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Competitive Relations

THE competitive situation in the sales finance business is greatly complicated by the fact that manufacturer and dealer, as well as consumer, have an interest in the services rendered. Competition takes forms quite different from what might be expected if the transaction were effected directly between sales finance company and the purchaser of the commodity financed, with no other interests to be satisfied. The business is characterized by highly competitive practices, but many of these benefit the dealer rather than the consumer; all are potentially of interest to the manufacturer, but his affiliation with the sales finance process is itself a varying factor, and a further element in the competitive situation.

The importance of automobile financing in the business of sales finance companies justifies disproportionate attention to competitive relations in that field. This chapter, therefore, is concerned primarily with automobile financing, a more summary discussion sufficing in the field of diversified commodities. The competitive situation among sales finance companies will be analyzed as a problem with three different centers, as stressed above—consumer, manufacturer, dealer—and a final section will consider how the sales finance business as a whole is affected by the competition of other agencies of consumer instalment credit.

THE CONSUMER'S INTEREST AS A COMPETITIVE FACTOR IN AUTOMOBILE FINANCING

The aspects of a sales finance transaction which are, or might be expected to be, of interest to the consumer are primarily

the finance company's credit standards and procedures, its contract terms and finance charges, and the insurance coverage for the commodity purchased. In these matters practice varies among the different companies, and is susceptible to the pressures of competition.

It is not primarily the consumer, however, who has led the finance companies to compete with one another in regard to these aspects of the transaction. As a general rule the consumer is mainly interested in acquiring immediate possession of the commodity he is purchasing, and he seldom has either the knowledge or the inclination to explore the technical aspects of the transaction. Many consumers find it an embarrassing matter to go into debt for a purchase, and prefer to conduct their financing arrangements with a minimum of conversation; for others it is a matter of convenience to accept a suggested company without question rather than spend time shopping around for more advantageous arrangements. Moreover, as often as not the consumer is entirely ignorant of alternative sources of credit available to him, and even if he knows of them he is likely to be unable to estimate relative costs and merits.

In regard to the charges imposed by finance companies, it has already been mentioned that even a considerable change in rate results in only a slight percentage difference in total time price. It would appear that this fact has some bearing on the nature of demand for sales financing services. Experienced salesmen report that the consumer is typically more interested in the total time price, and the size of the monthly payments into which it is divided after he has made his down payment, than he is in the finance charge as such, and that he is not generally interested at all in the components of the finance charge. Especially to the higher-income instalment purchaser even an increase of 15 or 20 percent in finance charge may be seen not as an additional several dollars of financing expense but merely as an insignificant increase—

probably less than 1 percent—in the cost of his purchase, and as an insignificant addition—probably around 25 or 50 cents—to his monthly payment. And a decrease of such proportions may be similarly disregarded, since the total investment is already so large that a few dollars' saving is considered relatively immaterial. Such purchasers' unresponsiveness to price fluctuations undoubtedly reduces the incentive of sales finance companies to engage in finance charge competition, particularly in periods of business depression when lower-income purchasers, to whom even small economies are important, are relatively less numerous.

In this connection it is important to remember that in any one community there is but a small number of companies competing for the business, and that there are great disparities among them in financial strength and in geographical scope of operations—factors which also tend to decrease the free play of competition. Since sales finance companies obtain their business not directly from consumers but through the mediation of retail dealers, price competition is further restrained by the difficulties of making price changes known to consumers. There is indication, however, that conditions of competition are being modified, and the result may be that the consumer will become a more active element in determining price.

The inefficacy of consumers, as a group, in influencing the conditions of finance company competition should not be interpreted to mean that the consumer has in all respects had to accept whatever arrangements were offered him. In the first place, he is a highly important focus of competition among dealers. The purchase of an automobile, whether for cash or on instalment terms, contains many possibilities for bargaining, especially in regard to the trade-in value of an old car. To the individual consumer an automobile is usually an important purchase, to be undertaken with some care. The amount he is allowed for his old car is to him a big consid-

eration in determining where he will buy his new car, and therefore he shops around among dealers, and bargains with them, until he receives an offer that seems to him to involve no reflection on his business sense. This dickering is made possible by the inevitable lack of standardization in the value of used cars, and in this part of the transaction the dealer is at a disadvantage: he is not yet sure of his customer and, with other dealers competing with him, he knows that he has to make sometimes unwise compromises on trade-ins in order to close the all-important sale of another car.

To be sure, the dealer has several ways of compensating his frequent losses on trade-ins. In some cases he has been able to increase the price of the new car. In instalment transactions his various participations in the finance charges may also make up to him for any loss he has taken on the deal; these participations will be discussed presently, in relation to the dealer's role in finance company competition. But the fact remains that the lack of standardization in used-car values, and the consumer's natural inclination to take advantage of this situation, have a significant bearing on the conditions that prevail in automobile instalment financing. It is not possible to say how greatly these conditions would change if trade-in practices could be standardized, but certainly in that case at least one reason for high charges would be removed.

In instalment transactions the dealer may be pressed by the consumer into compromises also on other aspects of the deal, primarily down payment and length of contract, and here too he may jeopardize his own interests if he goes too far, for the finance company may require a full-recourse or repurchase arrangement on a contract whose terms are too far below standard. On charges he is less likely to compromise, for there he must make up the difference directly out of his own pocket, with no possibility of compensation elsewhere.

Even in regard to finance charges, however, the consumer, while not an essential focus of finance company competition,

has not been entirely without influence. The finance companies have had to consider the fact that a consumer who contemplates an instalment purchase, even if he does not typically show much concern about what is offered him, is certainly not wholly indifferent to the price of the transaction, and that if he regards it as out of reason he may insist on other financing facilities or even withdraw from the market. Moreover, advertising by consumer credit agencies, in which the national sales finance companies also engage, is making the consumer somewhat more aware of charges and contract terms. Finally, as will be discussed presently, the manufacturer has an interest in seeing that financing arrangements are kept sufficiently reasonable that he can count on instalment as well as cash purchasers for his cars. Thus the consumer, while not important as a direct incentive to competition in retail sales financing, has benefited somewhat from competitive action.

These benefits pertain mainly to finance charges and insurance, but the effects of competitive action in regard to these items will be discussed in relation to the manufacturer's participation in the process of sales financing.

THE MANUFACTURER'S INTEREST AS A COMPETITIVE FACTOR IN AUTOMOBILE FINANCING

To the manufacturer of automobiles instalment financing is an important instrument for selling his product: wholesale financing enables him to receive prompt payment from dealers, and thus conserve his own cash resources; and retail financing opens for him a wider consumer market. It is equally to his interest, however, that in the provision of the financing service no undue advantage be taken of the purchaser, for ill-will resulting from sharp practices is likely to be directed at him as well as the finance company, and financial difficulties of dealers hamper the distribution of his

product. This means that the manufacturer himself has an interest in seeing that a uniform financing plan is offered to his prospective purchasers, that charges are competitively low and standard, and that reasonable facilities are available to care for the wholesale financing of dealers. The following discussion of manufacturer relationships is based to a considerable extent on material in the Federal Trade Commission's report on the automobile industry.

The degree to which a manufacturer may participate in the retail and wholesale instalment financing of automobiles is at present an undecided question. In the past—in fact, until very recently—his relationship to the business has taken the form either of direct ownership of a finance company subsidiary to his factory, or of special arrangements entered into with a particular finance company. Today there is only one factory-controlled sales finance company engaged in financing retail and wholesale purchases of passenger automobiles—General Motors Acceptance Corporation, organized in 1919 and wholly owned by General Motors. In 1928 the Ford Motor Company formed Universal Credit Corporation for the purpose of financing the retail and wholesale purchase of Ford cars, and Ford officials declared that a specific intention in the formation of this organization was that it might serve as a yardstick for determining justifiable finance charges on the products of the parent company.[1] This finance company continued under Ford ownership until 1933; at that time, however, the majority of its voting stock was sold to Commercial Investment Trust Corporation, although it continued to concentrate on the financing of Ford products.

Until 1938 two finance companies were factory-preferred, that is, they operated under special agreements with various manufacturers: Commercial Credit Company; and Commercial Investment Trust Corporation, with its subsidiary, Universal Credit Corporation. The two factory-preferred com-

[1] Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 660.

panies and the one that is factory-controlled may be referred to jointly as factory-related. All three are national in scope; the regional and local companies have been for the most part independent, of wider or narrower range of operation.

The division of business between factory-related and independent companies is indicated in Table 67, for the year 1937. This table covers the total automobile instalment paper handled by 424 sales finance companies, these companies together accounting for more than 95 percent of all such paper handled by sales finance companies. Of the total volume of automobile paper handled in 1937 by these 424 companies, about 73 percent went to the three factory-related companies. Thus on the average each of these companies received about one-fourth of all automobile business handled by sales finance companies—twelve hundred times as much as the average for each of the 424 companies[2] and seven times as much as the average for each of the three regionals, which were the largest competitors of the factory-related companies. It is worth noting that the latter received a higher proportion of wholesale than of retail business—79 as compared with 68 percent of the total—whereas the other companies received less of the wholesale than of the retail paper, and in decreasing ratio with decreasing size of the companies.

In any particular locality, of course, the relative position of the various types of companies may have been quite different from that indicated in Table 67. In a given area two or fifty companies may have been competing for the available business—or there may have been only one, or even none. Thus it may be that within a certain territory a smaller company had a dominant position in the local market. But

[2] These 424 sales finance companies handled about 71 percent of all retail automobile financing in 1937, the other 29 percent going to an unknown number of other credit agencies (including a negligible few sales finance companies not reporting to the Department of Commerce). Of the total volume of such paper handled by all agencies in 1937, about 49 percent went to the factory-related companies, 8 to the regionals, 7 to the large locals and 8 to the small locals.

TABLE 67

PERCENTAGE DISTRIBUTION OF RETAIL AND WHOLESALE AUTOMOBILE INSTALMENT CREDIT EXTENDED BY SALES FINANCE COMPANIES, 1937, BY TYPE OF COMPANY, AND AVERAGE PERCENT RECEIVED BY EACH COMPANY[a]

Type of Company	*Retail Credit*		*Wholesale Credit*[b]		*Total Automobile Credit*			*Number of Companies*
	Percentage Distribution	Average % Received by Each Company	Percentage Distribution	Average % Received by Each Company	Percentage Distribution	Average % Received by Each Company	Volume (in millions of dollars)	
Factory-related	67.66	22.55	78.70	26.23	73.43	24.48	2,661.4	3
Regional	11.09	3.70	9.50	3.17	10.26	3.42	372.0	3
Large local[c]	9.44	.25	7.36	.19	8.35	.22	302.6	40
Other local	11.81	.03	4.44	.01	7.96	.02	288.6	378
ALL COMPANIES	100.00		100.00		100.00		3,624.6	424

[a] The dollar volume was $1,731,900,000 retail and $1,892,700,000 wholesale. Volume of 424 companies is the sum of the volume of 419 companies reporting to Department of Commerce, Bureau of the Census, plus that of 5 companies which did not report to the Department of Commerce. Volume of 46 companies in first three groups based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market; of these 46 companies, 41 reported information on volume to the Department of Commerce, and 5 did not. Volume for the 378 companies calculated by subtracting that of the 46 companies from that of the 424 companies.

[b] Principally wholesale financing of new cars, but includes some loans to dealers on stocks of used cars.

[c] Including two small regionals.

through the country as a whole there is no doubt that the greatest volume of business has been conducted by the factory-related companies.

The degree to which the facilities of the factory-related finance companies have been used by General Motors, Ford and Chrysler dealers is indicated in Table 68. It appears from these data that about half of General Motors, one-quarter of Ford and one-fifth of Chrysler dealers have used almost solely the facilities of their factories' respective finance companies. About one-eighth of General Motors, more than one-third of Ford and half of Chrysler dealers reported no use of the factory-related finance companies, or replied indefinitely.

TABLE 68

PERCENTAGE DISTRIBUTION OF GENERAL MOTORS, FORD AND CHRYSLER DEALERS, BY DEGREE TO WHICH THEY USED FACILITIES OF FACTORY-RELATED FINANCE COMPANIES[a]

Degree of Use of Factory-Related Finance Company	*General Motors Dealers*	*Ford Dealers*	*Chrysler Dealers*
Practically entirely	53	26	19
50–90 percent	23	16	17
Less than 50 percent	11	21	15
No use, or replies indefinite	13	37	49
TOTAL	100	100	100

[a] Based on Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 281. Number of dealers reporting not disclosed in the report, nor the dates to which these figures apply. In response to an inquiry the Federal Trade Commission has stated: "These percentages are based on replies received in response to a questionnaire sent to the automobile dealers in the fall of 1938. They cover whatever periods the various dealers have handled the products of General Motors, Ford or Chrysler. Some, therefore, may cover only a few months, possibly subsequent to the action of the Department of Justice against the three large finance companies, while others cover a number of years prior to that action." The factory-related finance companies are as follows: for General Motors, General Motors Acceptance Corporation; for Ford, Universal Credit Corporation; for Chrysler, Commercial Credit Company.

The special arrangements made by a manufacturer with a preferred finance company usually provided that the latter would finance the wholesale purchases of the factory's dealers and would offer retail purchasers an "approved plan" of financing, evolved by the manufacturer with the avowed purpose of providing relatively low-cost and uniform facilities for instalment credit. The manufacturer, in turn, endeavored to influence his dealers to use, and to recommend to their customers, the facilities of the preferred company. Thus the finance company benefited through increased business and the manufacturer benefited through the fact that his dealers and potential customers were offered what were regarded as attractive financing facilities.

It was customary, however, to supplement, or guarantee, these benefits by specific financial arrangements. Thus, under the various contracts between Chrysler Corporation and Commercial Credit Company, Chrysler agreed to pay the latter the difference between its aggregate automobile finance charges, at rates and terms prescribed by Chrysler, and the amount of finance charges that would otherwise have been in force. The finance company, in turn, agreed to pay Chrysler a portion of its profits. This resulted in payments by Chrysler in 1927 and 1928, totaling $1,474,000 for the two years, and in payments by the finance company to Chrysler in each year from 1929 through 1937, totaling $3,820,000 for the nine years and ranging from $39,000 in 1932 to $1,339,000 in 1937.[3]

Hudson Motor Car Company entered into contractual arrangements with Commercial Investment Trust, Inc., in 1922, under which the finance company was paid subsidies for the retail and wholesale financing of the cars of this manufacturer. From 1923 through 1932 the finance company received $1,471,000 in such payments.[4]

[3] Federal Trade Commission, *op. cit.,* p. 615.
[4] *Ibid.,* p. 688.

The Studebaker Corporation became interested in the financing requirements of its dealers as early as 1915, when it arranged for certain local banks to extend accommodations to Studebaker dealers in amounts totaling the amount of deposits made by Studebaker in the banks. In 1916 the Corporation arranged that Commercial Investment Trust, Inc., should extend credit to dealers, and agreed to absorb all losses from uncollectible accounts. Since 1919 Studebaker has had agreements with three finance companies, each at a different time, providing for wholesale and retail financing of purchases. No subsidies were paid, however, until 1923, when financing rates were set by Studebaker; payments were made each year from 1923 through 1932, totaling $5,728,000 and ranging from $44,000 in 1932 to $925,000 in 1925. After 1932 contractual arrangements with finance companies were continued but no subsidies were paid.[5]

Some indication of the effect of manufacturer efforts to keep charges low is contained in data presented in Chapter 8. It was shown there[6] that on both new cars and used cars the factory-related companies' finance charges were lower, in annual percentage rate, than those of the independents. Chapter 8 showed also that in 1936-38 the new-car charges of all types of companies (except the independents, on 24-month contracts) were substantially lower, in annual percentage rates, than they had been in 1935. This general decrease in the average rates on new cars was primarily the result of General Motors' announcement of the "6 percent" plan in the fall of 1935.[7] The plan reduced charges on new cars by 25 percent on 12-month contracts and 19 percent on

[5] *Ibid.*, pp. 817-18. Of the total amount paid out, $4,845,000 went to Industrial Finance Corporation (parent company of the Morris Plan system of industrial banking companies) and its subsidiary, Industrial Acceptance Corporation (1923-28); Motor Dealers Credit Corporation received $218,000 (1928-29); and Commercial Investment Trust, Inc., received $665,000 (1929-32).
[6] Chapter 8, Tables 55 and 56.
[7] See Chapter 8, pp. 201 ff.

18-month contracts,[8] and the other finance companies announced competing plans as quickly as they could be devised and publicized. It may be noteworthy that for the factory-preferred and independent companies the insurance percentages (insurance in percent of cash selling price and in percent of original unpaid balance plus insurance) were noticeably higher in 1936-38, at least on 12-month and 18-month contracts, than they had been in 1935, before the finance charge reduction. The possible inaccuracies in these insurance percentages should be borne in mind, however.

The Federal Trade Commission decision on the 6 percent plan has already been discussed. In its report on the automobile industry the Commission declared that this plan may be said to constitute one step "in what is possibly a vicious circle": the manufacturers built up their relations with finance companies partly in order to reduce the time-sales price of their cars; the discounts which the manufacturers allowed to dealers were considered by the latter to be inadequate; the dealers were therefore tempted to pack the finance charge to add to their profits; the factory-related finance companies sought to eliminate the packs; some dealers retaliated by switching their business to finance companies that would allow them to pack the finance charge; and finally with the 6 percent plan GMAC went directly to the public, as it were, hoping to educate consumers to compute finance charges for themselves and to compare them with alternatives, thus disclosing the packed charges and making it even more difficult for the independent companies to obtain additional business or retain what they already had.[9] The independent companies contended that if manufacturers had not discriminated against them, but had permitted the free play of competition among all finance companies, this competition would have

[8] Federal Trade Commission, *op. cit.,* pp. 972, 975.
[9] *Ibid.,* pp. 943-44.

reduced finance charges at least as much as they were reduced under the preferential system.[10]

The manufacturer's interest in the financing process has had some effect also on the charges for insurance. As has already been mentioned, the factory-controlled company, GMAC, places its insurance with the General Exchange Insurance Corporation—also owned by General Motors Corporation—and the rates it files with state insurance departments are lower than manual rates by about 25 percent, the difference being passed on to the purchaser.[11]

Many other sales finance companies own their own insurance companies—it has been estimated that at least 80 percent of the volume of premiums from retail financing now flows through wholly owned insurance companies—but the general practice is to quote only manual rates. Thus the other finance companies, where they wish to compete with GMAC on a price basis, must offset this disadvantage. Their markets overlap with GMAC's, however, only where they attempt to receive the business of General Motors dealers, for it is only the paper of these dealers that GMAC purchases.

The insurance "package" provided on different transactions varies considerably—some transactions carrying single-interest and others double-interest insurance, some carrying protection for collision and others not—and the various possible combinations result in decidedly different services. Where policies are issued to the purchaser the protection bought and the amount of the premium are ordinarily stated clearly. This may be done also when certificates are issued, but many finance companies using this method have not shown the insurance premium separate from the finance

[10] *Ibid.*, pp. 944-45.

[11] Late in September 1939 GMAC organized a special insurance company, the Motors Insurance Corporation, which is under the same management as General Exchange Insurance Corporation. This company does business at manual rates in California, Oregon and Washington, where state laws permit dealers to receive insurance commissions, but it is reported that where its facilities are used there is a corresponding reduction in finance charges.

charge, or stated the coverage in a clear fashion. This lack of uniformity has presented a problem for the companies which offered the most insurance protection per dollar of premium. The purchaser's ignorance has often worked to the disadvantage of the company offering him the best value.

The factory-related companies' affiliations with manufacturers have been strongly opposed by the independent companies as unfair competition,[12] on the ground that such organizational relationships operated to divert the flow of paper from them, not by providing superior service but by coercing and discriminating against dealers. The independent companies, through the medium of the American Finance Conference, contended that factory services, such as advertising of authorized finance plans and providing the aid of factory representatives in soliciting business for the affiliated companies, greatly reduced the latter's acquisition expenses, and were a powerful influence in diverting paper in their direction. In support of this position the American Finance Conference quoted a prospectus of Commercial Credit Company, issued June 16, 1937, in connection with a debenture note issue: "The services performed by Chrysler Corporation and its subsidiaries are believed to be a valuable advertisement of Commercial Credit Company and its business, plans and financing facilities, to save the Company a substantial sum in promoting and acquiring additional business from dealers, and to increase its business and profits."[13]

In its extreme form factory assistance was said to constitute dealer coercion by such methods as: "1. Refusal of independent finance company checks at the factory to cover wholesale loans to dealers when they take delivery of cars; 2. Delayed delivery of body types needed; 3. Forced delivery of other

[12] This and the following exposition of the independent finance companies' position is taken from "The Automobile Finance Business," a mimeographed monograph of the American Finance Conference, Chicago (July 15, 1937).

[13] *Ibid.*, pp. 4, 13.

types not wanted; 4. Delayed delivery of any type of car at time of introduction of new models; 5. Threat of cancellation of franchise; 6. Multiple dealer representation without economic justification; 7. Various and sundry dealer persecutions."[14]

The independents contended also[15] that the factory-related companies had access to funds at lower rates, that if the difference was not passed on to the public the result was higher profits, and that if it was passed on to the public the result was a reduction in rates "to the point where competition from independent finance companies disappears and a virtual monopoly without regulation ensues." The independents held that a borrowing position which was improved by factory affiliation was "nothing less than a case of indirect subsidy."

Through the American Finance Conference the independent companies brought these allegations to the attention of the Anti-Trust Division of the Department of Justice. In September 1937, after an investigation of the complaint, the Department instituted criminal proceedings in the Federal Court at Milwaukee against General Motors Corporation, Chrysler Corporation, Ford Motor Company, their associated finance companies and certain officials of the companies. In December the grand jury was dismissed on the ground that the government had been guilty of impropriety in holding discussions with representatives of the parties under investigation in order to arrange for a civil remedy in the form of consent decrees; these discussions had been held at the request of some of the parties concerned, and they were in conformance with the legal procedure provided in the Sherman Act. In May 1938 the Department instituted similar proceedings, this time in the United States District Court for the Northern District of Indiana. The grand jury re-

[14] *Ibid.*, p. 7.
[15] *Ibid.*, p. 20.

turned indictments against manufacturing companies, officials and finance companies on May 27, 1938.

The Ford Motor Company, the Chrysler Corporation and their associated finance companies were still willing to discuss consent decrees, and in order to provide a basis for them the Department of Justice instituted proceedings before the same court sitting in equity. As a result the government and the respondent companies consented to decrees which were issued November 15, 1938, effective March 15, 1939.[16] Meanwhile the contract between Chrysler Corporation and Commercial Credit Company had been canceled, the motor company's stock in the finance company had been sold, and it had been announced, in April 1938, that "Chrysler Corporation has no interest in and no contractual relations with any finance company." Similarly, it was announced, in December 1938, that Commercial Investment Trust Corporation had purchased the outstanding minority stock of Universal Credit Corporation, thus making the latter a wholly owned subsidiary of the former and divesting Ford Motor Company from any financial interest in the company.

General Motors Corporation refused to sign a consent decree and the case against that organization was prosecuted in the fall of 1939. A verdict of guilty was returned against the four corporate defendants (General Motors Corporation, General Motors Sales Corporation, General Motors Acceptance Corporation and General Motors Acceptance Corporation of Indiana) though the seventeen individual defendants —officers and agents of these corporations—were acquitted. The convicted corporate defendants, however, have filed notice of intention to appeal, thus leaving the issues of the case still pending.

The Department of Justice hoped to reach three objectives:

[16] U. S. *v.* Ford Motor Company, *et al.*, District Court of the United States for the Northern District of Indiana, Civil Number 8. U. S. *v.* Chrysler Corporation, *et al.*, District Court of the United States for the Northern District of Indiana, Civil Number 9.

the first was to eliminate any existing coercion of dealers by the manufacturers and their related finance companies intended to induce dealers to use the related companies; the second was to eliminate any manufacturer discrimination against independent finance companies by practices concerning wholesale financing (such as providing office space at the factory for representatives of the related company, or accepting payment directly from the related company for the cars it financed for the dealer, though not allowing the dealer this convenience in regard to the services of any other company); and the third was to eliminate from purchaser payments to dealers or finance companies any excess amount intended for bonuses or packs or for reserves which are actuarily larger than necessary to cover losses. This third objective cannot be achieved until the GMAC case is settled, but the first two were covered in the provisions of the consent decrees.

According to these provisions both manufacturer and finance company are to leave the dealer complete freedom to patronize any finance company he chooses. But although the manufacturer shall not recommend any specific finance company to his dealers or to the public, he can draw up his own new-car financing plans, recommend them to dealers, advertise them and arrange for one or more finance companies to make the plans available to the public. He is to accord equal treatment to all finance companies, though in regard to certain privileges hitherto reserved for the preferred company (such as office space at the factory, information concerning dealers, financing plans which give the finance company a competitive advantage through various manufacturer services or facilities) he is allowed to exclude "unregistered" companies.

A company that wishes to be regarded as "registered" is required to file with the court a statement, addressed to a particular manufacturer, agreeing to abide by certain regu-

lations in acquiring retail automobile instalment paper from that manufacturer's dealers. These regulations include provisions that the finance company, if it arranges for insurance, shall send to the purchaser, within 25 days after its acquisition of the contract, an insurance policy or certificate stating the coverage and the amount of premium; that it will not require or accept wage assignments or garnishments in collection of deficiency judgments on retail cars sold for less than $1000 unless it has requested the customer to surrender the car and he has not done so; that it shall take no deficiency judgment if the retail purchaser has paid at least 50 percent of his note; that its delinquency fees, its charges for extending or refinancing a contract, and its charges for collection or repossession shall conform with certain stated limitations; and that it shall not require dealers to take any collateral in addition to the car sold. As yet no finance company has registered.

The decrees signed by Chrysler and Ford and their related finance companies provide also that the manufacturer may not pay a subsidy to a finance company for the purpose of enabling or inducing it to offer his dealers lower finance charges unless he offers to pay similar subsidies to all finance companies offering the same finance charge, and finance companies are prohibited from paying money to a manufacturer in return for business acquired from his dealers. The manufacturer cannot lend money to or buy the securities of any finance company unless the outcome of the General Motors case is such that General Motors Corporation is not required to give up all ownership and control of GMAC.

If the prosecution of General Motors is ultimately successful the decrees will be subject to reconsideration, if the respondent companies request it, so that the requirements imposed on Chrysler, Ford and their preferred finance companies may be redrafted to conform with those imposed upon General Motors Corporation and GMAC. If the case against

General Motors is finally terminated with any result other than a judgment of conviction, all provisions of the consent decrees shall become inoperative.[17]

Thus the manufacturer's interest in the sales financing process is so strong that it has raised the question of anti-trust act violation. But this factory influence in the business, though it both contributes to and results from imperfect competition, is not to be taken as an explanation of high charges and above-average profits. On the contrary, the main reason for the manufacturer's interest has been his desire to see that consumers are granted attractive rates for the time purchase of his cars. His cooperation with the finance company for this purpose was made possible by his existent contractual relations with a large body of dealers—a group vital not only to his own but also to the finance companies' interests.

THE DEALER'S INTEREST AS A COMPETITIVE FACTOR IN AUTOMOBILE FINANCING

The importance of the retail dealer to the finance company derives from the fact that he is the one through whom it acquires its paper. The purchaser may occasionally make his own financing arrangements, or insist that the dealer finance his contract through a particular agency, but in the great majority of cases ignorance and inertia lead the consumer to accommodate himself to the finance plan offered by the dealer, whatever the agency with which it originated.

This strategic position of the dealer, which makes him, rather than the purchaser, the focus of finance company ef-

[17] It may be mentioned that the Federal Trade Commission's proposed trade practice rules for the automobile industry contain provisions stipulating it to be an unfair trade practice for any member of the industry to coerce another "to dispose of sales finance contracts to a specific finance company . . . or to specify or accept insurance through a specific insurance company, with the effect of thereby substantially lessening competition." Final action has not yet been taken on the Commission's proposals.

forts to obtain business, has led to many competitive practices which pertain only to him. Some of these practices—particularly the arrangements in regard to wholesale financing and in regard to responsibility for losses—have no direct bearing on the interests of the consumer; but other practices—particularly the arrangements concerning packs, reserves and bonuses—are directly reflected in what the consumer pays for the financing service.

The manufacturer demands cash for the cars shipped to his dealers, and many dealers, not being able to finance with their own capital the number of cars they need for display and stock purposes, meet the factory's requirements through wholesale loans. Sales finance companies extend them credit for 90 percent or more of the wholesale value of the cars.

When it finances the wholesale requirements of dealers the finance company ordinarily receives title to the car directly from the manufacturer, and a trust receipt, chattel mortgage or conditional sale contract from the dealer, who takes physical possession. If the same finance company finances also the retail instalment sale of the car, it retains title, under a new instrument, until the payments are completed. This is obviously the most convenient arrangement in regard to the amount of clerical work involved. Questions and paper work concerning title to the car are minimized, and payments on retail deals can be applied directly to liquidate wholesale loans. The independent companies' complaint that the dealer is not allowed this convenience except in dealings with factory-related companies has already been discussed, and also the provisions of the consent decrees which were intended to remedy the situation. On this type of business the most common charge made by finance companies during recent years has been a rate of 6 percent per annum. Early in 1939 a 4 percent rate was introduced, and at this charge the business is certainly unprofitable for many com-

panies, because the rates currently paid by finance companies themselves on their short-term borrowings range from ¾ percent, on paper sold in the open market, to as high as 8 percent for money borrowed directly from banks.[18] When losses and the expenses of handling the loans and taking periodical inventories of the cars are considered it is obvious that only those companies which are able to borrow at low rates can extend wholesale accommodations at 4 percent and not lose money. No company can be making much profit on the wholesale business and others must be taking it at a loss.

The importance of wholesale business is not in its profits, however, but in its serving as a lever for obtaining retail business from the dealer. It is a part of the total service the finance company extends in order to induce dealers to sell them retail contracts, which are profitable. The inducement may be the mere fact that it is more convenient for the dealer to do business with only one finance company, but as has already been indicated the dealer has sometimes been required—by manufacturer as well as finance company—to give the latter his retail business as a condition for receiving the favorable wholesale plan. The relatively low rate on wholesale financing is compensated by the relatively high rate on retail business. And since wholesale financing is a service extended on all cars, the instalment purchaser at present is paying, among other things, for a service extended to the dealer on cars eventually sold for cash.

Ordinarily an appreciable amount of the dealer's capital, which he could well use in other ways, is tied up in used cars. Many companies will make advances on these cars, pending their resale, but some frown on the practice. The used-car loan is in one sense the counterpart of new-car wholesale financing, but from the viewpoint of the lending agency there

[18] This is the range within which the bulk of the loans are made. In isolated instances lower and higher rates will be found. This information was compiled from data received from approximately 200 commercial banks widely distributed over the country.

is a good deal of difference between the two. The value of the collateral is much more difficult to ascertain in used-car than in new-car loans, and therefore greater risks are involved. This, along with the fact that the unit amounts involved are smaller, results in higher expenses than in new-car wholesale financing. If finance companies keep within the limits imposed by the usury laws the rates they can charge compared with the expenses involved make the business unattractive.

Used-car loans, like the wholesale financing of new cars, are principally a means of attracting the dealer's retail business. The companies not providing this service for the dealer have nothing with which to meet such competition directly, but they contend that the total service they extend is more advantageous to the dealer than the total service, including used-car financing, extended by their competitors.

In the early days of automobile instalment financing, before 1920, most of the paper was purchased with full recourse on the dealer in case of default. As an increasing proportion of his sales came to be made on the instalment basis this contingent liability became a continual threat to his solvency, and the finance company found itself in the position of protecting its own interests at the expense of its customers, the dealers, who were crying for relief. The result was the development of the repurchase plan about 1920.[19] This plan relieves the dealer of his recourse endorsement on the instalment contract but provides, through a general agreement covering all his relations with the finance company, that if repossession becomes necessary he will pay the balance of the purchaser's obligation, with, however, certain stipulated exceptions (referring mainly to cases of conversion, confiscation and collision). Later the non-recourse plan was developed by certain smaller companies which, in an effort

[19] See Chapter 4, p. 116. For a more detailed account of this development previous to 1927 see E. R. A. Seligman, *The Economics of Instalment Selling* (1927) vol. 1, pp. 75-81.

to obtain business, were willing to offer the dealer complete freedom from responsibility.

In regard to these dealer arrangements there is a clear, but by no means rigid, difference in policy between the larger and the smaller companies. The nationals usually purchase paper from dealers under the repurchase plan, but with the exception of GMAC they also buy some paper without recourse, one national company following one plan with some dealers and the other plan with other dealers. The regionals and locals conduct most of their business without recourse, but many of them buy a sizable percentage of their paper under repurchase agreements, and all of them buy some paper in this way. As a rule they buy the better-quality paper without recourse, and take the more questionable business on a repurchase arrangement. Data on 32 large locals show that in 1937, when they handled a retail automobile business of $123,587,000, these companies purchased 35 percent of their new-car paper and 45 percent of their used-car paper (40 percent of their total retail automobile paper) under recourse or repurchase agreements.[20]

The proponents of the repurchase agreement contend that the responsibility thus placed on the dealer causes him to be more discriminate in his selling of automobiles on the instalment plan, and that the result is a better credit situation than would exist if the paper were purchased on a non-recourse basis. The non-recourse companies, on the other hand, contend that they are close enough to the circumstances surrounding each deal to form an adequate judgment concerning the creditworthiness of the purchaser without the guarantee of the dealer.

Dealers selling their paper to repurchase and to non-recourse companies have not such a difference in losses as

[20] These figures include a small amount of paper classified as "partial recourse" by 10 companies. Data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market; companies selected according to availability of data.

might be thought. The great majority of notes are collected without repossession, and on these no one loses. On the contracts of purchasers whose credit standing is doubtful from the beginning, even non-recourse companies typically require endorsement with recourse. As to the repossessions that do occur under repurchase agreements, there is often room for a difference of opinion in determining the extent of the dealer's stipulated exemption, and this difference must be settled by administrative decision of the finance company's representative after discussion with the dealer. It is frequently advisable to favor the dealer in such decisions, and if this is done he does not pay as much as a strict interpretation of the agreement would require. Thus, at least in relatively prosperous times, the two methods of purchasing paper have not, in themselves, very different effects; in times of depression, when the repossession ratio is higher, a greater difference may be expected.

The development of these plans has been accompanied, however, by practices which constitute a highly important aspect of sales finance company competition for dealer business and which have a direct bearing on the interests of the consumer, and therefore of the manufacturer. These are the payments made to dealers in the form of reserves, bonuses and packs.

In the middle 1920's companies purchasing paper with full recourse endorsements or under repurchase agreements introduced the dealer's reserve in order to protect the dealer against losses arising from repossessions and thus meet the growing competition of companies offering non-recourse plans. An amount equaling a certain percentage of the customer's original unpaid balance, regarded as part of the finance charge, was set aside as a reserve for the dealer, to be used in cases of repossession loss; when this reserve exceeded an agreed-upon percentage of the outstanding amount of his notes held by the finance company, he was paid the

difference. The non-recourse companies were now at a disadvantage and countered by offering dealers a bonus for their business. The bonus also was computed on the original unpaid balance, and included in the finance charge. Both the reserve and the bonus provided a source of income to dealers, and some provided themselves with further income by arbitrarily increasing the finance charge; this additional amount, the "pack," was paid by the customer as part of his debt, and given the dealer by the finance company.

The resultant situation is clearly unsatisfactory for the finance companies as well as for the consumer, but, as was indicated in Chapter 9, attempts to remedy it have met with little success, at least partly because the problem of dealer payments is closely connected with the larger problem of manufacturer affiliation with the sales finance process. Most of the non-recourse business has been conducted by independent companies, using this plan of operation as a competitive device against companies that have received factory help in acquiring dealers' paper. The independent companies have contended that the dealer's reserve allowed by the larger companies is greatly in excess of the amount needed to cover actual losses, and that therefore they too are justified in allowing the dealer a special benefit, in the form of the bonus. They also maintain that if it were not for this inducement dealers would sell their lower-risk paper to the companies offering repurchase plans and would sell only higher-risk paper to the non-recourse companies.

Toleration of the pack has also been justified as a competitive necessity, but if this is the case the practice appears to have defeated its own ends, for packing is permitted by practically all companies. And even where the dealer is not permitted to pack the finance charge he has sometimes achieved about the same result by packing the cash selling price, a procedure over which the finance company has no control. This latter practice has recently been made difficult,

however, by factory requirements that the dealer stipulate to the customer all the component items in the price of his car.

Data on these various payments, classified according to the companies' factory relationships and expressed in percent of total insurance and finance charges, were presented in Chapter 8. It was shown there[21] that in 1936-38, according to the samples collected by the Federal Trade Commission, the packs allowed by factory-preferred companies took, on the whole, a larger fraction of total charges than did those allowed by the other companies. For all companies approximately one-tenth of the average insurance and finance charge on new cars—and a somewhat larger fraction on used cars—went to dealers for reserve or bonus.

It is not possible to determine with any accuracy whether the amounts allowed for dealer loss reserves are indeed excessive, for cyclical and geographical variations make this an extremely complicated problem. The Federal Trade Commission attempted an analysis of the question[22] but was unable to obtain sufficient information for reliable results. In the end it felt justified in stating only that "there is a certain amount of evidence that the amounts allowed as dealer's loss reserves do exceed somewhat the average loss ratio."

If in all cases the reserve were exactly sufficient to cover losses incurred by dealers which they would not have incurred under the non-recourse plan, its effect would be simply to equalize the attractiveness of the two types of plans in the eyes of the dealer. In so far as the reserve is greater than this it is, like the bonus and the pack, a subsidy or commission paid to the dealer for his business.

There is no doubt that the amounts of these increments vary considerably as between different finance companies, and even as between different transactions. And apparently

[21] Chapter 8, Table 54.
[22] Federal Trade Commission, *op. cit.*, pp. 938-40.

one reason for this variation is that some finance companies, in their competition for dealers' business, have relied more on factory relationships than on these special financial arrangements. But in any case, all these increments are paid by the purchaser of the car, through increased finance charges. It is possible that in cases involving a trade-in the dealer passes on to the customer at least a part of his bonus, reserve or pack, in the form of a larger trade-in allowance than he would have extended had he not expected to receive a part of the finance charge on the deal. It is difficult, however, to ascertain whether this has been done in any particular transaction, for individual used cars have no standard trade-in price. Moreover, a large trade-in allowance, granted the customer as a special inducement, may be the cause rather than the result, of a dealer's pack.

As has been mentioned, the Department of Justice hopes to eliminate all payments that are of the nature of a subsidy, and limit the dealer's reserve to an amount no larger than necessary to cover actual losses. But in the meantime these dealer payments have become entrenched as a highly important aspect of sales finance company competition, and as a problem with a direct bearing on the interests of the consumer.

COMPETITIVE RELATIONS IN DIVERSIFIED FINANCING

In diversified financing, too, the manufacturer's interest has an important effect on competitive relations. Since this field is so extensive and so miscellaneous far more manufacturers are involved, though none of them conducts a business so large as that of any of the "big three" in automobiles. Some manufacturers have close relations with preferred finance companies, but much more often than in automobile financ-

ing the manufacturer has his own financing subsidiary or department.

Again the independent companies complain that the manufacturers coerce dealers to give their business to the related finance companies, that they discriminate against the independents in favor of the related companies, and that they are sometimes more liberal with terms and charges than they would be if they were not interested in the manufacturing profit to be made by extending the market for their goods. It is contended, for example, that electric power companies, in their desire to increase their power loads, extend overliberal terms in financing the purchase of electric appliances, and are able to absorb their repossession losses by charging them against the profits from their total business instead of against the profits from the financing business alone.

Government agencies (Electric Home and Farm Authority and Federal Housing Administration) have also had an influence on the competitive situation in diversified financing. The competitive importance of FHA, in its insurance of financial institutions against losses on certain types of loans, has been mainly in the fact that it has encouraged banks to enter the field of diversified sales financing. EHFA, which is specifically in the sales finance business, has served to focus attention on the question of terms, for its charges are lower and its contract terms are on the whole more liberal than those characteristically made by private agencies in the same field.

In diversified financing there has not been such a widespread standardization of contract terms as has developed in regard to automobiles, and therefore low down payments and long contracts are of more importance as competitive devices than they are in automobile financing. The dealers who can offer financing facilities under the more liberal contract terms have obviously a significant sales advantage.

Diversified financing is typically conducted on a recourse

basis, and dealers' reserves are in common use. Sometimes, however, especially in regard to refrigerator paper, dealer recourse is limited to the period of four or six instalment payments, though with various stipulated exceptions. Packs are allowed by some companies, though the practice is generally frowned on.

The purchaser has ordinarily been required by the terms of the contract to assume the risk of loss from fire, theft and other special causes. If insurance is required it has been placed in some instances by the dealer, in others by the finance company and in others by the purchaser himself, the cost being separate from the finance charge. EHFA, however, and also, since 1939, certain of the national sales finance companies that conduct diversified financing provide insurance themselves, without special charge to the customer. If this practice proves to be an effective competitive measure other companies may have to follow suit, but in general insurance has not been such an important consideration in diversified as in automobile financing.

COMPETITIVE RELATIONS WITH OTHER CONSUMER CREDIT AGENCIES

This summary description suggests answers, though necessarily complex ones, to the question why competition among sales finance companies has not developed in such a way as to bring about a lower level of charges, and ultimately of profits. Not so complex is the further question as to why other credit agencies have not attempted to share in the profits of the sales finance business.

The answer is that to a considerable extent this is now happening. In recent years sales finance companies have met increasing competition from other consumer credit agencies, both in the form of new institutions entering the sales financing field itself and in the form of new rivalry from alterna-

tive methods of consumer instalment financing. Commercial banks and industrial banking companies have actively sought not only to obtain a larger share of the retail dealer's financing business but also to reach the prospective commodity purchaser directly, thus entirely eliminating the dealer's role in the credit transaction. This latter form of competition inheres also in the activities of personal finance companies, which make cash loans direct to consumers. How acutely the sales finance business feels this competition of other consumer credit agencies is difficult to say; inter-agency competition is reportedly keen today in some regions and potentially it is keen in all. It does not appear to have resulted in an absolute decline of sales finance company business, but there is some basis for inferring that the sales finance companies' relative share of the consumer credit market has suffered somewhat of a contraction.

In acquiring retail instalment business some banks concentrate their efforts on the consumer, and others consider it more desirable to establish contacts with dealers. The latter method of acquisition is likely to result in a quicker development of volume, but the building up of direct consumer relationships is believed by some bankers to make for a more secure basis of business.

When banks attempt to reach the consumer directly the sales finance companies can meet their competition only as they meet that of direct cash lenders—by going directly to the consumer, that is, by advertising. One or the other competitor may experiment with a reduction in rates, and it may be because of this competitive situation between banks and sales finance companies that a somewhat lower level of charges has prevailed in recent years, though it is not possible to say whether the decrease is the result of bank or of finance company leadership.

When the dealer is the focus of the banks' efforts to obtain business there are several ways in which the finance com-

panies attempt to maintain their position. The loss reserve, the bonus or other finance charge participation allowed the dealer is of course a strong competitive weapon, and one of the most customary ways in which the finance company attempts to meet the bank's competition is by offering the dealer a more substantial participation. Also, the finance company may emphasize its willingness to take all the reasonable paper offered by a dealer, thus capitalizing on the fact that some banks are willing to finance only the best-quality notes. The finance company's willingness to accept a dealer's wholesale paper is a strong talking point in some cases, for not all banks will extend the dealer this service.

Finally, the handling of insurance may serve as a useful competitive weapon. Since the sales finance company, in contrast to the bank, usually places all insurance with the same company it can emphasize to its dealers its ability to divert repair business in their direction. In the states on the west coast, however, it is possible for the bank, which is prevented by law from acting as an insurance agent, to arrange for the dealer to participate in the commission on insurance, and in automobile financing this may be a serious threat to the sales finance company's customary procedure and even to its competitive position. In this connection it is interesting to note the report that Motors Insurance Corporation allows the dealer a commission on the insurance he writes; this is the new company which GMAC organized late in 1939 and which now conducts business at manual rates on the Pacific coast, where dealers may be licensed as agents, and where bank competition is especially keen.

A more difficult type of competition for the sales finance company to meet is the direct cash loan to a prospective commodity purchaser. This kind of instalment credit is extended mainly by the personal loan departments of commercial banks, by industrial banking companies and by personal finance companies. Sales finance companies have recently at-

tempted to counteract the loan promotion activities of cash lenders by means of national advertising and circulars to customers affirming the superiority of sales finance company services over those of other credit sources.

The strategic position of the dealer in the extension of retail instalment credit has already been abundantly emphasized. All competing sales finance agencies receive at least some of their paper—usually most or all of it—direct from the dealer, and therefore, as has been shown, competitive practices are likely to center around him more than around the consumer. But frequently the dealer enters the field himself, and to the extent that he does this he becomes a formidable competitor of all the competitors. In automobile retailing, the high unit value of the good prevents dealers from any extensive financing of their own instalment paper; probably no more than 10 percent at the outside is carried by dealer capital. In other retail fields, however, such as furniture, household appliances and equipment, jewelry and "soft" goods, dealer capital may finance a large proportion of instalment sales. There is no doubt that the high profits which have characterized consumer financing are an incentive to the dealer to provide his customers with this service without resort to an outside agency.

Against this form of competition the various agencies of sales finance credit can do little, but though their share of the market may be curtailed by some of the larger retailers, it is not likely that their function will be replaced. For they have all the advantages of specialization: greater capital resources available for a specific purpose; an organization geared to the procedures required; and, especially important, a valuable store of experience in regard to the intricate problems of contract terms and finance charges. The extent to which the sales finance company excels its institutional competitors in these respects is probably the best indication of the extent to which it will withstand their rivalry.