

FINANCE, TRADE, AND TRANSPORTATION

VII. THE CLEARING-HOUSE SYSTEM¹

THE CLEARING-HOUSE SYSTEM A MODERN INSTITUTION

THE clearing-house is a comparatively modern institution, the Edinburgh bankers claiming the credit of establishing the first one. The earliest clearing-house of whose transactions we have any record is that of London, founded about 1775. For fully seventy-five years the London clearing-house and that of Edinburgh were the only organisations of the kind known to exist. The monetary systems of most European countries centring around one great national bank located at the capital of each, found in this a means of effecting mercantile settlements. The New York clearing-house was established in 1853, from which date the American clearing-house system has grown to enormous proportions. No country in the world has so large a need of clearing-houses, for in no country is the bank cheque so generally used in the payment of ordinary accounts.

TRANSFER OF CREDITS IN CLEARING-HOUSES

The purpose of the clearing-house is largely to facilitate the transfer of credits. This is explained by the fol-

¹ See also Lesson VIII. of Part I. of this book ("General Business Information").

lowing illustration: Suppose that Brown and Smith keep their money on deposit in Bank A and that Brown gives Smith his cheque for \$100 and Smith deposits it in the bank to his (Smith's) credit. The officers of the bank will subtract \$100 from Brown's account and add the same amount to Smith's account. No actual money need be touched. It is simply a matter of arithmetic and bookkeeping. Credit has been transferred from Brown to Smith. If all the people of a city kept their money in one central bank there would be no need of a clearing-house. The bookkeepers of the bank would be kept busy transferring credits from one customer to another on the books of the bank. But if Brown keeps his money in Bank A and Smith keeps his money in Bank B it is necessary that Bank A and Bank B come together somewhere to conveniently make the credit transfer, and this is practically what they do in the clearing-house. Then, again, if Bank A should be located in San Francisco and Bank B in Boston, the difficulty of transfer of credit is greatly increased.

Through the agency of clearing-houses located in money centres and of co-operation between banks at distant points, the transfer of credits between business men located anywhere in the United States, or for that matter in the world, has become a comparatively simple matter. If it were not for the agency of this system it would be utterly impossible for a great city to do the business of a single day. All the actual money in all the banks and stores and safes and pockets of New York City to-day would fall far short if used to pay to-day's transactions. It is estimated that the cash transactions of a single day are fifty times greater than the actual cash changing hands in one day. So that the great bulk of the business of the country, both cash and credit, is done on a system

of credit transfers made possible wholly through the agency of our banking system.

ORGANISATION OF CLEARING-HOUSES

Each large city has its clearing-house system. To establish a clearing-house a number of banks associate themselves together, under certain regulations, for the purpose of exchanging daily at one time and place the cheques and other commercial paper which they hold against each other. The usual officers are a president, a secretary, a treasurer, and manager, and a clearing-house committee. The cheques, etc., which the banks take to the clearing-house are called the clearing-house exchanges, and the total amount of paper exchanged is called the day's clearings. Those banks which bring a less amount than they take away are obliged to make the difference good in cash or its equivalent within a fixed time upon the same day. Suppose, for illustration, that a clearing-house association consists of five banks—A, B, C, D, and E—and that Bank A took to the clearing-house cheques against B, C, D, and E amounting to \$20,000, and that B, C, D, and E took to the clearing-house cheques against A amounting to \$21,000. Then A is on this particular day a debtor bank, and owes the clearing-house, or the other banks through the clearing-house, \$1000. The payment of the balances by the debtor banks and the receipt of the balances by the creditor banks complete each day's transactions. As the total amount brought to the clearing-house is always the same as the amount taken away, so the balances due from the debtor banks must be exactly equal to the amounts due the creditor banks. The clearings in New York City in one day amount to from \$100,000,000 to \$200,000,000, and the actual cash handled, if any, need

only be for the actual debit balances. Usually once a week (in some cities oftener) the banks of a city make to their clearing-house a report, based on daily balances, of their condition. The clearing-house establishes a fellowship among banks that has already proved in times of money panics of the greatest service to themselves and the community.

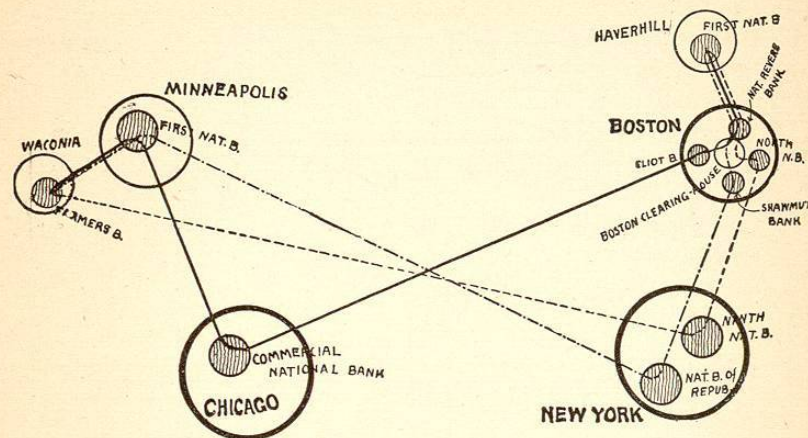
PAYMENT OF BALANCES IN CLEARING-HOUSES

Clearing-house certificates are made use of in many cities for the payment of balances by debtor banks. These are issued against gold deposited with one of the associated banks. They are numbered, registered, and countersigned by the proper officer, and are used only in settlements between the banks. Various methods of making settlements are in use. In some of the cities the balances are paid by drafts on New York or other money centres. The debtor bank sells some creditor bank New York exchange, and receives in return a cheque or order on the clearing-house, which when presented makes the debits and credits balance. It is estimated that the actual cash employed in New York clearings is less than one half of one per cent. of the balances.

HOW DISTANT BANKS ARE CONNECTED BY THE CLEARING-HOUSE SYSTEM

To illustrate the connection between banks at distant points let us suppose that B of Haverhill, Mass., who keeps his money on deposit in the First National Bank of that city, sends a cheque to S of Waconia, Wis., in payment of a bill. S deposits the cheque in the Farmers' Bank of Waconia and receives immediate credit for it in

his bank-book, just the same as though the cheque were drawn upon the same or a near-by bank. The Farmers' Bank deposits the cheque, with other cheques, in, say, the



Illustrating cheque collections.

First National Bank of Minneapolis, or it may send the cheque to its correspondent in New York—say the Ninth National—asking to be credited with the amount. For sake of illustration, suppose that the cheque is deposited with the First National of Minneapolis. Now, this bank has a correspondent in Chicago—the Commercial National—and a correspondent in New York—the National Bank of the Republic. If sent to the Commercial National, this bank has a correspondent in Boston—the Eliot Bank, where the cheque would be sent. Now, the First National of Haverhill has a correspondent in Boston—the National Revere Bank. The Eliot Bank would likely take this cheque to the Boston clearing-house as a charge against the Revere Bank. The Revere Bank would deduct the amount from the First National of

Haverhill's deposit and send the paid cheque to the Haverhill Bank, where at the close of the month it would be handed to B, showing on the back the indorsement of S, and stamping representing all the banks through whose hands it passed. If the Farmers' Bank of Waconia had sent direct to its New York correspondent, the Ninth National, this bank would have sent to its Boston correspondent, the North National, and the cheque would have been charged up through the clearing-house against the Revere Bank. If the First National of Minneapolis had sent direct to its New York correspondent, the National Bank of the Republic, this bank would have sent to its Boston correspondent, the Shawmut National, etc. As a rule, banks collect by whatever route seems most convenient or advantageous. It is estimated that millions of dollars are lost to the banks each year on account of the time consumed by cheques en route:

FINANCE, TRADE, AND TRANSPORTATION

VIII. COMMERCIAL CREDITS AND MERCANTILE AGENCIES

HOW THE WORLD'S TRADE IS LARGELY TRANSACTED UPON CREDIT

It is estimated that about ninety per cent. of the world's trade is transacted upon credit. And in no country of the world are commercial credits so freely granted as in the United States. This is a land of seemingly unlimited faith in humanity, and yet a land in which hazardous speculation, extravagance, and bankruptcy have often prevailed. Statistics show that about ninety-five per cent. of our merchants "fail to succeed," and yet no other country can boast of such wealth, industrial energy, and generous confidence in business integrity. While credit is not money, in that it cannot settle a debt, it must be considered a very powerful agent in the creation of capital. Credit is another name for trust. The business world bases its confidence or trust in men upon their character and resources. And the extent of this trust becomes the only limitation of the business man's purchasing power. He who can show conclusively the ability and disposition to fulfil obligations, has it within his power to command

the capital or merchandise of others. Credit is one of the fruits of a higher civilisation and a settled condition of a country's business. It bespeaks a quality of government, too, that is not to be depreciated. The nations that are most successfully and equitably governed and show the most stable conditions of currency also show us the most extensive and efficient credit systems. It is abundantly true that these same nations have on many occasions passed through periods of great distress from failures widespread and panics severe, but it must also be borne in mind that these very bankruptcies are more often the abuse of prosperity than the product of adversity. Over-confidence in men and things has resulted in speculation and precipitated bankruptcy. And if it be urged that to the undue expansion of credit is traceable the greater number of our financial disasters, it may be said with still greater force that all our impetus to industrial achievement has been and still is dependent upon the generous exercise of credit. The construction of our railroads and canals, the operation of our mines, the improvement of our great farm areas, the building of our towns and cities, and the development of our extensive manufacturing interests are all the result of the trust reposed in men and the industrial interests they represent.

THE IMPORTANCE OF A HIGH STANDARD OF CREDIT TO BUSINESS MEN

Reticence on the part of business men respecting their financial position may seriously impair their credit. It is universally regarded by the intelligent business man to be good policy to make known his condition. A refusal to do so throws a suspicion and doubt upon his financial

ability, and at some future time when confidence in his integrity may be essential to the very life of his business, he may find the necessary help unobtainable. An applicant for credit should be willing to prove himself worthy of it. But the keen competition among merchants eager for sales often enables the buyer to obtain credit without the necessity of giving very much evidence as to his commercial standing. Since some risks must be taken merchants frequently conclude to accept an account because of its possible acceptance by some competitor. If business is to be had risks must be taken, is the theory.

When former customers apply for credit the merchant is guided by the record made in previous dealings. A business man's ledger is a very valuable history of credits. It is his compass in a sea of doubt. If upon the inspection of an old account it be discovered that in former years the customer paid cash and discounted his bills, and that later his method of payment was by promissory notes, and that on several occasions he asked for special favours, such as dating bills ahead or the privilege of renewal of notes, one is able to read a certain unmistakable sign of degeneracy in the customer's credit. New orders from such a customer will bear scrutiny; and a closer attention to the present condition of the account may save the firm from some bad debts.

While it is possible to-day to determine the average losses from bad debts in the various lines of business, individual risks cannot be accepted on that basis. Each requires special study. If an applying customer paints his financial condition in roseate colours, let him be willing to reduce his statement to writing, and when his signature is affixed his statement is much more reliable, because he knows of the impending liability of fraud if he has misrepresented. Men averse to transforming an oral

statement to writing have discredited themselves immediately. Men who mean to be honest may be optimistic in picturing prospects and be inclined to set an unreasonable value upon their property and extent of business. It may be easier to tell the absolute truth about one's liabilities, because they are such persistently real things; but assets have elastic qualities in many men's minds and seem capable of any extension in an emergency. Buyers who impress themselves most favourably upon the business house are frank in their statements. The explicit, candid man of few words will merit consideration. The cringing or pleading kind predisposes one unfavourably. Stephen Girard said of one who in tears asked for a loan: "The man who cries when he comes to borrow will cry when he comes to pay."

To determine the right of a buyer to credit and the safe limit of credit to be extended to him is the seller's serious problem. It is customary to request references in order to discover how other firms regard the applicant's credit. But these references may be cautious of reply. A selfish desire to retain the customer for themselves, or the higher motive of a desire to be true to the interests of both the inquirer and the customer may produce dubious or very incomplete reports. If a bank be among the references one does not place too much stress upon a very favourable reply from it, because a merchant usually learns the lesson of expediency in making a friend of his banker. And, moreover, one endeavours to reveal only the best side of his business affairs to the bank. Favourable replies from several firms showing a uniform line of credit go a great way toward reaching a safe conclusion. But in these days of vast and multifarious interests there has developed, as a result of this desire for adequate knowledge respecting men's credit, an agency for the ex-

clusive purpose of arriving at definite and reliable evidence upon financial matters; and after years of experience men have learned to depend upon these mercantile agencies as the most valuable and trustworthy assistants.

MERCANTILE AGENCIES

Mercantile agencies had their origin in the system adopted by several prominent firms of keeping on record all the information obtainable relating to their customers. In 1841 "The Mercantile Agency of New York City" began its history, and was the forerunner of the present great agencies whose record books of credits and ratings include the names of all the business houses and corporations in this country and Canada. The pioneer institution of this character in the United States was the one bearing at present the name of "R. G. Dun & Co.," an outgrowth of "The Mercantile Agency of New York City." Since 1860 it has borne the name of Mr. Dun, who was formerly a partner with Mr. Douglass when the agency was known as "B. Douglass & Co." Another popular and influential concern is the one known as "The Bradstreet Company," familiarly spoken of as "Bradstreet's." Besides these two leaders there are many others, whose reports on credits are limited to particular lines of trade. The larger agencies soon found it necessary to establish branches in all the business sections of the country. A particular field of investigation is allotted to each branch, and an interchange of information is in constant progress.

To be a recipient of the valuable information afforded by these agencies business men, by paying an annual fee, are enrolled as subscribers and furnished with books of ratings, as they are called. Besides this book special typewritten reports with elaborate details respecting a

INQUIRY—Form A. ESTABLISHED 1841. "O. R." INQUIRY FORM.

The Mercantile Agency.

R. G. DUN & CO.

Corr. _____ 189_____

County of _____ State of _____

DEAR SIR:
As we have no information on record, will you please answer, to the best of your knowledge, the questions asked below, and greatly oblige us. We assure you that any information you may give us will be held in the strictest confidence.

Respectfully yours,
R. G. DUN & CO.

Inquiry Form

Is above correct style and location? _____

In what business are they engaged? _____

Full names of partners? _____

Ages of partners? _____ Married or single? _____

How long in this business? _____

Whom do they succeed? _____

Where do they come from? _____

What was their former occupation? _____

Character? _____ Habits? _____ Ability? _____

About how much capital is invested? _____

How much of same, if any, is borrowed? _____

Average amount of stock carried? _____ Outstandings? _____

Average indebtedness for merchandise? _____

Any chattel mortgages or judgments vs. them? _____

Value of their real estate, and of what does it consist? _____

In whose name is the real estate? _____

How much of it is exempt? _____

Amount of mortgages on real estate? _____

Any other means outside of business? _____

How much do you consider them worth over debts and exemptions? _____

Have they ever failed? If so, when and where? _____

Insurance on stock? _____ On real estate? _____

Do they pay promptly? _____ Prospects? _____

REMARKS: Please give here any further information that you think would be of value to this report.

Please add on back hereof names and reports of all new traders, changes, failures, or other items of interest in your vicinity.
IF IMPORTANT, PLEASE TELEGRAPH AT OUR EXPENSE.

A mercantile agency inquiry form.

firm's credit are sent upon the request of the subscriber. The volume of information recorded in these agencies concerning any one's credit is obtained through the effort of officials of the agencies known as reporters. These men of experience, integrity, and discernment are seekers after truths. Usually each reporter has a distinct line of trade assigned him for research and investigation. This brings him into intimate acquaintanceship with every trader in his particular field. He is a constant solicitor of the banker and merchant for facts. His business is not merely to gather information respecting the resources of business men, but to investigate rumours that in themselves may be detrimental to one's credit, and to disprove them where possible and sustain and support the credit of a house. Too often it is supposed that the reporter is seeking evidences of weakness when in reality his business is most frequently that of discovering elements of strength. Information is freely given him as he interviews men whose businesses and experiences are the depositories for a wealth of credit information. He soon becomes a confidant of the merchant himself, who not only tells him all he knows about the customers and their accounts upon his books, but his own business affairs as well. Indeed, the relation becomes so very reciprocal that the reporter often furnishes information to the merchant in the interview on some matter of credit of pressing notice. In this way a corroboration of facts or the denial of a rumour may be effected. He inspects the books of the offices of public record to find the evidence of mortgages, judgments, and transfers of property, and have the same recorded on the agency's books. It is the reporter who finally has gathered the information that determines a firm's ability to have and to hold a line of credit.

It is essential to the life of the agency that its reports

be honest and free from any element of doubt. The public confidence in the reliability of the reports will determine the prosperity of the company. Perhaps at first glance it would seem as if the system of reporting financial information was a serious discrimination against the men of smaller capital and in favour of the wealthy. But mere capital is not the only element entering into an estimate of one's ability to pay. Character and reputation are powerful forces in assisting a merchant in determining credit. An agency discloses facts and not opinions. And it is within the range of possibility of any one to create and maintain his credit. Capital may grow gradually but credit is sometimes established or destroyed by a single act.

The facts obtained by mercantile agencies are not public property. They are given in confidence and for the sole purpose of aiding the business with respect to the propriety of granting credit. The private reports are for the eyes of the interested inquirer and not the curious. Whenever some particular item of interest finds its way to an agency that would affect one's credit seriously, such as the giving of chattel mortgage or the confession of a judgment or the sale and transfer of property, it is customary to send unsolicited a special report of these facts to all subscribers on the agency's books who have ever at any time made inquiry concerning the firm. One might expect that these agencies expose themselves to risk of prosecution for libel, but since no malice is ever intended in any report circulated, and since it rarely occurs that damaging reports are sent out by these institutions unless abundantly confirmed, there is little opportunity for litigation of this sort.

Another field of usefulness of the mercantile agency is in the exposure of the absconding debtor and his where-

abouts, and also the dishonest trader who in arranging a fraudulent failure may be striving to open many new accounts. The unusual demands for reports respecting such a one lead to careful investigation. Instead of a restrictive tendency a mercantile agency promotes the expansion of credit and yet permits of proper conservatism. It opens to the trader as a market for his merchandise every new and trustworthy account. It curbs speculation, stimulates diligence in business, habituates punctuality, and develops character. When we remember that the present annual internal commerce of our country is estimated at about 800,000,000 tons of merchandise carried an average distance of 120 miles, and that this volume of trade is worth over \$10,000,000,000, we are forced to admit that the unique system of these credit agencies has done much to further and make possible this commercial prosperity.

FINANCE, TRADE, AND TRANSPORTATION

IX. BONDS

UNITED STATES, STATE, AND MUNICIPAL BONDS

WHEN a country borrows money it gives a guaranty that the money will be returned at a particular time and that interest will be paid at regular intervals at a fixed rate. This guaranty is called a bond. In actual practice, instead of borrowing the money required and then giving bonds for its return, countries usually issue the bonds first, and sell them to the highest bidder. For instance, if our government needed to borrow \$1,000,000 it would issue bonds for this amount, stating definitely the rate of interest to be paid, and call for bids. If the rate of interest were four per cent. and a buyer paid more than \$1000 for a \$1000 bond he would, of course, make less than four per cent. upon his investment. Such bonds are absolutely safe and always marketable on account of our strong financial standing among the nations of the world. Similar bonds are issued by States, cities, towns, school districts, etc. They are not mortgages in the ordinary sense, and their worth consists entirely in the ability of the issuer through its taxing power to meet the obligations incurred. Municipal bonds are issued by cities and other municipalities to raise money for local improvements.