Volume Title: Sales Finance Companies and Their Credit Practices

Volume Author/Editor: Wilbur C. Plummer and Ralph A. Young

Volume Publisher: NBER

Volume ISBN: 0-870-14461-8

Volume URL: http://www.nber.org/books/plum40-1

Publication Date: 1940

Chapter Title: Sales Finance Companies As Credit Agencies

Chapter Author: Wilbur C. Plummer, Ralph A. Young

Chapter URL: http://www.nber.org/chapters/c5655

Chapter pages in book: (p. 33 - 53)

# 1

# Sales Finance Companies as Credit Agencies

DURING the period 1915 to 1929 retail instalment selling in this country experienced an enormous growth, a development that was accompanied by the rise of a new kind of financial institution in the form of the sales finance company. This new type of credit business grew to a billion-dollar size within a few years' time, and today, in volume of credit extended, it easily dominates the entire field of consumer instalment financing.

Sales finance companies may be described provisionally as specialized financial institutions which extend credit through retail dealers to consumers, thus enabling dealers to sell and consumers to buy goods on the instalment plan. In other words, sales finance companies are institutions which customarily purchase at discount the credit instruments that are given to retail dealers by their instalment-buying customers. These institutions are known variously as finance, credit, discount, trust, contract-purchasing or acceptance companies.

## RISE OF SALES FINANCE COMPANIES

Before 1915 there were few companies in the United States that made a business of financing for retail dealers their open and instalment accounts receivable. Of the leading companies now identified with the business, only six date their original organization prior to that year: Bankers Commercial Corporation, first established in 1904 as Fidelity Contract Corporation to discount retail piano paper; Commercial Investment Trust Corporation and National Bond and Investment Company, both organized in 1908; Pacific Finance Corporation, dating its origin in 1910; Commercial Credit Company and Northern Finance Company, both formed in 1912. About 1915 several of the existing companies introduced instalment financing of automobile sales, and a number of new companies were organized to specialize in instalment paper originating in this field. The subsequent founding of sales finance companies was notably rapid, and within the span of twenty years many hundreds were organized.

It is not known exactly or even approximately how many companies have been established, or what annual changes in their number have taken place. Not all companies entering the business have stayed in it, and many of the companies formed have later consolidated with others. Moreover, the field of operation of sales finance companies is vaguely defined, shading off into the small loan and industrial banking businesses, and this adds to the difficulty of determining their number.

For several years a common estimate of the number of separate sales finance companies has been "more than a thousand." The National Association of Finance Companies estimated that there were 1,297 such companies in 1928 and that this number had fallen to 1,099 by January 1, 1934.[1] The Census of Business for 1935 included an enumeration of "instalment finance companies,"[2] according to which there were 2,331 "establishments" (counting units of branch systems as separate establishments) in that year. Of this number 1,386 were single-unit companies; consequently, according to this census, there were at least that many separate companies. The remaining 945 were branches, but it is not known

[1] National Association of Finance Companies, press release, April 5, 1934.
[2] This term is used by the Census of Business to designate sales finance companies.

how many separate companies owned these branches. Whatever that number was, it would be added to the 1,386 single-unit companies to obtain the total number of sales finance companies for the year 1935.

The Census of Business found that the 2,331 establishments had 18,639 full- and part-time employees, of whom 2,230 were executives and salaried corporation officers, and that for these employees the payroll for the year amounted to $30,936,866. It reported, in addition, 598 active proprietors and firm members of unincorporated businesses who devoted the major portion of their time to the business; the compensation of this group was not ascertained.[3]

Many of the existing companies devote themselves exclusively to the financing of a particular commodity. Some of them specialize in financing automobiles in general or a particular make of automobile; others specialize in financing furniture or electric appliances; and there are some which purchase paper arising from the sale of any or all kinds of goods. Some of the finance companies are subsidiaries of manufacturers, having been organized by the manufacturer to help market his product by providing necessary credit facilities.

The growth of sales finance companies and the growth of instalment selling have been closely interrelated. The selling of automobiles on the instalment plan resulted in a demand for some special agency to finance the sales, and the finance companies which were organized to supply this need furthered the growth of instalment buying by providing the necessary credit facilities for the extension of the system. Each new increase in instalment buying caused a still greater demand for the services of the finance companies, with a consequent increase in the size and number of such companies.

[3] U. S. Department of Commerce, Census of Business, 1935, *Financial Institutions Other than Banks* (January 1937) pp. 9-11.

## ACTIVITIES OF SALES FINANCE COMPANIES

The procedure followed in financing instalment sales is not always the same, but some generalization is possible. When an individual buys an article on the instalment plan he is usually required to make a down payment, which may be in cash or wholly or partly in the form of a trade-in, and to sign a credit instrument for the balance plus the finance charge and in some cases insurance. This balance is payable in instalments, usually equal in amount, at equal intervals of time, ordinarily monthly but in some cases weekly, quarterly or semi-annually. The dealer, if he wishes and is able to do so, sells the contract to a finance company and thus receives cash for his goods. In some cases his responsibility for the fulfilment of the contract ends with its sale to the finance company; when the sale is made in this way the procedure is known as selling without recourse. In other cases the dealer continues to be responsible until the debt is fully paid by the purchaser; a transaction made on these conditions is known as selling with recourse.[4] In either case the collection of the instalments is in the hands of the sales finance company.

While the primary function of sales finance companies is retail financing—that is, lending, through retailers, to individual instalment purchasers—they may also engage in wholesale financing. At the present time this is an important part of the instalment system, for without it instalment selling could not be carried on in its present volume. Through wholesale financing dealers are supplied funds with which they can buy goods, and through retail financing they are enabled to sell the goods on the instalment plan. The first makes it possible for the manufacturer to be paid in cash for goods that he sells to the dealer, and the second makes

[4] There are of course many variations between recourse and non-recourse business. The entire question of loan and credit procedure is discussed more fully in Chapter 4.

it possible for the dealer to receive cash immediately for the goods he sells to his customer.

The retail financing conducted by sales finance companies pertains principally to consumer goods, but to a considerable extent it includes also producer goods. The present study is concerned only with the sales finance company as an agency extending consumer credit, but the fact that it extends also producer credit must be made clear in order to give a complete picture of its activities. The distinction between consumer goods and producer goods is highly useful, though in some cases it is hard to draw the dividing line. In general such goods as passenger automobiles, furniture and appliances for use in the home, clothing and jewelry in the possession of the user, may be thought of as consumer goods, while taxicabs, business vehicles, agricultural implements, appliances sold to small businessmen for use in their businesses rather than in their homes, may be thought of as producer goods. To the extent that sales finance companies finance the purchase of goods in the latter classification they are extending credit to producers as well as consumers.

Some companies not only finance commodity purchases, wholesale and retail, but also discount open accounts receivable or engage in the business of making small loans or conduct still other types of business activity. This diversification of activity finds expression in the membership rules of the two trade associations in the field. The National Association of Sales Finance Companies[5] will not accept new members who have more than 25 percent of their outstandings in small loans. Aside from this limitation it welcomes any company engaged in the business of purchasing instalment contracts, whether these arise from the sale of motor vehicles or from the sale of any other kind of commodity. It also accepts

[5] This is a trade association organized in 1924 as the National Association of Finance Companies. The name was changed in 1935 by the addition of the word "Sales" to indicate the predominant type of finance business conducted by the members.

companies engaged in the business of financing doctors' and dentists' bills and insurance premiums. Quite a number of its members do not engage in automobile financing. The American Finance Conference,[6] in its membership eligibility rules, provides that companies applying for membership must be engaged principally in the instalment financing of automobiles and that 50 percent of their outstanding receivables must be in the form of discount paper as contrasted with small loans. Discount paper on products other than automobiles may be included with that on automobiles in meeting the 50 percent rule.

Some fragmentary data give an indication of the relative importance of various types of business conducted by sales finance companies. It was estimated in 1933 that automobile paper (retail and wholesale) represented at that time 90 percent of the total volume of receivables purchased, though to an increasing extent sales finance companies had participated in the financing of other articles.[7] Of 788 companies included in a computation in that year, 212 did no automobile financing.[8] During the early 1930's some sales finance companies extended their activities into the small loan field, and subsequently small loan companies have increasingly extended their business to include the financing of instal-

[6] In the autumn of 1933 the National Association of Finance Companies, in an effort to curb undesirable "business buying" practices, prepared a National Recovery Administration Code. Much opposition was aroused among the "independent" companies, who claimed that the proposed code perpetuated technical practices that permitted "coercion" by the "big three" (General Motors Acceptance Corporation, Commercial Investment Trust Corporation and Commercial Credit Company). As a result they formed another trade body, the Mid-West Finance Conference, which subsequently became the American Finance Conference. Many sales finance companies are members of both the National Association of Sales Finance Companies and the American Finance Conference.

[7] Statement of R. P. Babcock, *Hearing on a Code of Fair Practices and Competition for the Finance Company Industry,* National Recovery Administration (October 26, 1933).

[8] *Ibid.,* Exhibit H, p. 12.

ment sales. Table 1 shows the distribution of the various types of business conducted by 48 sales finance companies, as of the end of 1937.

It may be said, in short, that sales finance companies are

TABLE 1

PERCENTAGE DISTRIBUTION OF OUTSTANDING RECEIVABLES OF 48 SALES FINANCE COMPANIES, YEAR-END 1937, BY TYPE OF BUSINESS REPRESENTED[a]

| *Type of Business* | *National Companies*[b] | *Regional Companies*[c] | *Local Companies*[d] | *All Companies* |
|---|---|---|---|---|
| Total retail | 78.6 | 84.9[e] | 77.5 | 79.1 |
| Automobile retail[f] | *63.6* | *76.7*[e] | *75.2* | *66.0* |
| Other retail[g] | *15.0* | *8.2* | *2.3* | *13.1* |
| Total wholesale | 15.9 | 11.0 | 11.2 | 15.0 |
| Small loans | .. | .. | 6.0 | .5 |
| Open accounts receivable and factoring | 5.4 | .5 | 1.5 | 4.6 |
| Rediscount | .. | 3.5 | 3.4 | .7 |
| Miscellaneous | .1 | .1 | .4 | .1 |
| TOTAL | 100.0 | 100.0 | 100.0 | 100.0 |
| | $1,310,816,000 | $171,622,000 | $143,957,000 | $1,626,395,000 |

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market. For the few companies whose fiscal year did not end on December 31, 1937, the nearest fiscal year-end figures were used.

[b] General Motors Acceptance Corporation, Commercial Investment Trust Corporation (excluding National Surety Company) and Commercial Credit Company.

[c] Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California, Bankers Commercial Corporation and its subsidiary, Maytag Acceptance Corporation.

[d] A sample of 40, selected according to availability of data.

[e] Includes some small loans for one company.

[f] Includes commercial vehicles.

[g] Includes industrial equipment paper as well as consumer credit. For two regional companies some rediscounted paper is included.

financial middlemen serving as a link between manufacturer and dealer and between dealer and consumer, for they supply funds to move goods on a credit basis from manufacturer to retailer to consumer. They may also be thought of, with banks, as middlemen standing between original lenders and ultimate borrowers, for they obtain funds from banks and investors which, in turn, they lend to dealers and, through dealers, to individual purchasers of goods bought on the instalment plan.

## QUANTITATIVE IMPORTANCE OF RETAIL INSTALMENT CREDIT

The quantitative importance of retail instalment credit in the entire credit system is suggested by the fact that its total volume in 1937, according to our estimates, was approximately $4,279,000,000 (including finance charges, and including not only consumer credit but also a certain amount of producer credit which was extended at retail). This figure measures the volume of retail instalment credit extended by retail dealers during the year, and thus indicates the maximum supply of retail paper theoretically available for purchase by sales finance companies. The average amount of retail instalment credit outstanding during the year we have estimated at approximately $3,073,000,000.

It should be emphasized that these figures do not account for all instalment financing of retail purchases. Cash loans made by various consumer instalment credit agencies are often used for the purchase of goods at retail, and therefore when a retail customer pays cash he may in actual fact be financing his purchase by an instalment loan from a personal finance company, industrial banking company, commercial bank or credit union. In cash transactions the dealer has no way of knowing whether this is the case. The figures cited

TABLE 2

DISTRIBUTION OF VOLUME AND AVERAGE OUTSTANDINGS OF RETAIL INSTALMENT CREDIT, 1937, BY TYPE OF RETAILER[a]

| *Type of Retailer* | *Gross Credit Extended* (in millions) | *Average Outstandings* (in millions) |
|---|---|---|
| Motor vehicle dealers | | |
| Passenger cars | $2,143 | $1,524 |
| Commercial cars | 306 | 217 |
| Furniture and household appliance stores | 744 | 651 |
| Department stores | 441 | 239 |
| Jewelry stores | 85 | 47 |
| "All other" stores[b] | 560 | 395 |
| ALL RETAILERS | 4,279 | 3,073 |

[a] Complete estimates and explanation of methods used will be presented in National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38,* by Duncan Holthausen in collaboration with Malcolm Merriam and Rolf Nugent (ms. 1940). The figures include finance charges.

[b] Includes the following types of stores: automobile tire and accessory; women's specialty; men's clothing; office equipment; coal, fuel oil and wood; lumber and building material; hardware; heating and plumbing; farm implement stores.

above refer only to that part of retail instalment financing which does not involve the transfer of cash to the buyer-borrower.

Table 2 shows how various types of retailers participated in the extension of this credit. The estimates presented in the table include retail instalment credit extended for such producer goods as motor trucks, farm implements and office furniture. Allowance for these items cannot be made with exactitude. Available evidence indicates, however, that it is reasonable to assume a volume of about $3,667,000,000 for retail instalment credit extended for consumer goods, and that the average amount of indebtedness outstanding for these goods was approximately $2,641,000,000.[9]

There are no complete data on the proportion of retail instalment credit extended through the medium of sales finance companies, and therefore this measure of sales finance company importance can be only roughly indicated. Purchases of retail automobile paper by 419 sales finance companies reporting to the United States Department of Commerce totaled $1,721,000,000 during 1937;[10] according to Milan V. Ayres, Secretary of the National Association of Sales Finance Companies, these reporting institutions accounted for about 95 percent of all automobile financing conducted by such companies.[11] This estimate would indicate that sales finance companies handled about $1,812,000,000 in retail automobile financing in 1937, or about 75 percent of the gross retail instalment paper originating in that year with motor vehicle dealers. For only one state, Wisconsin, is complete information available on the proportion of retail automobile paper handled by sales finance companies,[12] and these data indicate an even greater participation than does the estimate above. In Wisconsin, of a total automobile instalment sales volume of $48,000,000 for the year ending October 31, 1937, sales finance companies handled as much as 87 percent, split about evenly between the national and other companies; 5 of the remaining 13 percent was purchased by banks, and 8 percent was carried by automobile dealers themselves.

[9] See National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38*, by Duncan Holthausen in collaboration with Malcolm Merriam and Rolf Nugent (ms. 1940).

[10] The Department of Commerce release refers to 456 rather than 419 companies, but with the notation that "of these organizations, 37 have discontinued automobile financing."

[11] "The Economic Function of the Sales Finance Company," National Association of Sales Finance Companies, *Time-Sales Financing*, vol. 3, no. 1 (January 1938) p. 3.

[12] Data furnished by the Division of Consumer Credit, State Banking Department, Wisconsin.

Data for estimating the proportion of other retail instalment paper handled by sales finance companies are much less adequate, but available evidence suggests, for diversified finance paper, an outside figure of 20 percent, or a volume of about $366,000,000, handled by sales finance companies in 1937.

Taken together, these estimates give a total of approximately $2,178,000,000 for the gross retail instalment credit extended through sales finance company operations in 1937, or around 51 percent of all retail instalment credit granted by retail dealers. This would mean that 49 percent of all retail instalment paper and 25 percent of automobile paper of this type was carried by dealers themselves or was financed through banks or other agencies.

For one state, Indiana, data are available showing the distribution of total retail instalment paper among the various agencies that handle it. Indiana passed a retail instalment sales act, effective July 1, 1935, which requires all agencies to be licensed that are engaged in retail instalment financing; this requirement does not, however, apply to retailers themselves, who frequently carry the notes arising out of their own sales. In the administration of the act the state's Department of Financial Institutions has obtained information which indicates how many and what kinds of institutions are engaged in retail instalment financing, and what share of the total outstandings and number of accounts is held by each kind of institution. A compilation of these data is presented in Table 3.

Although in both 1936 and 1937 banks constituted, numerically, by far the greatest proportion of all agencies engaged in retail instalment financing, they held only small percentages of total year-end outstandings and of total accounts. In all three respects, however, they showed higher than average increases between 1936 and 1937. Sales finance companies were next in importance, in number, but in busi-

TABLE 3

AGENCIES ENGAGED IN RETAIL INSTALMENT FINANCING IN INDIANA, AND PERCENTAGE DISTRIBUTION OF THEIR YEAR-END OUTSTANDINGS AND ACCOUNTS, 1936 AND 1937[a]

| Type of Agency | Number of Agencies | | Distribution of Outstandings[b] | | Distribution of Accounts[c] | | Average Size of Accounts Outstanding | |
|---|---|---|---|---|---|---|---|---|
| | 1936 | 1937 | 1936 | 1937 | 1936 | 1937 | 1936 | 1937 |
| Sales finance companies | 75 | 71 | 70.0% | 67.4% | 64.6% | 62.8% | $239 | $224 |
| Small loan companies | 57 | 64 | 13.4 | 13.8 | 15.4 | 15.2 | 192 | 190 |
| Banks (state and national) | 193 | 239 | 7.3 | 8.6 | 7.6 | 8.9 | 213 | 200 |
| Morris Plan banking companies | 6 | 10 | .7 | 1.0 | 1.8 | 2.2 | 83 | 100 |
| Miscellaneous (includes public utilities and agricultural implement companies) | 16 | 12 | 8.6 | 9.2 | 10.6 | 10.9 | 179 | 178 |
| ALL AGENCIES | 347 | 396 | 100.0 | 100.0 | 100.0 | 100.0 | 221 | 209 |

[a] Based on annual reports of the Department of Financial Institutions, state of Indiana, for the fiscal years ended June 30, 1937 (p. 178), and June 30, 1938 (pp. 166-68). These figures do not include instalment sales financed by the dealers themselves or those financed by Electric Home and Farm Authority.
[b] Total outstandings were $55,621,184 in 1936 and $63,079,553 in 1937.
[c] Total number of accounts was 251,625 in 1936 and 300,737 in 1937.

ness carried they held over two-thirds of all outstandings and nearly two-thirds of all accounts. For each of the three items they showed slight decreases from 1936 to 1937.

In studying these illuminating figures several facts should be kept in mind: first, while they are highly satisfactory from the standpoint of completeness, their coverage is restricted to the state of Indiana; second, they do not include the instalment sales financing that is carried on by retailers themselves, without being transferred to other agencies; and third, while they refer to retail sales they include sales to farmers and small business people and thus to some extent represent financing of businessmen as well as consumers.

As to the number of those who make use of retail instalment credit, we have estimated elsewhere that a minimum of 5,900,000 non-relief families had a net change in instalment debt for commodity purchases during 1935-36, or just under one-quarter of all non-relief families in the United States.[13] The number would, of course, be still larger if we could include those who incurred and paid off their instalment obligations within the year 1935-36, and there should be a still further addition for the unknown number of relief families and single individuals who carried instalment debt. It is impossible to estimate how many families and single individuals have been indebted to sales finance companies in any single year, but the number is certainly in the millions. In regard to automobiles it is known that as many as 9,400,000 new- and used-car deals were in process of collection by sales finance companies during 1937.[14] This figure

[13] See National Bureau of Economic Research, *Bulletin,* nos. 76-77, "The Statistical Pattern of Instalment Debt," by Ralph A. Young and Blanche Bernstein (October 15, 1939). See also Chapter 3, in which these data are partially summarized.

[14] This figure is based on the volume of retail automobile instalment paper of the 419 sales finance companies reporting to the United States Department of Commerce, inflated by 5 percent for omissions. On both new and used cars the average contract length was over 12 months in 1936, and therefore it is assumed that all retail instalment paper bought by these

represents the maximum number of single individuals and families that could have made use of sales finance company services in the purchase of automobiles during that year. The actual number of single individuals and families served was certainly less than this maximum, for some financed more than one car, and some cars financed were doubtless purchased by business concerns.

## SALES FINANCE AND OTHER CONSUMER INSTALMENT CREDIT

As has already been indicated, sales finance credit is not the only type of consumer credit that entails the payment of finance charges and the repayment of principal in prearranged instalments. Cash loans, made by personal finance companies, industrial banking companies, personal loan departments of commercial banks, and credit unions (and in some cases by sales finance companies themselves), also involve instalment payments. The cash obtained in this way may be, though is not necessarily, used for the purchase of retail commodities. The present study is not concerned with this type of financing, but its scope and its main differences from sales financing should be outlined briefly.

Table 4 shows the way in which cash loan financing was distributed in 1937 among the principal agencies that engage in this kind of business. The total volume of cash loan credit which they extended in that year (including interest or finance charges, and including loans insured by the Federal Housing Administration under the provisions of Title

companies in 1936 was outstanding in 1937. For 1935 it is estimated that new- and used-car contracts averaged respectively 16 and 13 months duration. Since consumers make their first payments the month after purchase, this means that sales finance companies held 1935 new- and used-car paper 17 months and 14 months respectively. Therefore on new cars the volume for the last four months of 1935 is included, but on used cars only the volume for December 1935. No adjustments are made for repossessions or for prepayment of contracts.

I) was $1,616,000,000, and their average outstandings on such loans amounted to $1,033,000,000. Thus in 1937 the whole volume of consumer instalment credit was about 3¼ times the amount of instalment credit extended in the form of cash

TABLE 4

Distribution of Volume and Average Outstandings of Cash Loan Instalment Credit, 1937, by Type of Lender[a]

| *Type of Lender* | *Gross Credit Extended* (in millions) | *Average Outstandings* (in millions) |
|---|---|---|
| Personal finance companies[b] | $ 701 | $ 361 |
| Industrial banking companies | 409 | 207 |
| Commercial banks (personal loan departments) | 306 | 179 |
| Credit unions | 148 | 79 |
| All lenders, FHA Title I loans[c] | 52 | 207 |
| All Lenders[d] | 1,616 | 1,033 |
| Total cash loan instalment credit | 1,616 | 1,033 |
| Total retail instalment credit for consumer goods | 3,667 | 2,641 |
| Total Consumer Instalment Credit | 5,283 | 3,674 |

[a] Complete estimates and explanation of methods used will be presented in National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38,* by Duncan Holthausen in collaboration with Malcolm Merriam and Rolf Nugent (ms. 1940).

[b] To make the gross credit extended and average outstandings estimates comparable for all agencies, we have added to the figures for personal finance companies the estimated interest due and to become due, using methods described in National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices,* by Ralph A. Young and Associates (1940) Chapter 1. Without this item the figures for personal finance companies are $615,000,000 gross credit extended and $317,000,000 average outstandings.

[c] Notes under $2000 insured by Federal Housing Administration.

[d] These totals do not include loans extended by unregulated lenders. Such lenders are situated mainly in states that have no adequate small loan laws, and estimates concerning them are necessarily only crude approximations. With this reservation the gross credit extended by them in 1937 may be estimated at $175,000,000 and their average outstandings for the year at $90,000,000.

loans, and average outstandings on all consumer instalment credit were over 3½ times the average cash loan outstandings.

In sales financing, credit is extended for the purchase of a specific commodity or service, in the manner and under the conditions already explained in general and subsequently to be described in more detail. The buyer-borrower receives no cash; he simply obtains a particular commodity or service by means of a loan. In the granting of cash loans, however, there is a transfer of cash, which may be used to pay off old sales finance loans or to retire old cash loans or to purchase new goods or services either now or later. Regardless of the use to which the funds are put, the loans are in cash and are not directly associated with a selling-lending, buying-borrowing transaction, as are sales finance loans.

In the typical sales finance transaction the commodity is the collateral or physical security for the loan, and upon default of payment the seller-lender has the right to seize and resell the commodity. In the extension of cash credit the lender is protected in other ways. Personal finance companies, as a rule, take a chattel mortgage on household goods which are not otherwise related to the loan in any way. Industrial and Morris Plan banking companies and personal loan departments of commercial banks frequently require endorsers or comakers. All these types of cash lenders, however, make unsecured loans and loans with other types of security.

Sales finance companies, as a rule, do not negotiate loans directly with borrowers, as do cash-lending agencies, but lend indirectly by discounting notes from instalment sales. If the retail dealer himself holds the notes, he is the lender, and in this case the loan is negotiated directly between lender and borrower. When he discounts the note, however, the sales finance company is the lender, even though it has had no personal contact with the buyer-borrower; since the finance company collects the instalments—and if necessary handles the questions arising from delinquency—it has a direct relationship with the consumer *after* the loan has been negotiated.

There is an important legal difference between sales finance and cash loan credit. Charges for the former, according to judicial interpretation, are exempt from laws regulating rates of interest. This distinction is based on the theory that the finance charge is not interest but is part of the selling price of the commodity. Also, sales finance agencies are relatively free from government regulation, quite in contrast with licensed small loan companies, whose activities are regulated in detail.

There are differences between sales finance and cash-lending agencies in the methods of stating charges. The sales finance company provides the dealer with a schedule of charges to be used by him in transactions with consumers. In general it expresses its charges as a flat dollar amount, roughly proportionate to the amount financed. This is in contrast with personal finance companies, which typically state their charges as so many percent per month on the unpaid monthly balance. Sales finance company practice is different also from that of industrial banking companies and personal loan departments of commercial banks, which usually state their charges on a flat percentage basis, plus incidental fees.

As has been mentioned, some sales finance companies engage in cash lending. In cases of delinquency on instalment sales contracts, when the debtor is in temporary financial difficulty but has a substantial interest in the commodity, it is frequently advantageous, both to the sales finance company and to its debtor, to refinance the debt by drawing a new contract running for a longer term and providing for smaller payments. It is the opinion of some that when a new contract of this kind is drawn the transaction becomes, like a cash loan, subject to statutory interest provisions. Some companies, however, do not make this distinction, and assess a new finance charge comparable to the original one.[15] The cash-lending activities of sales finance companies are usually carried on through affiliates licensed under the small loan laws, but some sales finance companies do their refinancing through industrial banking affiliates.[16]

An examination of the financial statements of 24 leading sales finance companies for the six-month period ending June 30, 1938, made by the First National Bank of Chicago, shows that of this number 13 engaged in making small loans. The small loan business of these companies, expressed as percentages of their total volume of business, ranged from a low of 0.1 to a high of 52. The concern showing the latter percentage may be classified quite properly either as a sales finance or as a small loan company, since approximately half its volume was in the field of sales financing and the other half in small loans.

## GOVERNMENT AGENCIES IN THE SALES FINANCE FIELD[17]

In addition to the private agencies of instalment financing there is an agency of the federal government, the Electric Home and Farm Authority (EHFA), which has been engaged in financing instalment sales of electric appliances since 1934. It was organized as a coordinate agency with the Tennessee Valley Authority and the Rural Electrification Administration, and it employs the instalment financing technique in "developing and fostering an increased use of

[15] For a description of statutory and administrative rulings on this issue see Chapter 9.

[16] Of the 37 offices in Pennsylvania licensed, as of September 1939, under the Consumer Discount Company Act (industrial banking act), 18 were conducted by the Bancontract Discount Company, an affiliate of the Commercial Investment Trust Corporation, organized especially to handle that company's refinancing.

[17] For a detailed discussion of these agencies see National Bureau of Economic Research (Financial Research Program), *Government Agencies of Consumer Instalment Credit*, by Joseph D. Coppock (ms. 1940).

electric power through the double reduction of cost of electricity to the consumer and the cost of electrical appliances."[18] In August 1935 it was reorganized as a District of Columbia corporation and established as an independent federal credit agency, its services being made available through any utility accepting its facilities, provided, however, that the residential electric rates of that utility conform to the standards of reasonableness held by the Authority. Aside from its federal ownership, its requirement that residential electric rates of cooperating utilities be reasonable, and its responsibility as a public agency to furnish its financing services to retail appliance purchasers at the lowest charge compatible with expense, it functions very much like any private sales finance company.

Since EHFA provides its credit services on a comparatively liberal basis the mechanics of its plan are of some interest. After the purchaser has filled out a sales finance contract, and made the required down payment to an accredited dealer, the latter sends the contract, with his endorsement, to the cooperating utility, which in turn forwards it for acceptance to EHFA. If the contract is approved and acquired by EHFA the dealer is paid the amount of the credit advance and the utility then makes the monthly collections from the purchaser, receiving in return for its service a booking payment of $1 per contract and a fee of 12½ cents per instalment collection. The utility reports delinquent customers to the Authority, and cooperates with the latter's field representative and with the dealer in handling delinquent accounts.

EHFA activities are financed from capital and surplus ($902,000 at the middle of 1938) and from short-term bank borrowing. Over the first four years of the Authority's existence (June 1, 1934, to June 30, 1938) it purchased 74,095 contracts, having a face value totaling $11,640,000, an average

[18] Electric Home and Farm Authority, Bulletin C-1 (1935).

of $157 per contract. A total of 59,181 contracts, four-fifths of all contracts purchased, were outstanding on June 30, 1938, the unpaid balances on which amounted to $6,755,000, or $114 per contract.

Mention has already been made of the Federal Housing Administration (FHA), in connection with cash lending. In pointing out the relationship between this organization and sales finance companies, still another phase of the latter's activity will be mentioned—the financing of betterments on improved real estate. In the general examination of consumer instalment financing, of which the present study is a part, consumer real estate financing involving mortgage security is not considered, but reference must be made to instalment credit that is employed in making improvements on existing real property because, to a limited extent, it is one of the activities of sales finance companies.

Under Title I of the National Housing Act of 1934 provision was made for the insurance of "modernization" loans or credit advances made by approved financial institutions, including sales finance companies. Most of the insured notes arose from cash instalment loans by commercial banks, but the plan permitted the insurance of credit advanced on sales finance instalment contracts. The insurance is designed to stimulate an increase in the flow of loanable funds to small income receivers not prepared to offer typical collateral as security. Approved financial institutions are insured against losses of as much as 10 percent (20 percent before April 1936) of the total of their insured loans. A special kind of insurance available since April 1936 is the "catastrophe loan insurance," designed to make it easier for small borrowers to secure funds for the repair of their properties after natural disasters, but little use has been made of it. The regular modernization (non-catastrophe) loan insurance was permitted to lapse at the end of March 1937, but was revived in February 1938 and is authorized, along with the catastrophe loan insurance, to continue until July 1941.

Before July 1939 the cost of the insurance was borne entirely by the federal government.[19] Notes covered are those that are written primarily to finance "additions, alterations or repairs," but notes to finance the purchase of "machinery and detachable equipment," including household electric appliances, were eligible for insurance from June 1935 to April 1936. Borrowers are required to be property owners or long-term lessees. In ordinary cases notes may not exceed $2000, but higher limits have been set on special types. From the inauguration of the plan in August 1934 until its first expiration in April 1937, a total of 1,450,860 Title I modernization notes of an aggregate face value of $560,603,240 were insured; only 1 percent of the number and 10 percent of the dollar amount were for more than $2000. The average size of all notes insured was $386; for over 50 percent of the loans duration was exactly 36 months, although the range was from 6 to 60 months.

Property improved was located in nearly every county in the United States, and 6,433 different financial institutions participated in this insurance arrangement provided by government subsidy. Most of the institutions were commercial banks but 149, or 2.3 percent, were finance companies—mostly sales finance companies in the building materials field. Over the period from August 1934 to April 1937 the finance companies handled 367,357 notes with a face value of $123,653,378; these figures represent 25 and 22 percent respectively of the total number and the total amount insured by FHA during this period.

[19] Beginning in July 1939 insured institutions were required to pay a fee of ¾ percent per annum on the net advance.