to a decision not to extend lines of credit was lack of demand.

The banks in the 'A' group which indicated they did not extend lines of credit frequently mentioned that there was little demand for this type of credit extension, but that they would be willing to extend lines if the need arose. These indications probably reflect, to some extent, close relationships possible between smaller rural banks and their borrowers. Also the other forms of credit extension mentioned above may be serving the needs of their borrowers.

In the third group 75 per cent of the banks not extending lines of credit had considered doing so, but decided against it. The reason given for this decision in two cases was bank policy. One of the respondents indicated that a large portion of their loan business is with farmers and a constant revision of lines of credit would be necessary to keep loans on a sound basis. The rapidly changing financial condition of farm borrowers is probably related to policies established by the banks concerning lines of credit.

It was found that the greatest amount that could be loaned by a single officer of banks in the first group was about \$20 thousand. Two banks in the second group allowed an officer to lend more than \$50 thousand, while in the third division four permitted an official to lend amounts greater than \$50 thousand. In some cases more than two officers were required to approve loans. Twenty-three of the banks

had no upper limit on loans set by bank policy. At least twenty-nine banks permitted officers to lend amounts up to the legal limit of the bank.

More than half of the banks granting lines of credit had an upper limit set by bank policy. In each group the percentage of banks with such a limit fell between 53 and 57 per cent.

Legal limits were the most frequently mentioned factors in setting limits on lines of credit.

In answering the general question of what factors limit the extension of lines of credit, bank policy was most frequently mentioned, followed by economic conditions, and stability of the firm. Legal limits and repayment ability were also mentioned as major factors limiting the extension of lines of credit. These factors undoubtedly reflect the general character of borrowers and past banking experiences.

An interesting point brought out was that while approximately the same number of banks in the 'A' and 'C' groups indicated that limited capital and surplus was a problem in extending lines, on the basis of total reasons listed, banks in the 'B' group mentioned it more frequently.

This information is significant because it might be expected that more banks in the 'A' group than in the 'B' group would find limited capital surplus a major obstacle in extending lines of credit. The data may indicate that a number of banks in the 'B' group are faced with an opportunity to extend substantial lines, but they are unable to do so because the amounts desired exceed their legal limits. This assumption would imply that possibly the 'B' banks are somewhat reluctant to

place excess loans with their correspondent. It might also indicate that the banks are more interested in serving their communities with other types of loans and are unwilling to subordinate these loans to possible lines of credit.

Only 20 of the 110 banks granting lines of credit had established a department to take care of this type of loan. A number of the banks with no specific department indicated that lines were administered by top officials of the bank.

One-quarter of the banks in the 'A' group had established a department, while only 8 per cent of the banks in the 'B' group indicated that a separate department had been established. In the 'C' group 20 per cent of the banks had a department. The high percentage of banks in the first group having a department probably reflects to some extent bank organization. In many cases it was mentioned that the bank was essentially a one to three man operation, and that the president or vice president was in charge of credit lines.

In order of frequency, the person or group in charge of placing limits on loans in general were loan officers, loan committees, then the Board of Directors.

The larger banks in the sample indicated the least degree of flexibility concerning rules and procedures employed in granting loans. Sixty-two per cent of the banks in the 'C' group indicated that loan policies were governed by definite rules and procedures established by bank policy. The greatest degree of flexibility was found in the 'A' group where at least 41 per cent of the bankers indicated that the

procedures used in granting loans were not set forth in a formal way. These variations can probably be traced back to size differences. As the operations become larger more definite policies are required for smooth operation.

Slightly more than half of the banks granting lines of credit indicated that limits on the size of lines were set by bank policy. Bank policy, as a base, probably included such factors as demand for lines, types of borrowers, capital structure, location, and special interests of the bank in making loans to certain kinds of businesses.

There was nearly an equal division between banks answering the question inquiring whether or not lines of credit were granted primarily at the initiative of the bank since fifty-five banks gave an affirmative answer while fifty-six gave a negative answer. Data obtained concerning the actions of the group 'C' banks indicating that in 65.8 per cent of the cases lines were set up primarily at the borrowers request was in agreement with information obtained in the Federal Reserve survey. However, their findings indicating that small banks tended to set up lines of credit only at the request of the borrower were not consistent with the findings of this study.²³ Of the banks surveyed in 'A' and 'B' groups, 60 and 76.8 per cent, respectively, reported that lines of credit were established primarily at the banks's initiative rather than at the request of a borrower. Prather indicated in his book, Money and Banking, that a line of credit is generally set up at the borrower's

²³The Federal Reserve Bulletin, loc. cit.

request, but that there are cases in which the bank establishes lines in order to build up its loan business.²⁴

The bankers were then asked to indicate whether or not lines of credit were granted to increase loan activities. Only one-quarter of the group said that lines were granted for this purpose. This would seem to indicate that the banks in this survey commonly establish lines at their own initiative, but only to a limited extent as a means of increasing loan activities. The information above is substantiated to some extent by indications made by the bankers of the extent of their loaning activities in lines of credit.

Lines of credit did not, in general, seem to constitute a large portion of the banks' loan business. Of the banks that gave figures, about half said lines of credit made up less than 20 per cent of their loan business.

Bankers that said lines of credit were not primarily granted at the initiative of the bank were asked to indicate, for three different borrower relationships, whether or not most requests for lines of credit were from: (a) firms with whom they had dealt within other capacities; (b) firms that had been previously granted lines of credit, or (c) firms that they had not dealt with in the past. Forty-three out of fifty-six respondents indicated that many customers, with whom they had dealt with in the past in other capacities, requested lines of credit. Forty-four indicated that many requests were from borrowers that had

²⁴Prather, loc. cit.

been previously extended a line, while only fourteen indicated that they had frequent requests from borrowers that were not bank customers for lines of credit.

The number of lines of credit granted by the banks investigated was generally low. Most of the banks with total resources of less than one million dollars indicated they were granting fewer than thirty lines. As many banks in this group were in primarily agricultural communities, it might be expected that many of their loans were to well established farm borrowers. Four banks in this group indicated that they extended more than 100 lines of credit. This appeared to be out of line with what might be expected. It is possible that some of the banks were not exactly sure what constitutes a line of credit. This may be a partial explanation of the high percentage of banks indicating that they extended lines of credit in this group.

In the second group, a number of banks extended up to fifty lines of credit, although about one third of the banks in the group granted less than ten lines. The attitudes of the bankers in this group toward lines of credit, as reflected in some of the comments they made, were generally favorable. One respondent indicated that the extension of a line of credit gives the businessman or farmer a sounder basis on which to operate, and stimulates his thinking on the extent of his operation. This may well result in an increase of the business of the community in general. One banker said that lines of credit grew out of prior experience on specific loans where the bank had established a favorable borrower performance. This statement is similar to the discussion of

lines of credit in Davis's book, Credit Administration, in which he stated that lines of credit may make it possible for the bank to establish permanent relations with valued business customers and to keep the type of loan business in which it is interested.²⁵ In the third group, half of the number of banks granted less than 30 lines. The greater resources of these banks and locations in urban, rather than mainly agricultural areas might be factors that enabled the banks in this group to do more business in lines of credit.

About eighty-four per cent of the banks granting lines of credit established a definite repayment schedule for line of credit borrowers. More banks in the 'B' group required a definite repayment schedule than in the other groups. About 92 per cent of the banks in the 'B' group established a definite schedule of repayment. Eighty-seven per cent of the banks in the 'A' group and 69 per cent of the banks in the 'C' group had established definite repayment schedules.

A possible explanation of the differences noted in the establishment of repayment schedules might be found in the type of business granted a line of credit. Banks in the first and second group indicated that a good portion of their loans were to farmers. It might be expected that these farm loans were to farmers who were very good credit risks and capable of meeting a periodic repayment schedule easily. Also about half of the banks in the second, or 'B' group specialized in extension of lines of credit to certain types of operations. This would probably make it

²⁵Davis, op. cit., p. 20.

possible to establish certain definite repayment periods through a careful choice of the type of businesses granted lines of credit. In the 'C' group approximately two-thirds of the banks established definite schedules. This might reflect a systematic choice of the type of business granted a line. Also it might be expected that the larger banks requiring definite repayment schedules is in line with a statement made by the Federal Reserve that banks commonly require periodic payoffs of borrowing under lines of credit.

Banks that established a definite repayment schedule were asked to indicate what time periods were customarily established. The most frequently mentioned period was monthly. Then came semi-annually, variable, annual, and quarterly. One bank established a seasonal schedule.

On their other loans, the banks providing the above information listed, in order of frequency, repayment periods of semi-annually, yearly, variable, monthly, quarterly, and seasonally. One of the banks established two and five year periods on real estate. This information may indicate that, in general, longer repayment periods are established for other types of loans than on lines of credit. Also it may indicate that lines are watched more closely than other loans. An accurate decision can not be made concerning the above information without figures listing the number of loans and the type in relationship to repayment periods.

In the Federal Reserve study it was indicated that the prevailing practice was to review credit lines at least once a year. In this study it was found that there was a wide variation in the frequency with which

lines were reviewed. All of the banks in the first group reviewed lines at least on a quarterly basis. In the second group the most frequently indicated period was monthly, and in the third group, annually. A number of respondents indicated that more than one period for review was established. In only 14 cases out of 56 was an annual period of review indicated. Slightly more than 76 per cent of the banks using an annual review were in the 'C' class which included banks with more than four million dollars. This may be an indication that the smaller banks, in general, review lines more often than the larger banks.

The review period, as mentioned before, may reflect the type of borrower granted a line. It is probably also related to the number of lines granted, the risk involved, the amount of the line, and other pertinent factors. In addition, the number and distribution of larger banks throughout the country may have been a significant factor in the Federal Reserve Study.

Slightly more than one-third of the banks granting lines of credit specialized in credit lines to particular business groups. The highest degree of specialization was found in the 'B' group where 45 per cent of the banks specialized. In the first and second groups farming was the type of business operation granted lines of credit in roughly one out of two cases. In the third classification manufacturing and farming were the most frequently mentioned operations. It is of note that none of the banks in the second and third groups specialized in extending lines to construction companies.

This specialization is probably related to a desire on the part of the bank for keeping certain types of loan customers. The above

information is essentially the same as presented in the Federal Reserve study of lines of credit with respect to the banks extending lines to particular business groups.

The relatively frequent review periods established by country banks probably reflect a close relationship between farm borrowers and the bank. As farming is a seasonal type of business a closer inspection of the status of the operation may be required than in the case of other undertakings such as manufacturing. Banks in the third group indicated that they extended lines to farming and manufacturing operations in most cases. A greater stability of operation is probably found in manufacturing than in farming; consequently, the bankers may feel that these lines do not require frequent reviews. If this is the case, the review periods established might be said to reflect the type of operation granted lines of credit by the banks.

In some cases banks require certain balance requirements of line of credit borrowers. These balances are customarily related to the amount borrowed or the type of business granted a line.

In this study it was found that 30 per cent of the banks had some sort of minimum balance requirement imposed upon their line of credit borrowers. There a number of reasons for this type of requirement. The bank is able, in some degree, to discourage borrowing from another source. It may help to promote a better relationship between the customer and the bank. The Federal Reserve found that approximately one in every four banks they investigated in the Kansas City Federal District required some sort of a minimum balance. There was only a five

per cent difference in the findings of this study. At least one bank investigated in this survey planned to establish minimum balance requirements.

The banks requiring compensating balances were asked to indicate whether or not the requirements applied to all borrowers and 21 per cent indicated that this was the case. An interesting point brought out was that none of the banks in the first group required minimum balances of all borrowers.

The bankers were next asked to indicate whether or not balance requirements were set according to a division of borrowers into classes or types. Thirty-six per cent of the banks in the sample indicated that requirements were set in this way. The banks in the first group indicated that most divisions were based on the type of business. In the second group balances were set, in all cases, according to the size of the company, and in half of the cases the type of business was also considered in establishing requirements. In the third group most of the banks indicated that the type of business was considered, and in about one-third of the cases the size was considered important.

The findings of this study indicate that fewer of the banks investigated are requiring minimum balances according to a division of borrowers into classes or types than was indicated in the Federal Reserve study, where it was found that 59 per cent of the banks with minimum balance requirements applied them without designation as to type.²⁶

²⁶The Federal Reserve Bulletin, op. cit., p. 573.

These differences are, to some extent, probably traceable to differences in the dominant factors of the regional economies. Kansas is partially an agricultural state and is directly concerned with agribusiness. Other states may have quite different economic factors to evaluate. These differences could quite conceivably limit the degree of specialization possible, from the standpoint of the bank, in granting lines of credit.

Balance requirements were related to the use of the granted line in 54.5 per cent of the cases where minimum balance requirements were established. The percentage of banks in the first and third groups relating balance requirements to the extent of use of the granted line was nearly equal. In the second group, three-quarters of the banks related requirements to use of the line.

CHAPTER IV

SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

This investigation was initiated to analyze the activities of Kansas banks in granting lines of credit. The examination involved the determination of the extent to which lines of credit are granted, methods by which banks delegate authority in granting lines of credit, and how loan policies and practices differed among banks surveyed.

It was assumed that the findings of the study might conceivably aid in the improvement of existing banking facilities, and provide an indication of the effectiveness of the banks in granting this type of credit to their borrowers.

The data were derived from a study of banks in Kansas. The banks chosen for the investigation were selected by the use of a Table of Random numbers. In many cases the institutions examined in detail were those that had extended, or were currently extending lines of credit. In some cases information obtained from banks that had not granted lines of credit was employed to further clarify certain situations.

A fifty per cent sample, taken at random from a total of 595 banks, resulted in the selection of 136 institutions for investigation from a total of 151 returns. One return was rejected because the bank had consolidated with another, and another 14 were not used because the questionnaire was not returned in the manner requested. The 136 banks investigated comprised a random sample of 45 per cent of the banks on the master list, and approximately 23 per cent of the total number of

banks operating in Kansas as of June 24, 1963. The final sample included almost one out of every four banks in Kansas.

A review of material in the field concerning the activities of banks in granting lines of credit, and an inquiry to the Board of Governors of the Federal Reserve System was made in order to facilitate determination of the major items to be included in a questionnaire. This questionnaire was used as a means of eliciting the information required for the survey.

All of the data obtained were taken from the questionnaires or comments made by officials of the banks investigated. The data were then transferred from the questionnaires to master sheets from which the data were analyzed and organized into tables.

FINDINGS

Approximately half of the banks investigated had total resources in the range of one to four million dollars. Only 17, or one-eighth of the banks surveyed had resources of less than one million dollars, and the remainder, 31 per cent, had total resources of more than four million dollars.

Eighty per cent of the banks investigated were granting lines of credit. A higher percentage of the banks in the group with resources of four million dollars or more were granting lines of credit than in the two other groups.

There were 109, or 80 per cent, of the banks investigated that indicated they had granted lines of credit in the past. Two of the

banks in the second, or 'B' group began granting lines of credit in 1963. At least 110 of the banks investigated planned to extend this type of credit in the future. One bank in the 'C' group that neglected to indicate whether or not lines of credit were being currently extended planned to grant lines in the future.

There were three banks in the 'A' group that had not granted any lines of credit. None of the officials of these banks indicated that any consideration had been given to engaging in this type of loan activity. In the 'B' and 'C' groups three banks, 19 and 75 per cent respectively, had considered granting lines of credit. In both of these classifications lack of demand was the most frequently mentioned factor limiting extension of lines of credit. In the 'C' group bank policy was the limitation indicated by two of the banks that were not extending lines of credit.

Approximately 18 per cent of the banks had a separate department established to administer lines of credit.

The least degree of flexibility in procedures and rules established by the bank concerning loan policy was found in the third group which included banks with resources of over four million dollars. Sixty-two per cent of the respondents in that group indicated that loan policies were governed by definite rules and procedures established by bank policy. The highest degree of flexibility was found in the group which included banks with less than one million dollars. About half of the banks in this group had no definite policy for making loans.

With respect to the limits placed on loans by the banks, it was

found that only banks in the 'B' group indicated that the legal limit was a significant factor in establishing loan limits.

There was a degree of similarity among the banks in policies dealing with lines of credit. In all three groups there were indications that upper limits were set on lines of credit by bank policy. The percentage of the three groups indicating such a limit fell between 35 and 57 per cent.

In the first and second classifications most lines of credit were granted at the bank's initiative. The majority of the lines were granted at the customer's request in the third group.

The 'A' and 'C' groups indicated that more requests for lines of credit were from past customers and borrowers who had been previously granted lines than otherwise. It was also revealed that few requests for lines of credit were received from borrowers who were only prospective customers.

Approximately half of the banks in the second group specialized in granting lines of credit to certain kinds of businesses. In the other groups approximately one out of four banks indicated that they specialized. The 'A' group had the least specialization.

Farming was one type of operation that was frequently mentioned as a type of business granted lines of credit. This may indicate that many of the lines of credit granted are somewhat seasonal in nature.

This assumption was substantiated to some extent by the information provided concerning the repayment periods established by the banks on lines of credit. In the group of banks that indicated a large number of their lines were in farm loans, fairly short repayment periods were established.

On an overall basis 28, or 34.6 percent, of the banks extending lines of credit required compensatory balances of their borrowers. Some of the banks related balances to a division of borrowers into classes or types or use of the granted line.

CONCLUSIONS

The data gathered in this study indicated that a higher percentage of Kansas banks are granting lines of credit than might be indicated from an inspection of the data presented in the Federal Reserve Survey of lines of credit in 1955.

The results of the study further indicated that the smaller banks, those with total resources of less than \$4 million, appeared to be very aggressive in granting lines of credit. This is an interesting point because only one-fourth of these banks indicated that lines were extended to increase their loan activities. This statement appeared to be consistent with the information obtained concerning the number of lines granted and the portion of the banks' loaning activities made up by lines of credit. The number of lines granted was generally low; approximately half of the banks indicated

that credit lines made up less than 20 per cent of their lending activities.

Bankers who granted lines primarily at the customer's initiative reported that most lines were granted to customers of the bank with whom they had dealt in other capacities or those who had been line of credit borrowers in the past. They further indicated that few requests came from outside sources.

Although the number of lines granted was generally small, there were a number of officials stating that they extended more than 100 lines, and in one instance the respondent reported that 2,500 lines were currently being extended. This may indicate that bankers may not have a common understanding of a line of credit.

Review periods were quite varied with the smaller banks indicating the shorter periods.

Balance requirements were varied but were generally similar in nature to those pointed out by the Federal Reserve study.

The most frequently mentioned factor limiting the extension of lines of credit was bank policy, followed by economic conditions, stability of the firm, legal limitations, and repayment ability. Approximately half of the banks in the 'A' and 'B' groups showed a high degree of flexibility in granting lines of credit. On an overall basis nearly half of the banks set limits on lines of credit according to individual bank policy. Perhaps established loaning policies are related in some degree to attitudes toward the extension of credit lines.

RECOMMENDATIONS

There are a number of areas discussed in this study that might be well worth additional examination.

The indicated increase in the extension of lines of credit might be investigated in relationship to changing patterns of credit extension to agricultural, consumer credit, and manufacturing areas.

An extensive investigation of the bankers' understanding of lines of credit in the strict sense as used in this study might point out a lack of agreement as to a common understanding of the term.

The aggressiveness of the smaller banks in granting lines of credit might be investigated in relationship to bank loaning policies, the number and extent of lines, and earning potentials.

There were some indications that lack of demand is a significant factor in limiting the extension of lines of credit. A determination of the factors leading to this conclusion might be of value.

A similarity between the 'A' and 'B' groups in practices and policies was noted in a number of cases. An investigation of factors leading to this similarity would be of interest.

Kansas farmers and agri-business in general needs a strong commercial banking system to take care of their credit needs. Many of the Kansas banks are in a position to provide this service. They have close contact with the changing agricultural credit needs of their communities. Although some of the banks may currently feel that a limited capital structure prevents them from extending the number and

type of loans they might desire, they are, in a sense, as large as their correspondent. As farmers require more capital and mechanized equipment for effective operations the rural banks may be able to provide a great deal of the farmers' credit needs through diversified credit extension, and it is reasonable to assume that the use of lines of credit would provide a much needed credit base upon which farmers might operate more effectively.

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APPENDIX A

Questionnaire

ANALYSIS OF PROCEDURES AND POLICIES USED BY BANKS IN KANSAS
IN ESTABLISHING LINES OF CREDIT

1. Name of Bank _____ Location _____
2. Name of respondent _____
3. Exact title of respondent _____
4. Are you currently extending lines of credit? yes ___ no ___
5. Have you granted lines of credit in the past? yes ___ no ___
6. Are you planning to grant lines of credit in the future? yes ___ no ___
7. If the answer to six is "No," have you considered doing so? yes ___ no ___
8. If you have not extended lines of credit what were your reasons?
 - a. ___ Bank policy
 - b. ___ No demand for extended credit
 - c. ___ Limited capital and surplus
 - d. ___ Other (specify) _____
9. a. Does your institution have a separate department that deals with lines of credit only? yes ___ no ___

b. What is the title of the person handling this department?
 - (1) ___ President
 - (2) ___ Senior Vice President
 - (3) ___ Executive Vice President
 - (4) ___ Cashier
 - (5) ___ Assistant Cashier
 - (6) ___ Other (specify) _____
10. Are your loan policies governed by definite rules and procedures established by the bank? yes ___ no ___
11. Are the limits of loans determined by the
 - a. ___ Board of Directors
 - b. ___ Loan Committee
 - c. ___ Loan Officers
 - d. ___ Other (specify) _____
12. Is there an upper limit on the amount of lines of credit set by bank policy? yes ___ no ___
13. If there is an upper limit set, what are the reasons for the limitation? _____

14. What is the maximum amount that may be granted by a single officer?

15. Are lines of credit granted primatily at the initative of the bank?
yes ___ no ___

16. If the answer to fifteen is "No," are most requests for lines of credit from firms with whom you have
a. dealt with in the past in other capacities? yes ___ no ___
b. previously granted lines of credit? yes ___ no ___
c. not dealt with at another time? yes ___ no ___

17. Do you specialize in extension of lines of credit to certain types of businesses? yes ___ no ___

If so, what types? (1) ___ Manufacturing (3) ___ Consumer Credit
(2) ___ Construction (4) ___ Other (specify)

18. Approximately how many lines of credit are you granting at present?
(numerically) _____

19. How often are lines reviewed? _____

20. What is the usual repayment period agreed upon? a. ___ six months
b. ___ One year
c. ___ Other (specify)

21. Are there compensating balance requirements? yes ___ no ___

22. If the answer to twenty-one is "Yes," do these requirements apply to all borrowers? yes ___ no ___

23. a. Are balance requirements set according to a division of borrowers into classes or types? yes ___ no ___
b. If so, what is the schedule? (1) ___ Size of company
(2) ___ Type of business
(3) ___ Other (specify)

24. Are requirements related to the extent of use of the granted line?
yes ___ no ___

25. a. Do you establish a definite repayment schedule? yes ___ no ___

b. If so, what is the schedule? (1) ___ Monthly (4) ___ Semi-annually
(2) ___ Quarterly (5) ___ Other (specify)
(3) ___ Annually

26. Number the following in order of importance in consideration of granting lines of credit. (Rank items by numbering them from one to ten. Number one indicates that this item is of highest importance. Number ten indicates that this item is of least importance.)

- a. General economic conditions
- b. Limitations of credit worthiness
- c. Limitations of business and credit considerations
- d. Legal limitations
- e. Trends in balance sheets and operating figures
- f. Capacity and progress of the business
- g. Integrity and experience of management
- h. Market value of collateral
- i. Percentage of net worth
- j. Other

27. Are lines of credit granted primarily to increase loan activities?
yes no

28. If you extend lines of credit what portion of your loan activities are in this type of lending? (per cent) _____

29. What factors limit the extension of lines of credit?

- a. Bank policy
- b. No demand for extended credit
- c. Limited capital and surplus
- d. Other (specify) _____

30. Check the following blank if you wish a summary of the findings of this study _____

ADDITIONAL COMMENTS MAY BE PLACED ON THIS PAGE

(Would you please enclose a condensed statement of the financial condition of your bank?)

APPENDIX B
CORRESPONDENCE

June 14, 1963

Cashier
The Riley State Bank of Riley, Kansas
Riley, Kansas

Dear Sir:

I am conducting a study of the loan activities of Kansas banks with respect to extension of lines of credit. The findings of this research will be presented in partial fulfillment of the requirements for the degree of Master of Science in Economics at Fort Hays Kansas State College, Hays, Kansas. I am attempting to complete these requirements during this 1963 summer session.

The objectives of this investigation are to determine:

1. The extent of use of lines of credit by banks in Kansas
2. Methods by which banks delegate authority in granting lines of credit
3. The extent to which smaller banks might adopt the practices used by larger banks in granting lines of credit
4. Whether or not small banks might benefit by increasing or decreasing use of lines of credit

The definition of a line of credit as used in this research is an advance commitment, expressed by the bank, of the maximum amount of credit which it is willing to extend to a borrower during a given period of time.

The data will be gathered by means of the enclosed questionnaire. The information which you provide will be kept strictly confidential. Any additional comments you might wish to make will be welcomed.

Your help in making this study a success will be greatly appreciated. Will you please complete the enclosed questionnaire and return the form to me before June 24, 1963. I have enclosed a self-addressed stamped envelope for your convenience.

Sincerely yours,

Kerry Cain
508 West 21st St.
Hays, Kansas