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Competitive Relations

SINCE the entrance of commercial banks into the field of consumer instalment financing, their volume of this business has grown rapidly. Recent estimates of the outstandings of the four principal cash instalment lending agencies—commercial bank personal loan departments, personal finance companies, industrial banking companies and credit unions—show that the total volume of cash loan outstandings of these agencies combined increased steadily from 1934 to 1938.[1] Furthermore, the proportion of these outstandings[2] held by commercial banks rose from 7.3 to 20.3 percent in this period while the proportions ascribed to other cash lending agencies, with the exception of credit unions, declined.[3] Although data are not available to show the distribution of retail instalment outstandings, trade reports indicate that in this field too commercial banks have acquired increasing importance in recent years.

The fact that the total volume of cash loans to consumers has risen steadily since 1934, so that each type of lending agency has been able to increase the aggregate volume of its business, helps to explain the competitive conditions which prevail in the field. If the total volume of personal loan credit were decreasing or even merely constant, the relations among the several types of lending institutions would probably be

[1] See National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38,* by Duncan Holthausen, Malcolm Merriam and Rolf Nugent (ms. 1940) Chapter 4, Chart V.

[2] Includes outstandings of the four principal cash loan agencies, unregulated lenders and FHA (Title I) insured loans.

[3] *Ibid.,* Table B-4. Proportions are exclusive of FHA loans made by commercial banks.

characterized by more intense rivalry. At the end of 1938 the outstandings of personal finance companies and industrial banking companies were larger than they had been at the close of 1929 or at any other time during the intervening years.[4] Despite the more rapid growth of the cash loan outstandings of commercial banks and credit unions, the other lending agencies are therefore able to regard their own gains with considerable satisfaction.

GENERAL CHARACTERISTICS

While commercial bank personal loan departments differ from other consumer credit institutions in a number of important respects, they are subject to certain conditions which are common to all types of lending agency. Customer charges, for example, rarely constitute a clear-cut competitive issue. Borrowers are unlikely to compare very closely the charges offered by rival agencies, first, because they are often stated in a manner that makes comparison difficult; second, because the relationship between borrower and lender is sometimes so close that the offer of more favorable terms by a competing lender is not a strong enough inducement to cause the borrower to transfer his patronage; and third, because the customer's monthly instalment is not affected substantially by differences or changes in customer charges. There is, in short, less shifting than one would expect in view of the variations in charges among different consumer credit agencies.

Even if a borrower does make a study of credit costs, he will probably give consideration also to other aspects of the transaction. The number of months permitted for repayment, the type of security required for the loan, the extent and nature of the credit investigation, and the special concessions that may be offered with regard to possible delinquency

[4] *Ibid.*, Table B-9 and Table B-11.

generally count more heavily with the borrower than the charge alone.

In the financing of retail sales, too, charges play a less significant role in competition than one might at first suppose. Here the primary concern of the consumer is the acquisition of some durable good. The cash selling price, the trade-in allowance he may be offered, or the absolute amount of the periodic payment he is required to make may be of more consequence to him than the finance charge involved. It must be remembered, furthermore, that the agencies that compete for this type of business—industrial banking companies, sales finance companies and commercial banks—are more likely to center their competitive effort on the dealer who sells the commodity than on the ultimate consumer. Once a dealer has established a connection with a consumer instalment financing agency, he is expected to sell all of his paper to that agency. For these reasons, the competition between consumer financing agencies frequently consists of attempts to establish dealer relations rather than of campaigns to attract ultimate purchasers. On the other hand, some national sales finance companies have recently advertised directly to customers, and a number of commercial banks and industrial banking companies are now making intensive efforts to reach the consumer directly and to avoid negotiations with dealers. To the extent that these efforts are successful, competition in the field of time-sales financing will tend to resemble more closely that characteristic of cash lending.

In the following sections the competitive situation of the commercial bank as a consumer credit agency will be considered in terms of the bank's relationship to each of the other principal lending institutions. These agencies will be compared with commercial banks in respect to the services they offer, the terms upon which their contracts are written, the markets they serve and the techniques they employ to obtain business.

PERSONAL FINANCE COMPANIES AND COMMERCIAL BANKS

Although there is considerable rivalry between personal finance companies and the personal loan departments of banks, several factors have served to mitigate its intensity. One factor has already been mentioned—the growth in the aggregate volume of personal finance company outstandings, which stood higher at the end of 1938 than at the end of 1934, and slightly higher than at the close of 1929.[5] Another is the fact that personal finance companies have in general specialized in single-name loans granted mainly on the security of household chattels, while commercial banks extend somewhat over one-half of their personal loans on a comaker basis.[6] In their advertising personal finance companies have taken advantage of this difference by pointing out the confidential nature of their lending services. They stress as a unique and highly desirable feature the fact that single-name loans secured by household chattels may be obtained without reference to friends or employer. It is doubtless true, indeed, that many borrowers are willing to pay a higher interest rate in order to avoid disclosing their financial position by asking a friend to act as comaker. Moreover, the weight attached to such considerations by large numbers of potential borrowers may have an appreciable effect upon the future competitive position of the agencies which require the signatures of comakers.

Commercial banks and industrial banking companies still make most of their cash loans on a comaker basis because comakers normally increase the protection, enable the lender to offer a lower rate and provide an effective and almost cost-

[5] See above, pp. 219-20.

[6] B. E. Henderson, "Competition for Consumer Credit," *Banking* (January 1937) p. 24. The author, president of Household Finance Corporation, states that personal finance companies do not fear the competition of commercial banks because of the comaker requirement of the latter.

less collection service. Nevertheless there is discernible a persistent tendency for both types of institution, and particularly for industrial banking companies,[7] to grant an increasing proportion of their loans on a single-name basis. They have an advantage over the personal finance companies, furthermore, in that they rarely require the additional security of a chattel mortgage on household furniture. The comaker loan remains, however, the mainstay of the personal loan business of commercial banks. Of more than 881,000 personal loans made in 1938 by 520 reporting commercial banks, 56 percent were of the comaker type, 21 percent were single-name notes and 23 percent were secured by such collateral as conditional sales contracts, savings passbooks, life insurance policies and securities.

In response to the competitive situation, the personal finance companies have tended to grant an increasing number of loans on a single signature without the protection of a household chattel mortgage.[8] In 1936, for example, Household Finance Corporation established several offices exclusively for the making of unsecured small loans, and the number of these "honor" offices has since been increased.[9] With respect to similarity of services offered, it appears therefore that the competition between small loan companies and commercial bank personal loan departments is growing sharper.

While there is some overlapping of their respective markets it is nevertheless true that the two types of lending institution cater to substantially different classes of borrowers.[10] The

[7] See National Bureau of Economic Research (Financial Research Program), *Industrial Banking Companies and Their Credit Practices,* by R. J. Saulnier and Staff (ms. 1939) Chapter 4.

[8] See National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices,* by R. A. Young and Associates (1940) pp. 49-50.

[9] *Ibid.,* p. 49.

[10] Personal finance companies sometimes minimize such competition on the ground that banks take only a relatively few carefully selected borrowers and

data available for a study of the borrowers served by commercial banks and personal loan companies are not entirely comparable, but they indicate that the customers of personal finance companies come from lower income groups than those of commercial banks. We have already noted that 55 percent of the borrowers from personal finance companies had incomes of less than $1500 per annum while only about 24 percent of the borrowers from commercial bank personal loan departments were in this class.[11] Wage-earners constituted about 52 percent of the customers of personal finance companies but only about 28 percent of the bank borrowers. On the other hand 44 percent of the bank borrowers were people engaged in clerical work as compared with 25 percent of the personal finance company clientele. Finally, banks made a larger proportion of their loans to business and professional borrowers than did personal finance companies.[12]

The competition between personal finance companies and commercial banks is limited to a significant degree also by the fact that the former are prohibited by the small loan statutes in nearly every state from making loans in excess of $300. Commercial banks are generally not subject to this sort of restriction[13] although they may voluntarily limit themselves to loans of a certain size, e.g., $1500 or less.

Comparative data on the average size of loans show quite clearly the effect of legal restrictions in the case of personal finance companies. The average size of loans made by a very inclusive sample of such companies varied from $126 in 1933 to $147 in 1937[14] and the loans made by the two largest chain personal finance companies were only slightly greater in

leave the larger part of the market to other agencies. See B. F. Douthit, *Personal Finance News* (June 1932) p. 12.

[11] See above, Chapter 3, Table 11.

[12] See above, Chapter 3, Table 12.

[13] See above, Chapter 2, p. 57.

[14] R. A. Young and Associates, *op. cit.,* Table 7, p. 47.

amount.[15] In contrast, the single-name loans made by the personal loan departments of 520 banks in 1938 averaged $202.

Loans made by personal finance companies are on the average smaller than those of their commercial bank competitors and the former institutions tend to charge higher rates of interest. The most typical commercial bank rates on personal loans range between 11 and 14 percent per annum when computed on declining balances, and the bulk of the bank loans are made at the lower limit of this range; some large metropolitan banks grant personal loans at a discount of 4 percent per annum or even less, so that their effective interest rates are considerably below 11 percent on unpaid balances.[16] It appears that the charges made by personal finance companies[17] come to at least twice as much as the typical rate, computed on unpaid balances, charged by commercial banks.

Another comparison of the interest rates of commercial banks with those of personal finance companies may be made by reference to data on their gross incomes expressed as a percentage of their average employed assets. The gross income of the personal loan departments of 39 banks reporting to the National Bureau ranged from $8 to $10 per $100 of average funds employed,[18] but from supplementary information it appears that a gross of $12 to $14 would be more nearly typical.[19] These figures are to be compared with data for the year 1936 on the gross income of personal finance companies, which is calculated to have amounted to about $27 per $100 of average assets employed—approximately double the income realized from charges made by the personal loan departments of commercial banks.[20]

Competition between personal loan departments and per-

[15] *Loc. cit.*
[16] See above, Chapter 6, pp. 141-56.
[17] For a discussion of personal finance company rates, see R. A. Young and Associates, *op. cit.*, pp. 124-28.
[18] See above, Chapter 7, Table 49.
[19] See above, Chapter 6, pp. 151-56.
[20] R. A. Young and Associates, *op. cit.*, Table 32, p. 113.

sonal finance companies is influenced also by the fact that the latter may operate branch offices on a wide scale. Statewide branch banking, on the other hand, is permitted in only a few states, and even citywide branch banking is prohibited by a number of states. In localities where branch banking is permitted, the commercial banks have utilized these branches for their personal loan business, frequently concentrating credit work in one office. Particularly in areas where branch banking is prohibited does it appear that an organizational advantage lies with the non-banking lending agencies. The latter benefit, moreover, from their widespread operations in this field: they can gain some efficiency from their large-scale, standardized activities, train and maintain a selected personnel, and diversify the risks more successfully. These advantages are not, however, of paramount importance in the field of consumer lending, because so much of the business is based on personal relationships.

A more significant advantage of personal finance companies is the fact that they can usually adapt the location and character of their loan offices to suit particular market needs more readily than can commercial banks. Personal finance company offices are often located on the second floor of a building and are generally much less ornate than the commercial bank office. To the extent that customers prefer to conduct their borrowing in such surroundings, and with a maximum of privacy, the commercial bank which establishes its department on the first floor of its main office is somewhat handicapped. The short banking hours also tend to give the personal finance company an advantage over the personal loan department that is established in the main banking quarters of a commercial bank. Many banks have attempted to resolve the problem by setting up separate offices for the conduct of their personal loan business where legal and other conditions permit, and in general have tried to conduct these operations in locations other than the principal floor of the bank or branch. When they establish separate offices they are able, of course, to keep the personal loan department open for business after the regular bank closing hour.

INDUSTRIAL BANKING COMPANIES AND COMMERCIAL BANKS

Primarily because they resemble each other in the kinds of service they offer and in their manner of quoting charges, competition between industrial banking companies and commercial bank personal loan departments is much keener than between banks and other cash lending agencies. Like commercial banks, the industrial banking companies engage in both instalment cash lending and time-sales financing. The industrial banking companies are not restricted, as are the personal finance companies, to relatively small cash loans. Nor do they limit their activities chiefly to sales financing as do most of the sales finance companies. Furthermore, the charters of many industrial banking companies give them the right to do a full banking business; thus in some states they can offer lending and deposit services equal in many respects to those provided by commercial banks.[21] Even in states where such companies have only limited banking privileges they are often permitted to accept time deposits as well as to lend money. The chief competitive advantage of the commercial bank is the fact that only a few states permit industrial banking companies to accept demand deposits.

Aside from the breadth of their services, industrial banking companies resemble commercial banks also in their manner of quoting cash loan and time-sales financing charges as a certain rate of discount and not (as with the personal finance companies) as a rate per month on unpaid principal balances. Then too, the cash loans of both types of institution are

[21] See R. J. Saulnier and Staff, *op. cit.*, Chapter 2, for a discussion of the legal status of industrial banking companies.

generally made on a single-name or a comaker basis. While some of the relatively small industrial banking companies make loans on the security of household chattels, they account for a very small part of the total industrial bank credit extended.

Finally, there are certain organizational similarities between commercial banks and industrial banking companies. The two agencies operate in general as independent units, although some exceptions are to be noted. There are a few extensive branch banking systems, for example, in the state of California, and there are also some systems of affiliated industrial banking companies. Where widespread branch banking systems are permitted, commercial banks can operate as statewide consumer credit agencies. In other cases banks may conduct only intracity branches, so that in order to gain the organizational advantages of a system of branches some operate through affiliated companies. Industrial banking companies are in substantially the same position where they operate as "banks" in the legal sense, but they enjoy wider branch office privileges when they function as non-banking agencies. Since, however, there are few important systems of industrial banking companies, it is quite accurate to say that on organizational grounds neither type of agency has any particular competitive advantage over the other.

Data on borrower characteristics are not available in sufficient quantity to enable us accurately to describe and distinguish between the respective markets served by commercial banks and industrial banking companies. It appears from the incomplete evidence at hand that the markets are similar in some respects and different in others. Studies of a sample of 1,259 personal cash loans made by commercial bank personal loan departments and of a sample of loans made by a group of industrial banking companies indicate that about 12 percent of the commercial bank borrowers had incomes of $1200 or less and that about 16 percent of the industrial bank loans were made to individuals in this income class. Further examination of these samples shows that about 18 percent of the commercial bank borrowers and 20 percent of the industrial banking company borrowers received incomes of $3000 and over. For both agencies, therefore, the bulk of borrowers are in the annual income class of $1200-3000.[22] These two lending institutions tend, furthermore, to make loans of about the same size: about 50 percent of the notes of each are written in amounts of $200 and less. Finally, the available data point to the conclusion that in some areas commercial banks and industrial banking companies serve approximately the same occupational and industrial groups.[23]

In a number of cities, however, commercial bank personal loan departments and industrial banking companies cater to quite different groups of borrowers. Broadly speaking, the larger industrial banking companies are in closer competition with the commercial bank personal loan departments than are the smaller companies. The latter appear to supply a market more nearly similar to that served by the personal finance companies. Again, the smaller companies make some loans on the security of household furniture, a practice typical of the small loan company and only rarely followed by the commercial bank.

As regards rate competition between industrial banking companies and commercial banks, it appears that the rates of the latter are, in general, lower than those of the former. It is true that in some cities for which information is available the difference is slight, but in the larger centers the banks with a substantial volume of cash instalment loans quote rates which are either equal to or somewhat lower than those offered by their industrial banking competitors.

Since industrial banking companies and commercial banks

[22] Compare above, Chapter 5, Table 34, with R. J. Saulnier and Staff, *op. cit.*, Chapter 6, Table 8.
[23] *Loc. cit.*

are expanding their volume of business, the competition between them is not as intense as it might otherwise be. Indeed some industrial bankers have expressed the thought that the entrance of commercial banks into the field of consumer credit has tended to improve the prospects of industrial banking companies rather than to detract from them. They believe that the prestige traditionally enjoyed by banking institutions has now spread to other consumer credit agencies, and that the practice of lending money to individuals for personal use has been raised to a higher status by the participation of commercial banks.[24]

SALES FINANCE COMPANIES AND COMMERCIAL BANKS

In the field of sales financing commercial banks encounter the competition of national, regional and local sales finance companies and of industrial banking companies as well. The crucial element in this competitive situation is the dealer rather than the consumer, except in cases where a bank negotiates automobile financing directly with the purchaser. This the bank may do in either of two ways: it may grant a straight cash instalment loan on a single-name or a comaker basis, so that the borrower uses the proceeds to make the purchase desired, or it may finance the purchase of the automobile on a conditional sales contract or bailment lease. Many banks follow the first method in their direct-to-consumer financing, and the extent to which this practice increases must necessarily be reflected in a decline in the proportion of goods purchased on an instalment basis.[25] We

[24] See *American Industrial Banker* (April 1938).

[25] See Holthausen, Merriam and Nugent, *op. cit.,* Appendix A, Table A-6 for data on instalment sales as a percent of total sales for five types of retail establishments. The series for new and used cars shows a tendency for instalment sales to decrease somewhat as a percentage of total sales. The purchase of cars for cash with the proceeds of a commercial bank personal loan may

have noted early in this study that the banks reporting to the National Bureau received slightly more than 50 percent of their total automobile paper directly from purchasers, and the remainder from dealers,[26] although in the case of all other commodities except household appliances the bulk of the paper was obtained through dealers.[27] Specialized sales financing agencies, on the other hand, acquire most of their paper through dealers.

The increasing significance of commercial bank competition in the field of sales financing has been a matter of deep and growing concern to other agencies. It has been reported that associations of automobile dealers have adopted resolutions pledging their business to the sales finance companies.[28] Sales finance companies, in turn, have urged purchasers to patronize them rather than the commercial banks or loan companies, maintaining that for approximately the same charge the sales finance company offers better service than is provided by other institutions.[29]

be a factor in this situation, but it is not possible to ascertain the degree of its influence as compared to other factors.

[26] In some regions the banks rely on dealers for practically all their automobile paper.

[27] See above, Chapter 4, Table 19.

[28] For example, the members of the South Carolina Automobile Dealers Association, at their Convention on July 26 and 27, 1939, adopted a resolution pledging themselves to place their time-sales paper with finance companies. A similar resolution was adopted by the Pennsylvania Automotive Dealers Association in June 1939. (*American Finance News,* July 18, 1939, p. 2.) Earlier in the same year the Montana Motor Trades Association passed a resolution urging all dealers to continue transacting their entire business with finance companies. (*American Finance News,* April 18, 1939, p. 1.)

[29] "The U.C.C. Campaign includes national advertising and letters to all Ford, Mercury, Zephyr and Lincoln dealers. The GMAC effort was initially confined to Cleveland, in which city letters have been sent to all owners of General Motors cars.

"In both campaigns it is pointed out that the purchaser does not usually save money, insurance costs being taken into account, by financing through banks or loan companies, while he runs the risk of less considerate treatment in the event of having difficulty in making his payments." (*Time-Sales Financing,* August 1938, p. 2.)

Commercial banks, too, have developed programs to increase their automobile sales finance volume. Where they seek to obtain the business directly from the consumer, they generally appeal to him on the ground of economy. Or they may urge local insurance agents to influence car buyers to finance their instalment purchases through banks. If the local agent does not write the insurance on cars financed by sales finance companies, and if banks will allow the purchaser to choose his own agent, it may be that the local insurance agent will seek to promote bank financing.[30] Furthermore, the commercial bank may have an advantage over the sales finance company if it is possible for the dealer to share in insurance commissions when the bank finances his sales. There is some tendency for sales finance companies to meet this sort of competition by the use of similar methods of providing insurance services to their customers.

If a commercial bank desires to obtain its sales financing contracts through dealers it must offer the dealer terms that are at least as favorable as those current among other sales financing agencies. Several important considerations are involved in such arrangements. First, the bank is very often called upon to finance the dealer's purchases of cars from the factory and his holding of these cars in inventory. Such wholesale financing is known as "floor-planning" and is subject to special risks, particularly fraudulent conversion.

The extent to which commercial banks have engaged in wholesale financing as an adjunct to their retail instalment sales financing is revealed by our questionnaire returns. Out of 141 banks that reported the acquisition of retail automobile paper from dealers, 74 were extending wholesale loans to dealers on new cars and 67 were not; 36 were floor-planning used cars and 96 were not. These returns show further that commercial banks may make loans to dealers to

[30] See *American Industrial Banker* (February 1940) p. 20.

enable them to carry their inventories even though the banks make no retail loans on the dealers' instalment sales.[31]

The necessity of meeting the competition of rival agencies through the grant of wholesale loans is not likely to be as great, however, when a bank seeks to finance instalment purchases of goods other than automobiles. Moreover, the investment which must be made in inventory is normally smaller in such cases. Where competition does take the form of granting wholesale loans its effect is likely to be a reduction of the interest rate applied to these loans rather than of the finance charge levied on the consumer.

Competition for dealers' business may be expressed in other ways. A financing agency may, for example, set up a "reserve" which permits the dealer to participate in the finance charge, or it may allow him to "pack" or inflate the scheduled customer charge.[32] It may even be willing, in order to keep the dealer's custom, to finance deals it would otherwise have rejected as poor risks. Similarly, the financing agency may accept contracts of longer maturity and lower down payment than would appear appropriate on grounds of credit risk alone. In car financing it is usually necessary, moreover, to finance the retail instalment sales of used cars in order to obtain the new-car business originated by the dealer—a practice which some banks are reluctant to undertake because of the special risks involved.

Nearly all of these features of the competitive picture are absent if the bank obtains its sales finance business directly from the consumer. Then it need make no concessions to dealers; quite independently it can determine its customer charge, set credit standards and fix terms for maturity and down payment. Nor does the bank have to extend wholesale

[31] See above, Chapter 4, pp. 82-83.

[32] See National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices*, by W. C. Plummer and R. A. Young (1940) Chapter 11, for a discussion of dealer "reserves" and "packs" in sales financing.

loans to automobile dealers under such circumstances, although if it seeks rapidly to expand its volume of time-sales financing it generally does turn to dealer contacts. The bank must normally choose, then, between a large gain in outstandings and a more independent credit policy.

If the competition revolves around the struggle for the dealer's favor, the financing agency may allow the dealer to set the customer finance charge. In this case the consumer may benefit very little, and indeed may actually be harmed, by competition.[33] On the other hand, when banks seek to acquire their sales finance business directly from the consumer they must offer lower charges or some special service in order to attract a volume of business. Competitive effort of this kind has a direct effect on consumer charges, and if commercial banks increasingly turn their competitive energies in this direction such charges are likely to decline.

When commercial banks obtain their sales finance paper through dealers they may also provide the latter with customer rate charts.[34] This practice characteristic of the sales finance companies seems to have been adopted by some commercial banks which do a substantial amount of instalment sales financing. The rate chart is important not because it is a convenient device for calculating the finance charge in a given transaction, but rather because it indicates that the financing agency is exercising some degree of control over the charges made by the dealer. While an agency's failure to provide a rate chart does not prove conclusively that the dealer is permitted to exact any rate he chooses, it does suggest that he is allowed some degree of freedom in this respect. In reporting to the National Bureau, some banks stated that while they supplied no rate charts they did specify the interest rate to be applied to the cash-selling price so that the cus-

[33] This type of competition may leave customer charges substantially unchanged and result mainly in a more liberal dealer "loss reserve."

[34] See above, Chapter 6.

tomer's finance charge might be computed for instalment purchases of different types of merchandise.

Available data concerning competitive charges are not very inclusive, but the information at hand indicates that the net sales finance charges (exclusive of insurance) of commercial banks are either equal to or slightly lower than those current among the larger sales finance companies operating in the same area. It must be remembered, however, that it is impossible to gauge the extent of rate competition in terms of the net finance charge alone. Other elements in the customer cost, notably the insurance charge,[35] may be more flexible than the interest rate and thus more sensitive to competitive influences. Furthermore, certain concessions which do not involve prices may be incorporated in the financing contract.

As to organizational differences between commercial banks and sales finance companies, the former are generally independent units, while sales finance companies can extend their operations over a wide area by setting up branches or agencies. In 1937 about 84 percent of the automobile financing handled by sales finance companies was concentrated among those operating on a national or regional scale.[36] Some banks, to be sure, can conduct their business on a relatively broad geographical basis. This is possible where statewide branch banking privileges are granted them, in which case they can offer a more satisfactory instalment financing service to distributors of goods than can unit banks. Then there are banks which operate through subsidiary or affiliated companies and in this way gain the advantages of a wider market.

It is difficult for a bank to finance the instalment sales of any given manufacturer's product unless it can operate satisfactorily over an extended area. If the product is distributed widely, the bank must conduct a substantial part of its fi-

[35] A willingness to accept insurance with less coverage or to accept single interest insurance may exert a considerable influence on customers since the insurance premium, especially on automobiles, is generally a substantial sum.
[36] W. C. Plummer and R. A. Young, *op. cit.*, Chapter 11, Table 67.

nancing by mail, and is then handicapped in its task of investigating credits and making collections. This is an important consideration, for many banks would like to expand their business by servicing all the time sales of local producers.

Recently there has been initiated in New England a movement for bank cooperation in a broad program of instalment sales financing. The scheme is designed to operate essentially as follows: the cooperating banks will solicit actively the business of their local manufacturers by promising to finance both producer and consumer goods, and will accept contracts regardless of the location of the buyer. If a manufacturer then makes a sale in a city remote from his local bank, the latter may send the credit application to the cooperating bank closest to the customer concerned. Thus each cooperating member bank can initiate business for itself and for other banks, and receive in turn a certain amount of business from other members.

As in the case of other forms of consumer credit, the competition for sales finance business is influenced by legal restrictions. The laws affecting sales financing are by no means as severe, however, as those which apply to cash lending. Only a few states have passed any legislation governing sales financing transactions, and of these Indiana's law is the most comprehensive. All sales financing agencies in Indiana are required to be licensed, and are subject to regulations covering customer charges, dealer reserves, repossession practice, the keeping of records and advertising policy.

INTERBANK COMPETITION

Competition for consumer loan volume among commercial banks themselves has not been as marked, up to the present time, as the rivalry between banks and other agencies of consumer credit. Nevertheless interbank competition does exist, and it appears to be gaining in intensity. The commercial bank's cash loan market, while substantially different from that of most other cash lenders, is almost identical with the market of its bank competitors, and for this reason inter-bank competition for personal loans is likely to become increasingly keen. It may, indeed, turn out to be as aggressive in this branch of consumer financing as the current competitive struggle between banks and other types of agencies in the field of sales financing. Even now the cash lending policy of a commercial bank is more apt to be influenced by the policy of other banks than by the methods followed by its non-banking competitors.

This sort of competition has developed only in the past three or four years, for prior to that time banks with personal loan departments were for the most part too widely separated to affect one another's business. More recently, however, competition between banks has given rise to rate reductions, elaborate advertising campaigns and carefully prepared programs.

Banks compete with one another also in making loans to non-banking consumer credit agencies. Such competition for commercial loans is probably an indirect cause of the expansion of commercial banks into the personal loan field. As the rate on loans to sales finance and personal finance companies declined in recent years (in December 1938 it was generally 1½ percent), many banks sought to improve their financial position by establishing consumer credit departments of their own.

In many states the competitive relations between banks and non-banking cash loan agencies are influenced by statutory enactments. Most small loan and industrial loan laws provide that the state supervisory authority may refuse a license or permission to incorporate if in his opinion the "advantage and convenience" of the community will not be served by the establishment of a proposed company. On the other hand, sales finance agencies with few exceptions are untouched by such legal restrictions and personal loan or time-sales departments of national banks are not generally subject to special regulation of their consumer credit activities. Even if state laws were to limit the entry of state banks into the field, they would probably not be rigidly enforced as long as national banks remained comparatively free of restraint. The present New York state law regarding personal loan departments of state banks contains a "convenience and advantage" clause,[37] but it refers only to the personal loan departments of state banks. It is unlikely, therefore, that in the absence of comparable restrictions on national banks, interbank competition will be seriously influenced by statutory provisions, although the activities of non-banking cash lending agencies in many states are distinctly affected by similar legislation.[38]

RELATION OF COSTS TO COMPETITION

In most discussions of the competitive relations between commercial banks and other consumer credit agencies considerable attention is devoted to the special character of the costs of consumer lending by commercial banks. It is argued by many that the commercial banks do not know how much it costs them to make consumer loans and that they therefore tend to quote rates which do not yield profits; the inference, of course, is that if banks did calculate their costs accurately they would find that their current arrangements were unprofitable. Critics of commercial bank personal loan departments frequently point out, moreover, that banks can com-

[37] "The superintendent shall issue a certificate of authorization to operate a personal loan department within sixty days of the receipt of a request . . . if he shall find after investigation that the convenience and advantage of the community . . . would be served by granting such a request." New York State Banking Law, Article III, Section 108, 1(b).

[38] See R. A. Young and Associates, *op. cit.*, Chapter 1, and R. J. Saulnier and Staff, *op. cit.*, Chapter 2, for discussions of legal limitations on personal finance and industrial banking companies, respectively.

pete favorably with other types of consumer credit agencies because their funds cost them nothing, whereas the non-banking institutions are required to pay relatively high rates for a considerable part of their working capital.

It is probably true that commercial banks have made little effort to determine their consumer loan costs. In most instances personal loan departments are small and do not call for a very substantial addition to plant or personnel. A number of banks have indicated[39] that the volume of their consumer loan business was insufficient to warrant their making any special attempt to determine the cost of operating the department. Furthermore, many commercial banks maintain that they are not in a position to make the detailed investigation basic to a determination of departmental costs, or that such research would be unjustifiably expensive.

With the marked increase in the number of departments and the volume of loans, the advantages of an adequate cost accounting system in this field are coming to be appreciated more fully. The growing interest in determining the cost of operating a consumer loan department contrasts sharply with the traditional indifference of many banks to departmental costing procedures. While a bank may know its total costs of operation (subject, of course, to the qualification that certain costs are difficult to fix definitely), few are likely to know the separate cost of running any particular department.

The banks, for their part, may well respond to their critics that they are no more ignorant of costs than many other consumer credit agencies. Since a good deal of competitive effort centers around the differentials between rates quoted by the same agency for different types and sizes of loans, it would appear desirable for all agencies—banking and non-banking alike—to ascertain how much it costs them to make and collect the various types of loans. Yet many other consumer

[39] See above, Chapter 7.

credit agencies are as unfamiliar with the costs of making and handling different types of loans as are the commercial banks. A few non-banking agencies have made systematic attempts to determine the costs of making various types and sizes of loans and some banks have undertaken comparable investigations.[40]

The competitive behavior of commercial banks, as reflected in the rates they quote on loans and especially in the differences between their rates on diverse types of loans, can be affected only slightly by considerations of total cost. In the absence of satisfactory cost data, moreover, there is no evidence to indicate that their rates are unprofitable to them. While in many cases banks may arrive at a rough and ready measure of the profitability of the consumer credit department by taking account only of direct costs, they are now tending increasingly to ascertain the nature and amount of the indirect as well as the direct expenses involved in the acquisition and handling of consumer instalment loans.

COOPERATIVE RELATIONS

Commercial banks engaged in extending credit to consumers have thus far lagged behind other types of consumer lending agency in the establishment of cooperative relationships. Yet in recent months there has arisen a widespread movement to secure more effective cooperation among the personal loan and time-sales departments of commercial banks.

A form of interbank cooperation has existed for some time in certain cities for the exchange of credit information, but the participants in this sort of enterprise are not always commercial banks exclusively. At present commercial bank officers are showing increasing interest in the setting up of a national organization.

One attempt in this direction was the formation early in

[40] See above, Chapter 7.

1939 of the Bankers Association for Consumer Credit. This Association, organized by several officers of commercial banks which had been active in consumer instalment credit operations, announced as its aim the establishment of "a central point to which any bank might refer for information relative to methods, practices and policies of consumer credit as it related to banks." Although the Association intended from the beginning to expand its activities to a national scale, membership was limited at first to banks in New York, New Jersey, Pennsylvania and Ohio, and later extended to Indiana, Iowa, Massachusetts, Michigan, Missouri and Wisconsin. Some of the state bankers' associations, particularly those in Ohio and Massachusetts, have long been concerned with problems involved in the extension of consumer credit, and since its formation the Bankers Association for Consumer Credit has participated actively in their conferences.

The Association has held two general and several regional meetings devoted exclusively to discussions of consumer credit problems. It has acted also as a kind of clearing house for information on consumer credit, and has planned to participate in the drafting of new legislation. In October 1939 it began to publish a monthly magazine on consumer credit, entitled *Time Notes.* This periodical, termed "a magazine for banks interested in consumer credit," is widely circulated and functions like the usual trade association journal. The Association has another publication in preparation, referred to as a *Manual of Suggested Procedure,* and in addition circulates a series called *Pointers* which contain brief discussions of techniques and procedures.

The officers of the Association have made plans for studies in cost accounting. They have worked out arrangements to provide automobile insurance services and to facilitate clearance of automobile deliveries at factories for dealers financing their instalment sales with commercial banks. Members may employ the Association's "skip service," and arrange with other member banks for the transfer of accounts. A series of standardized forms for the use of commercial bank consumer credit departments is now in preparation, and the Association welcomes suggestions regarding advertising and promotional activities in both cash lending and sales financing.[41]

In January 1940 the American Bankers Association, which had previously made a survey of personal loan department operations and drafted a proposed uniform law relating to commercial bank personal loan activities,[42] announced the formation of a Consumer Credit Division. On March 30, 1940, the Bankers Association for Consumer Credit reported a decision to merge its activities with those of the new division of the American Bankers Association. The reasons given for the merger were centralization of efforts and expansion of services. It is understood that the program of the new division will be to continue the work initiated by the Bankers Association for Consumer Credit and to undertake research in the field.

[41] See *Time Notes*, vol. 1, no. 5 (February 1940) pp. 8 and 15, for a statement of the Association's plans.
[42] See above, Chapter 2, pp. 58-59.