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The Significance of Personal Finance Company Credit

THE modern personal finance company specializes in small cash loans, usually limited to a $300 maximum. Repayments on principal, made in equal instalments, generally extend over a period of 5 to 20 months, although the loan period is gradually being extended to cover a period of 4 to 30 months. The business originated in legislative attempts to combat the loan-shark evil, and is conducted under statutory permission to make one over-all charge, including interest. Such permission is granted only to lenders who submit to license requirements and conform to regulations provided for the borrower's protection. Laws designed to permit the personal finance business, subject to regulations, have been enacted in 39 states, the District of Columbia and Hawaii. The latter two jurisdictions and 34 of the 39 states have laws resembling the Uniform Small Loan Law, a model draft first published by the Russell Sage Foundation in 1916 and subsequently revised at intervals. The Foundation has played an important part in developing and sponsoring legislation in this field.

In those states in which the personal finance business is authorized the maximum rate of charge ranges, for the most part, from 2 to 3½ percent per month, computed on unpaid balance. These rates are either a fixed monthly percentage or a graduated charge with one rate applying to the first $100 or $150 of unpaid balance and with a lower monthly rate applying to the remainder. The percentage rate represents

an all-inclusive charge, covering the entire cost of the loan to the borrower.

The rise of personal finance companies reflects the need for credit facilities which will help consumers to finance unusual personal and family expenditures. The borrower may seek this type of financing either because of an accumulation of many small debts or because of a large expenditure which he is unable or unwilling to meet from a single paycheck or from savings. By borrowing in this way he is enabled to make a series of small regular payments from current income, and to spread them over a period of many months. This kind of credit was available before the rise of the personal finance company, but at exorbitant rates and without legal sanction.

QUANTITATIVE IMPORTANCE OF PERSONAL FINANCE COMPANY CREDIT

The significance of personal finance lending in the modern credit economy is indicated both by the volume of consumer debt to which it gives rise and by the number of individuals who avail themselves of small personal loans. Volume figures covering reporting licensed lenders in 27 of the states whose legal enactments resemble the Uniform Small Loan Law show total small loan receivables outstanding at the end of 1937 of about $338,000,000.[1] This figure, however, represents only the face amount of unpaid loan balances outstanding; it excludes interest due but not received, and interest to become due before the expiration of the current loans. If comparison is to be made with similar figures for other consumer instalment credit agencies, these items must be included.[2] We estimate that $47,000,000 to $54,000,000 should

[1] See Table 1.

[2] In the personal finance business customer notes cover only principal borrowed; interest is charged at inclusive monthly rates. In other fields of consumer credit, such as sales finance and personal loan credit from industrial banks and commercial banks, customer notes cover principal borrowed plus

be adequate to cover interest due and to become due.[3] The total personal finance debt may therefore be set at $385,-000,000 to $392,000,000. The consumer loan receivables of all cash-lending agencies combined may be set provisionally at approximately $900,000,000 as of the end of 1937; thus the personal loan companies held a little over two-fifths of the total. This volume of receivables of licensed personal finance companies has been built up over a relatively short span of years; two decades ago probably less than $20,000,000 was outstanding in licensed small loans.[4]

According to available data about 3,000,000 individuals, or approximately 9 percent of the estimated total of non-farm family and individual income-receiving units in the nation,[5] were borrowers from personal finance companies at the end of 1937.[6] Probably as many as 17 to 23 percent of all non-farm family and individual income-receiving units in

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finance charges. Instalment receivables outstanding in these other fields therefore contain a finance charge debt as well as a debt on unpaid principal account.

[3] The "interest due and to become due" item has been estimated from the formula $oi\frac{(d+2)}{3}$, in which o is outstandings, i is monthly interest rate, and d is duration of loan. According to information supplied by Rolf Nugent, Director of the Department of Consumer Credit of the Russell Sage Foundation, the average duration of personal finance loans approximates 15 months, and the average rate of charge is 2.8 percent. Using Nugent's figures in the above formula, we get $53,700,000. If instead of Nugent's figure of 15 months duration we use 13 months—a figure obtained for several states from a collections ratio (outstandings divided by average monthly collections)—we get $47,300,000 instead of $53,700,000. These two figures, then, give the estimated range within which the true value of interest due and to become due probably lies.

[4] Rolf Nugent, "Small Loan Debt in the United States," *Journal of Business*, University of Chicago, vol. 7, no. 1 (January 1934).

[5] The total number of family and individual income-receiving units of the nation for 1935-36 is estimated by the National Resources Committee to be 39,458,300 (*Consumer Incomes in the United States*, 1938, p. 6). From this total we exclude farm non-relief families, numbering slightly over 6,000,000, because only an insignificant fraction of personal finance company borrowers come from this group.

[6] As estimated by M. R. Neifeld of the Beneficial Management Corporation in *Personal Finance Comes of Age* (1939) p. 138.

the country obtained credit accommodation from personal finance companies during the period 1933-37.[7] Since in many states lack of permissive legislation precluded access to the services of licensed lenders, the states having legalized lending contained, of course, an even greater proportion of nonfarm income receivers using personal finance facilities over this period. In fact, the 3,000,000 or more borrowers from licensed lenders at the end of 1937 were concentrated in somewhat more than half the states, including the more populous industrial states, most of which have enacted comprehensive small loan laws.

PERSONAL FINANCE AND OTHER CONSUMER INSTALMENT CREDIT

The two principal types of consumer credit extended on instalment or serial repayment terms are cash loan credit and sales finance credit.[8] They cannot be contrasted, as is often done, on the ground that only the latter is concerned with a commodity transfer to a final consumer. It can only be said that sales finance credit is invariably associated with such a transfer, while cash loan credit, including personal finance, although often extended for the immediate purchase of commodities or services, is sought for many other purposes as well.

The essential feature of sales financing is an advance of credit for the purchase of a specific commodity, the resale value of which serves as technical security for the loan. The first extension of credit is by the retail dealer who, in effect, lends to the customer an amount that equals the selling price of the commodity plus charges for the credit—and possibly

[7] In relating the number of borrowers to the number of families plus single individuals, we are assuming that the number of instances in which two or more borrowers come from the same family is insignificant.

[8] See National Bureau of Economic Research (Financial Research Program), *Sales Finance Companies and Their Credit Practices,* by W. C. Plummer and Ralph A. Young (ms. 1939).

plus costs of insurance against theft or damage—minus the required down payment. The retail dealer often sells the instalment purchase contract to a sales finance company, and the customer undertakes to pay off his indebtedness according to a specified schedule of equal—ordinarily monthly—instalments. There has been no transfer of cash between the purchaser and the seller, but the former has, in effect, obtained an article by means of a loan.

The making of cash loans is the primary activity of personal finance lenders licensed under small loan laws. Many of these cash loans are used to purchase commodities, and a considerable number of personal finance companies actively encourage borrowing for this purpose. The chief features that distinguish personal finance from sales finance companies are that they deal directly with the borrower, extend only cash loans, state their aggregate charges usually as so many percent per month of the unpaid loan balance, and extend loans chiefly upon the "character" of the borrower, taking a chattel mortgage or other security primarily for psychological effect. Sales finance companies, on the other hand, do not ordinarily negotiate directly with ultimate consumers; they state their charges in many different ways that do not permit of ready comparison; and as security for the credit extended they value their equity in the commodity serving as collateral more highly than do personal finance companies.

There is, moreover, a basic legal distinction between the two types of credit. Under traditional legal doctrine any charge to an individual debtor for the use of borrowed money is interest, and is therefore subject to possible statutory regulation of interest rates. But the special charge imposed by sellers on instalment buyers is not interest within the legal meaning of the term; it is rather a differential charge added to the cash selling price to compensate the seller for the special costs, inconvenience and risks incurred in a credit

sale.[9] Thus in sales finance transactions buyers and sellers of commodities are free, so far as usury laws are concerned, to determine mutually acceptable finance charges by a process of bargaining, while cash lenders must conform in their charges to regulative statutes. The situation may change, however, when instalment purchase contracts are readjusted or extended in order to bring them within the purchaser's ability to pay and thus avoid default and repossession. New contracts to refinance instalment purchase deals are regarded by many sales finance companies as money loans, and hence as governed by statutory interest provisions.[10] In order to take advantage of the higher interest charges permitted under small loan laws, a number of sales finance companies operate licensed small loan affiliates whose business is primarily derived from the refinancing needs of instalment buyers.

Quantitatively the credit extended by sales finance companies is much more important than that extended by personal finance companies. The amount of instalment loan paper held by the licensed personal finance lenders is probably less than a third of that held by sales finance companies. While total outstanding consumer debt to personal finance companies approximated $385,000,000 at the end of 1937, a group of 224 automobile finance companies, whose business does not cover the entire field of automobile financing, held then over $1,000,000,000 in instalment receivables.[11] The inclusion of furniture, radio, refrigerator and other paper held by sales finance companies would swell the total considerably.

[9] Although charges made by sales finance companies are not now generally subject to usury laws, there is of course nothing in traditional legal doctrine to prevent regulation of the sales finance business.

[10] Legal doctrine in this matter is in a state of flux. According to a ruling of October 15, 1936, by the Indiana State Department of Financial Institutions, charged among other activities with the regulation of retail sales financing, a partially unperformed contract "may be modified by the agreement of the parties to extend the time and manner of payment so long as the finance charge is not more than it would have been if the contract had originally been entered into for the longer period."

[11] According to a Bureau of the Census release dated February 14, 1939.

Personal finance companies are not the only agencies extending small cash loans on an instalment basis. Morris Plan and other industrial banking companies, personal loan departments of commercial banks, credit unions and remedial loan societies are the principal other agencies of this type. Remedial loan societies were originally semi-philanthropic agencies, but several of them are now strictly commercial ventures; they make loans at comparatively low rates of charge, but their resources at present suffice to meet only a very small fraction of the consumer credit demand which responds to such low rates. Credit unions are cooperative societies with rates also relatively low and with resources derived largely from member deposits. Their loan volume is much smaller than that of any other cash-lending agency except remedial loan societies. Industrial and Morris Plan banking companies and personal loan departments of commercial banks are in many ways the closest rivals of personal finance companies in the consumer cash loan field. In types of service both compete, in greater or less degree, with personal finance companies, but while the latter are usually restricted to a maximum loan of $300, industrial and commercial banks make consumer loans up to $2000 and more. The banks charge lower rates than those of personal finance companies, but they average larger loans and they draw borrowers from more secure and more stable economic classes.

GEOGRAPHIC DISTRIBUTION OF PERSONAL FINANCE COMPANY FACILITIES

The scope of personal finance company operations in 29 of the 34 states that have enactments resembling the Uniform Small Loan Law is shown in Table 1, which gives the number of licensees and the volume of reported outstandings at the end of 1937, both in absolute figures and per 100,000 of population. More than 3,600 licensees were reported by the

American Association of Personal Finance Companies, and over 3,300 were reported by state supervisory authorities; for the 27 states for which data were available receivables outstanding totaled $338,000,000. The greatest proportion of lending activity was in leading industrial and semi-industrial states, 9 of which accounted for more than three-fourths of receivables and for almost three-fourths of the loan offices.[12] Wide variations among states in average outstandings per loan office make the number of loan offices a less significant figure than the volume of outstandings in judging the relative concentration of personal finance lending; Pennsylvania with 502 licensees is first in number of loan offices, but ranks after New York and Ohio in outstandings.

The relative availability of personal finance facilities is most readily gauged by the density of loan offices per 100,000 of population, which varied in 1937 from 0.2 in Tennessee to 9.1 in Colorado. With three exceptions, Missouri, New Jersey and New York, all states reporting outstanding unpaid balances in excess of $10,000,000 had a loan office density of 4 or more per 100,000 of population. Available information indicates that facilities are almost non-existent where maximum legal rates of charge are relatively low,[13] as in Tennessee, and that where the small loan law empowers the state banking department to restrict the number of licensees in any particular community, as in New Jersey and New York, facilities are less numerous than in other states.

The comparative utilization of personal small loan facilities is clearly shown by outstandings per 100,000 of population. In general, states having a loan office density of 4 or above show outstandings per 100,000 of population of $300,000 or more. The ranking of states differs considerably, however, as between availability and utilization of facilities.

[12] In order of importance, according to receivables outstanding: New York, Ohio, Pennsylvania, Illinois, Michigan, Massachusetts, Indiana, New Jersey and Missouri.

[13] The effects of reductions in maximum legal rates are discussed in Chapter 7.

TABLE 1

GEOGRAPHIC DISTRIBUTION OF PERSONAL FINANCE COMPANIES IN 29 STATES, AND THEIR RECEIVABLES OUTSTANDING, DECEMBER 31, 1937[a]

State	Licensees Reported			Outstandings	
	By Amer. Assoc. of Personal Fin. Cos.[b]	By State Banking Depts.	Per 100,000 of Population[c]	Rep. by State Banking Depts. (in thousands)	Per 100,000 of Population[c]
Arizona	32	[d]	7.8	$ 1,276[e]	$311,980
Colorado	98	98	9.1	[d]	[d]
Connecticut	81	88	5.0	7,543	432,016
Florida	75	43	2.6	2,976	179,927
Georgia	7	8	.3	[d]	[d]
Illinois	354	358	4.5	35,054	443,722
Indiana	301	274	7.9	17,229	495,086
Iowa	136	117	4.6	7,675	299,688
Kentucky	32	32	1.1	3,069[f]	105,682
Louisiana	82	80	3.7	6,610	309,312
Maine	32	13	1.5	2,264	263,562
Maryland	129	112	6.6	9,773	579,656
Massachusetts	206	183	4.1	20,744	465,530
Michigan	192	191	4.0	22,411	465,248
Missouri	97	92	2.3	10,167	255,004
Nebraska	107	72	5.2	5,662	412,082
New Hampshire	9	[d]	1.8	105[g]	20,508
New Jersey	102	105	2.4	15,946	365,818
New York	271	265	2.0	53,067	407,393
Ohio	460	421	6.2	50,064[f]	740,482
Oregon	49	46	4.5	1,935	188,965
Pennsylvania	502	502	4.9	40,762	399,314
Rhode Island	67	61	8.9	4,705	685,860
Tennessee	6	[d]	.2	411[f]	14,251
Utah	25	18	3.5	1,369[h]	263,776
Vermont	10	9	2.3	446	116,449
Virginia	73	68	2.5	6,246	232,193
West Virginia	42	41[i]	2.2	4,552[i]	246,978
Wisconsin	42	43	1.5	5,801	198,054
TOTAL	3,619	3,340	3.6	337,862	384,833

[a] Of the 34 states that have enactments resembling the Uniform Small Loan Law we have included all for which data are readily available.
[b] American Association of Personal Finance Companies, *Roster of Personal Finance Companies in the United States* (1938). These data are as of July 1, 1938.
[c] Based on population estimates contained in *Annual Report, Comptroller of Currency* (1937). In deriving figures for number of licensees per 100,000 of population the number of licensees reported by state banking departments is used in the 26 cases where it is available; otherwise the *Roster* figure is used.
[d] Not available.
[e] As of July 1, 1937.
[f] After deduction of reserves for bad debts.
[g] Estimated.
[h] As of November 30, 1937.
[i] As of July 1, 1938.

Thus Ohio, with a loan office density of 6.2, utilized these facilities to the extent of $740,000 per 100,000 of population, but Arizona, with a loan office ratio of 7.8, showed outstandings of only $312,000 per 100,000. No simple explanation of these differences can be advanced. They can be accounted for in some measure by the relative concentration of population in urban industrial areas, and by the income and industrial composition of the population. High maximum legal rates appear to exercise some influence, permitting lenders to extend loans more freely among less reliable borrower groups. Another factor, of course, is the period of time during which legalized small lending has been practiced at rates attractive to lenders, a longer period enabling lenders to adjust their facilities more effectively to demand. One large chain lender has found that communities seemingly similar in all outward respects may contain widely varying numbers of borrowers, but it is not possible to say whether the reason lies in management, in varying local attitudes toward debt or in some other factor not readily perceivable.

LEGAL BASIS OF PERSONAL FINANCE COMPANY OPERATIONS

The personal finance business in its present form is an adaptation to specific legislative enactments. In most states until comparatively recently general statutory requirements as to interest charges precluded the lending of small sums at a profit, and this credit function was therefore fulfilled only in defiance of the law and at usurious rates. Sanction for higher legal charges was acquired only when the high-cost character of the small loan business became sufficiently widely recognized to compel permissive legislation. Underlying this legislation was a belief that statutory limitations on maximum interest rates must be relaxed in order to bring under regulation the lending of small sums to consumers, and to

encourage the flow of legitimate capital into such lending. In return for legal sanction of special interest charges lenders were required, for the protection of the borrower, to be licensed and to conform to certain standards of lending and collection in such matters as form of contract, maximum size of loan, repayment before maturity and penalties for infractions of the law.

The formulation of a practical model for uniform legislation in this field resulted largely from the work of two agencies, the Russell Sage Foundation and the National Federation of Remedial Loan Associations. Promotion of better standards in the lending of small sums has been a primary objective of the Russell Sage Foundation.[14] In 1907, the year of its establishment, this organization adopted a program actively sponsoring research in the small loan field and promoting the work of the remedial loan societies; later it cooperated closely with the National Federation in opposing unregulated lending and urging the passage of adequate small loan legislation. The National Federation was organized in 1909 to unify the work of the remedials, and Arthur H. Ham, a pioneer research worker in the small loan field for the Russell Sage Foundation, was active in both organizations. Within a few years many unlicensed lenders began to recognize the advantages that would accompany legal sanction of their operations, and in 1916 representatives of commercial lenders, remedial loan societies and the Russell Sage Foundation agreed upon a compromise plan for a Uniform Small Loan Law. This proposed law, in its original or in an amended form, has served as the model for most small loan legislation enacted since 1916.[15]

The sixth and latest draft of the model law was published

[14] See L. N. Robinson and Rolf Nugent, *Regulation of the Small Loan Business* (1935) pp. 85-87. We are indebted to this study for much of the historical material used here.

[15] For a more detailed history of the various drafts of the Uniform Small Loan Law see Robinson and Nugent, *op. cit.,* Chapter 6, and F. B. Hubachek, *Annotations on Small Loan Laws* (1938) pp. 4-6, 53-54.

in January 1935, and a seventh draft is in preparation (1939).[16] Drafts subsequent to the first have clarified various provisions and extended the scope of state supervisory powers. Recently the important changes have concerned rates; the principal modification introduced by the sixth draft was the substitution of a graduated rate, as described below, for the earlier fixed maximum rate of 3½ percent.[17] A summary of the chief provisions of the sixth draft follows:

Size of Loan. Loans are limited to a maximum of $300. This amount was chosen after preliminary studies of the market for small loans, and the limitation serves to restrict the lending activities of licensees.

Maximum Rate. The proposed maximum rate is 3½ percent per month on the unpaid balance up to $100, and 2½ percent per month on the remainder. No other charges or fees are permitted, and interest cannot be deducted in advance or compounded.[18] The borrower may repay in full before scheduled maturity, and may be charged only for the period during which he has the use of the money.

License. A license is required for each office. The supervisory authority, usually the state banking department, may license only persons of approved character and must consider community needs for additional loan office facilities. Applicants must have liquid assets of $25,000 per office, and must file a surety bond of $1000 or more to insure compliance with the law and protection of borrowers. No other business may be conducted in connection with the loan business without the consent of the licensing authority.

Supervision. To enable the supervisory authority to enforce the law, lenders must keep adequate records, file an annual report and permit examination at least once a year. The specified

[16] The seventh draft is not expected to differ substantially from the sixth.
[17] In proposing the initial maximum rate the Foundation recommended that it be reconsidered by each state after a reasonable period.
[18] The term "interest," when used for the charges of licensed lenders, includes all sums which the borrower may be required to pay; when employed by other lenders it may and frequently does include only a part of the charges paid by the borrower.

licensing official is authorized and empowered to make such general rules and regulations as may be necessary for the proper conduct of the business and enforcement of the law.

Regulations with Borrowers. Lenders must refrain from using misleading advertising. The borrower must receive a clear written statement of the terms of his contract, receipts for payments made, and the canceled note and security upon final payment. The lender must not accept from the borrower a note that is incompletely drawn, or a power of attorney or confession of judgment. Loans require the written consent of both husband and wife when made on the security of wage assignment or chattel mortgage on household furniture.

Penalties. Both licensees and unlicensed lenders are criminally liable for violation of the law; in such event their loans are void and their licenses, if any, suspended or revoked.

Exemptions. National and state banks, savings banks, trust companies, building and loan associations, credit unions and licensed pawnbrokers are exempted from the law.[19]

Small loan legislation of some kind had been adopted in 19 states and the District of Columbia by 1921, a number since increased to 39, including most of the leading industrial states. On December 1, 1939, the District of Columbia, Hawaii and 34 states had legislation resembling the model law, while in the remaining 5 states the small loan legislation deviated widely from the model. These two groups of states are classified in Table 2 according to the maximum rate of charge permitted. Of the total number, 5 states have a fixed maximum rate of 3½ percent per month on unpaid balance, and another 5 have a fixed maximum of 3 percent; others have various combinations of rates, and a few have fees. The 9 states which have no special laws covering small loans are: Idaho, Kansas, Montana, Nevada, North Dakota, Oklahoma, South Carolina, South Dakota and Washington.

[19] The intent of this provision is to exclude from the requirements of the law credit agencies that charge substantially lower rates or are regulated under other statutes.

TABLE 2

SMALL LOAN LEGISLATION AS OF DECEMBER 1, 1939, CLASSIFIED BY CONFORMITY TO UNIFORM SMALL LOAN LAW AND BY MAXIMUM CHARGES AUTHORIZED[1]

LAWS RESEMBLING THE UNIFORM SMALL LOAN LAW	MAXIMUM MONTHLY CHARGE ON UNPAID PRINCIPAL BALANCE
With flat maximum rate of charge	
Arizona, Florida, Louisiana, Maryland, Virginia	3½%
Minnesota, Ohio,[2] Oregon,[3] Rhode Island, Utah	3%
New Jersey	2½%
New Hampshire[4]	2%
Georgia[5]	1½%
District of Columbia[5]	1%
Arkansas[5,6]	10% per year
Alabama[5]	8% per year
With graduated maximum rate of charge	
Kentucky, West Virginia	3½% on first $150; 2½% on remainder
Hawaii	3½% on first $100; 2½% on remainder
Illinois, Maine,[7] New York	3 % on first $150; 2½% on remainder
Michigan	3 % on first $100; 2½% on remainder
Iowa,[8] Massachusetts,[8,9] Pennsylvania[10]	3 % on first $150; 2 % on remainder
Indiana[8,11]	3 % on first $150; 1½% on remainder
Connecticut	3 % on first $100; 2 % on remainder
Missouri[12]	3% on loans of $100 and less; 2½% on loans of more than $100
Vermont	2½% on first $125; 2¼% on remainder
California[13]	2½% on first $100; 2 % on remainder
Wisconsin[8]	2½% on first $100; 2% on second $100; 1% on remainder
With other forms of charge	
Colorado, Nebraska, New Mexico	10% per year, plus other charges[14]
Tennessee	6% per year, plus expense fee[5,15]

LAWS WHICH DO NOT RESEMBLE THE UNIFORM SMALL LOAN LAW

Delaware—Applies to loans up to $500. Rate is 6% per year, computed on original amount of loan and payable in advance, plus service charge of 2% of the loan.

Mississippi—10% per year plus fees that vary with size of loan. Company subject to $2000 privilege tax if rate of interest exceeds 20% per year.

North Carolina[16]—6% per year.

Texas—Loans subject to 10% per year maximum interest rate fixed by usury law and state constitution.

Wyoming[16]—25% per year.

[1] We are indebted to Frank B. Hubachek, counsel for the Household Finance Corporation, for help in revising this table and bringing it up to date. All rate quotations are maximum rates per month on unpaid balance, unless otherwise indicated.

As a possible alternative to classifying existing small loan legislation according to this standard Mr. Hubachek suggests a classification based upon the effectiveness of the legislation. Such a classification requires at least three subdivisions: effectiveness in providing capital to be lent; effectiveness in regulating the lawful lending business; and effectiveness in preventing high-rate lending. Mr. Hubachek has kindly supplied us with the following listing based on these criteria.

Laws in 27 states, and in Hawaii, resemble a draft of the Uniform Small Loan Law and meet the first test of effectiveness and in many cases the second and third: Arizona, California, Connecticut, Florida, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Utah, Vermont, Virginia, West Virginia, Wisconsin.

Laws in 3 states—Colorado, Nebraska, New Mexico—differ materially in rate structure and other provisions from the Uniform Draft, but those in the first two have been effective in creating an adequate source of credit; the third has not been in effect long enough to permit judgment. None of these laws has succeeded in regulating legal lenders or in prohibiting illegal lending.

Laws in 4 states—Alabama, Arkansas, Georgia and Tennessee—and in the District of Columbia resemble the Uniform Draft but permit such a low maximum rate that they are totally ineffective.

Laws in 5 states—Delaware, Mississippi, North Carolina, Texas and Wyoming —are fragmentary and ineffective, yet they contain enough material to be included under small loan legislation.

[2] Fee of $1 on loans of $50 or less; on loans of more than $300 small loan rate permissible up to $300 and usury rate of 8 percent per year on balance.

[3] Minimum charge of $1 per month on secured loans.

[4] Fee of $1 on loans of $50 or less; $2 fee on loans over $50.

[5] Maximum rate alleged to be too low to enable licensed lenders to operate.

[6] Maximum interest rate of 10 percent per year is fixed by general usury law and state constitution.

[7] Minimum charge of 25 cents per month.

[8] Rate subject to administrative control.

[9] This is rate on chattel loans and comaker and endorsed paper. Other rates are: unsecured loans, 3 percent per month on first $150, 2½ percent on remainder; real estate loans, 2 percent per month; loans secured by certain bonds, stocks, bank books or insurance policies, 1 percent per month.

[10] Rate of 6 percent per year on balances outstanding after 18 months.

[11] Fee of 50 cents on certain loans.

[12] Note that rate is graduated according to amount of loan instead of according to unpaid balance.

[13] The maximum rate is a flat 2 percent per month when the security taken is insured for the benefit of the lender.

[14] Provisions regarding fees and charges are obscure.

[15] This fee (not to exceed 1 percent per month) is not an authorization but a limitation. Only expenses incurred may be charged.

[16] Licenses not required; regulation fragmentary.

ORGANIZATIONAL STRUCTURE OF PERSONAL FINANCE COMPANIES

The Uniform Small Loan Law does not require any particular type of structure for lending companies, and therefore loan offices are operated by individuals and partnerships as well as by corporations. The corporate form of organization was seldom used before the adoption of small loan legislation, but has since become increasingly important, particularly with the rise of chain lending and the great increase in the number of chain offices.

In the period that preceded the drafting of uniform legislation personal finance lending was carried on both by chain offices and by independent, single-office units, the former usually operating under distinctive names without revelation of common ownership. The beginning of licensed lending was marked by a substantial, though temporary, decline in chain organization; some chain lenders transferred their loan funds and equipment to states that had not adopted the model small loan law, while others, in becoming licensed lenders, consolidated their offices. Those operating single offices generally found it too inconvenient to shift their operations to unregulated states, and many became licensed lenders.

Although chain business was comparatively small in the first years of licensed lending, it grew rapidly after 1920, resulting in a significant concentration of personal finance business in the hands of a few chain companies.[20] This is shown by the record of the two largest companies: the Beneficial Industrial Loan Corporation owned 54 offices in 1922

[20] The concentration of the personal finance business in the hands of chain lenders is strikingly illustrated by Indiana data. In 1937 about 55 percent of the number of offices and 73 percent of total employed assets were controlled by chains; these figures, incidentally, reveal the larger average size of the chain office. The offices of local chains, more numerous than those of outside chains, controlled a proportionate share of the total assets—roughly 50 percent; outside chains, with only 8 percent of the offices, held as much as 21 percent of all personal finance assets. See Table 35, p. 119.

but rose to 303 in 1932 and 372 at the close of 1937; the Household Finance Corporation, with 35 offices in 1918 and 62 in 1927, had 151 by 1932 and 215 (not including 13 in Canada) at the close of 1937. According to a recent estimate chains held 66 percent of all outstandings of licensed personal finance companies at the close of 1932, at which time the two largest chains, Beneficial and Household, had 30 percent of all the business.[21] At the end of 1937 Beneficial had $72,000,000 of receivables and Household $61,000,000, the two companies together holding almost 40 percent of the $338,000,000 outstandings that were reported for the entire country.

The chief advantages enjoyed by chain organizations are: easier access to sources of capital; mobility of capital, in that funds may be transferred from office to office in accordance with the demand for loans; geographic diversification of risk, including the risk of reductions in legal rates of charge; economies of large-scale organization, permitting the development of more refined and more systematic accounting controls.

Despite the advantages of chain-office organization, many independently operated loan offices are reported to be profitable enterprises, particularly in communities where competing offices are few. Even where the market is shared with chain offices, they frequently compete effectively for business. Long-established relations with customers may account for the success of an independent office, community goodwill obviating the necessity for advertising expense. Again, an independent office operated by a skilful owner-manager, using part-time employees and unpretentious office quarters, may enjoy lower salary and overhead expense than the typical chain office. Advantages derived from convenient office location, a vital factor in attaining profitable loan volume, may

[21] Robinson and Nugent, *op. cit.*, p. 143. The above discussion of chain lending and single-office lending is based upon pp. 141-44 of Robinson and Nugent.

account for the success of a particular independent lender. Finally, an independent lender may successfully compete with a chain lender in the same community by having less exacting credit requirements; though he may thus incur higher losses he compensates them by charging higher rates.

The absorption of independent offices is one method by which chain organizations have expanded; establishment of new offices is another; enlargement of existing offices a third. Extension in the number of loan offices operated under one management has usually resulted from a combination of these methods, though one large chain declares that it expanded, as a matter of policy, primarily through the establishment of its own new offices.

SOURCES OF FUNDS

The financing of small loan companies has developed along familiar lines, with some modifications arising from the unique character of the business. In the earliest stage practically all capital consisted of the investment of individual entrepreneurs. Then the reinvestment of earnings played an important and even a dominant role. Next the marketing of both stocks and bonds, the latter carrying high coupon rates and sometimes profit-sharing provisions, was undertaken by the loan companies themselves. Finally, toward the end of the 1920's, the flotation of securities was accepted by established investment banking houses, and the facilities of the short-term money market began to be used increasingly by the leading companies.

The changing financial structure of personal finance companies during recent years, though partly ascribable to altered capital market conditions and to the sharp decline in interest rates, mirrors the changing status of this business within the national economy. These companies now have

comparatively easy access to the leading credit facilities of the financial world—commercial banks, the commercial paper market and the security markets—a development that signals their recognition as stable, established financial agencies. The change, particularly marked in the case of chain lenders, is apparent even in so short a period as 1929-37.

This is evident from Table 3, which shows the relative importance of invested and borrowed capital for two groups of chain lenders in 1929, 1933 and 1937, and for a third group in 1937. Total assets doubled during this period, but while the equity capital (common stock and surplus) of the two largest chains and of five other chains was more than half of total assets in 1929, it amounted to only about one-third in 1937. The latter ratio was paralleled very closely by thirteen other chains in the same year. Preferred stock also showed a tendency to decline in relative importance as a source of funds. Borrowed capital, on the other hand, increased both relatively and absolutely, for although the small amount of funded debt existing in 1929 had practically disappeared by 1937, the proportionate importance of short-term debt more than doubled for the five chains and more than tripled for the largest two.

Today chain companies not only obtain a large part of their short-term funds from commercial banks but, in addition, sell notes in the open market through commercial paper dealers. In Table 4 wherever notes payable have a peak level greater than the bank credit line the excess indicates funds obtained through the open market, although this by no means measures the total of funds so obtained.[22] One company, the Industrial Bankers' Securities Corporation, reported in 1937 a peak level of notes payable that was double the amount of its bank line.

[22] Even companies whose notes payable have peak levels below the bank lines may be selling some of their notes in the open market.

TABLE 3

SOURCES OF FUNDS OF SELECTED PERSONAL FINANCE CHAINS, 1929, 1933, 1937, IN PERCENT OF TOTAL ASSETS[a]

Source of Funds	*2 Largest Chains*			*5 Other Chains*			*13 Other Chains*
	1929	1933	1937	1929	1933	1937	1937
Total borrowings	*12.8*	*22.0*	*33.8*	*18.7*	*11.9*	*34.1*	*40.6*
Short-term debt	10.3	16.5	33.8	14.9	10.4	33.8	26.6
Funded debt	2.5	5.5	0.0	3.8	1.5	.3	14.0
Total capital stock and surplus	*77.5*	*72.6*	*59.5*	*79.4*	*85.5*	*54.6*	*42.2*
Preferred stock	22.6	24.1	20.0	25.7	16.2	20.9	9.0
Common stock and surplus	54.9	48.5	39.5	53.7[b]	69.3[b]	33.7[b]	33.2[b]
Total assets							
In thousands of dollars	$ 77,513	$ 89,079	$ 143,544	$ 15,688	$ 17,753	$ 32,854	$ 48,863
In percent of 1929	100.0	115.0	185.0	100.0	113.0	210.0	.....

[a] Based on data obtained from the National Credit Office, Inc. Percentages do not add up to 100; the difference represents capital and other reserves.

[b] Common stock and surplus ratio obtained by subtracting preferred stock from total capital stock and surplus. The common stock and surplus item may be overstated, and the preferred item understated, since in some cases preferred stock was not reported separately and hence was not included specifically as preferred stock.

TABLE 4

BANK LINES OF SELECTED PERSONAL FINANCE CHAINS, AND PEAK LEVEL AND LOW POINT OF NOTES PAYABLE, 1937[a]

Company	*Bank Line*	*Peak Level of Notes Payable*	*Low Point of Notes Payable*
American Investment Company of Illinois	$ 3,850,000	$ 3,563,960	$ 2,722,740
Beneficial Industrial Loan Corporation	35,000,000	29,800,000	17,400,000
Capital Loan and Savings Company	1,950,000	1,800,000	660,000
Commonwealth Loan Company	4,100,000	3,700,000	2,160,000
Family Loan Society	3,905,000	[b]	[b]
Household Finance Corporation	25,500,000	22,625,000	14,390,000
Ideal Financing Association	1,275,000	[b]	[b]
Industrial Bankers' Securities Corporation	600,000	1,200,000	800,000
Local Loan Company of Delaware	1,550,000	2,020,000	1,170,000
Monroe Loan Society	300,000	575,000	395,000
North American Finance Corporation	250,000	360,000	200,000
Railroad Employees Corporation	650,000	600,000	190,000

[a] Based on data obtained from the National Credit Office, Inc.
[b] Not available.

The terms on which funds are obtained from banks are less favorable for personal finance companies than for sales finance companies.[23] Reports from larger banks in principal centers indicate that at the end of 1938 maximum maturities on notes of both agencies ranged mainly from 3 to 6 months, but that the most frequent maturity required of sales finance companies was 6 months while for personal finance companies it was only 3 months; similarly, interest rates on loans to the two agencies showed much the same range, but the rates

[23] See the discussion of bank financing of personal finance companies in National Bureau of Economic Research (Financial Research Program), *Commercial Banks as Agencies of Consumer Instalment Credit,* by John M. Chapman and Associates (ms. 1939) Chapter 8.

most frequently charged were higher for personal finance companies than for sales finance companies. This difference in credit standing with banks appears paradoxical. According to one banker who has had long experience in lending to both types of consumer instalment credit agencies, there have been several sales finance companies that have fallen into financial difficulties of some kind over the last fifteen years, but it would be hard to name a single personal loan company that has encountered serious trouble.

For comparing the independent offices' sources of funds with those of chain offices data are available only for Indiana. Table 5, presenting this information, shows that in this state independent individuals and partnerships depend less on bor-

TABLE 5

SOURCES OF FUNDS OF 274 PERSONAL FINANCE LICENSEES IN INDIANA, DECEMBER 31, 1937, IN PERCENT OF TOTAL ASSETS[a]

Source of Funds	*Indiana Chains*	*Out-side Chains*	*Inde-pendent Indi-viduals*	*Partner-ships*	*Affili-ated Com-panies*	*Inde-pendent Corpo-rations*	*All Com-panies*
Total debt	*37.9*	*34.8*	*24.2*	*3.5*	*67.0*	*43.6*	*39.4*
Short-term debt	30.3	27.9	20.0	...	22.9	35.7	28.4
Other current liabilities	6.4	6.9	4.2	3.5	37.7	6.1	8.3
Funded debt	1.2	...	...	...	6.4	1.8	2.7
Total capital stock and surplus	*59.4*	*60.6*	*73.6*	*96.3*	*30.8*	*53.3*	*56.9*
Common stock, surplus, proprietorship	40.8	35.4	73.6	96.3	10.7	39.2	34.8
Preferred stock	18.6	25.2	...	...	20.1	14.1	22.1
Number of reports	127	23	31	10	6	77	274

[a] Based on Indiana, Department of Financial Institutions, *Annual Report, July 1, 1937, to June 30, 1938,* pp. 139 and 142. Percentages do not add up to 100; the difference represents capital and other reserves.

rowed capital than do state chains, "outside" chains, affiliated companies and independent corporate lenders. In considering the Indiana figures it should be borne in mind, however, that parent companies extend loans to their subsidiaries, and that therefore what appears as borrowed capital on the balance sheets of subsidiaries may in fact represent funds that the parent concern has raised through the sale of its securities. To the extent that this occurs, the borrowed capital of outside chains and affiliated small loan companies stands in a lower ratio to the invested capital than is here indicated. Nevertheless, even the independent corporate lenders in Indiana use relatively more borrowed capital than do independent individuals and partnerships. One explanation is that since unincorporated lenders operate small offices, probably with a stable volume of business, short-term borrowing is unnecessary. Chains and incorporated independent lenders operating larger offices have a greater need for bank accommodation to finance their operations.