View metadata, citation and similar papers at core.ac.uk

brought to you by CORE

provided by Research Papers in Economics

This PDF is a selection from an out-of-print volume from the National Bureau of Economic Research

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: Credit Standards And Terms

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

Chapter URL: http://www.nber.org/chapters/c5659

Chapter pages in book: (p. 132 - 155)

5

Credit Standards and Terms

THE procedures just described, regulating the relations between the various parties, help to distribute and minimize the risk that is always present in sales finance as in other types of credit. Risk is further minimized, and to some extent avoided, by maintaining strict standards in judging applications for credit, and, when credit is granted, by stipulating certain requirements concerning repayment. Thus dealers and finance companies have evolved a more or less defined set of facts, bases, rules, principles and ideals which guide them in evaluating the prospective customer's ability and willingness to meet obligations when they are due. It is on the basis of these credit standards that it is decided to whom credit will be granted, how much credit, and on what terms.

CREDIT STANDARDS

There is a long list of standards, not necessarily mutually exclusive, that are given varying degrees of importance in judging applications for instalment credit. Conspicuous in the list are such factors as: collateral, or durability and resale value of commodity; cash selling price of commodity; size of down payment that the buyer-borrower is willing to make; the time he needs in order to repay his debt (length of contract); ratio of monthly payment to monthly income; occupation of buyer-borrower; permanence of employment as indicated by employment record; previous instalment payment record with lender; past debt payment record gener-

ally; extent of present indebtedness, instalment and other; personal character of applicant; and permanence of residence or ownership of home. Information pertinent to some of these items is obtained directly from the contract; other items are covered in the customer's credit application blank; still others necessitate reference to friends, relatives, credit bureaus or business establishments with which the customer has had dealings.

The relative importance attached to these factors varies from one company to another, and varies even more as between the different types of articles financed. The durability and resale value of the commodity itself are unquestionably important factors, since it is an accepted principle of instalment financing that the commodity purchased shall be the security for the loan. The underlying consideration is of course the possibility that repossession and resale will become necessary; in that case the avoidance of loss depends on resale value, and this in turn depends largely on the durability of the commodity. But the importance attached to durability and resale value necessarily varies from one type of commodity to another, roughly in accordance with the original cash selling price. This explains why factors relating to collateral security are given more weight in automobile than in diversified financing. It also goes far toward explaining the role of cash selling price in credit standards; cash price is merely a convenient quantitative measure that dealers and credit men use in appraising the durability and resale value of the collateral.

The importance attached to down payment and length of contract is related both to considerations of collateral security and to considerations of debtor solvency. Down payment determines what proportion of the original loan is still to be realized if repossession becomes necessary, and length of contract determines how quickly this proportion will be decreased by repayments. These are especially important con-

siderations in automobile financing, not only because of the relatively high amount of the loan but also because depreciation of the security is comparatively rapid. Whatever the commodity financed, however, down payment and length of contract have to be considered in relation to the purchaser's income. The higher the down payment the less that remains to be paid out of future income, and therefore there need be less concern if that income is small. But the shorter the contract the heavier is the fixed commitment against income, and therefore a short contract, desirable on one reckoning, may be hazardous on another, and the proper balance must be found. In settling these questions finance companies are well aware that the larger the down payment the greater is the buyer's original equity in his purchase, and the shorter the contract the more quickly he increases his equity; these, too, are important considerations because the more he has to lose the more likely he is to make every effort to avoid default and possible repossession.

An official of an automobile sales finance company declared in an interview on this subject of credit standards that his company had formerly relied primarily on resalability, down payment and length of contract, but the instability of the used-car market in recent years, and also the dealers' demand for smaller down payments and longer contracts, had made it necessary to give increasing consideration to factors concerning the purchaser himself—his income, the ratio of monthly payment to monthly income, his occupation and the permanence of his employment. Another finance company executive declared without hesitation that he regarded the value of the collateral, that is, the car itself, as the most important standard for judging credit risk, and that there must be a down payment of one-third of cash selling price in order to assure sufficient collateral security. Even while he was being interviewed, however, he approved a transaction in which a trade-in allowance of 25 percent of

cash price was accepted as down payment for a new car. This contradiction he justified by citing the applicant's long and steady employment record, and also the fact that the transaction carried the signature of a reliable cosigner. In still another interview a finance company official pointed to an application which had been questioned because the purchaser of the car was nearly seventy years of age and a manual laborer. This transaction too had been approved because of the cosigner.

Thus even in automobile financing, where there is an active resale market and the value of collateral security affords the lender a certain protection, it is customary to consider also the reliability of the purchaser himself and his partners in responsibility. The "human element" can never be entirely disregarded, even when it is not considered in itself a sufficient guarantee.

In the field of diversified financing these "human elements" necessarily take a foremost place in credit standards, for there is less possibility of reselling the collateral promptly at an assured price. Moreover, lower down payments are customary in this field than in automobile financing, and contracts are substantially longer. In view of these circumstances an executive of a diversified finance company declared in an interview that it is very doubtful whether the resale value of diversified commodities purchased on sales finance credit is sufficient, on the average, to enable the lending company to recover its investment. Therefore other criteria, relating to the customer's solvency, have to be given primary emphasis.

In sales financing—whether automobile or diversified—the retailer has the first voice in the granting of credit, and in most cases he assumes a liability in the event of purchaser default. Therefore the retailer's credit standards are more immediately decisive than those of the sales finance company, though the latter must continuously check his judgment,

not only in order to maintain the quality of the paper it handles but also because it has an interest in the credit standing of the retailer.

Table 25 presents the results of a questionnaire on the relative importance attached to different credit standards by various types of retailers. It can be seen that "occupation and permanence of employment" and "past payment record"—both of them factors relating to the customer's creditworthiness rather than to the terms of the contract—were consistently given greatest emphasis by all types of dealers. Automobile dealers, however, accorded relatively less weight to "past payment record" and "additional instalment obligations to other stores" than did those who conducted diversified financing, and they gave, on the whole, relatively more emphasis to standards pertaining to contract terms.

Credit extension by sales finance agencies often depends on the general judgment of the credit man, on the principle that the weight given to various factors depends on the specific case and that no two cases are alike. Not uncommonly, however, a credit rating system is used, by means of which credit men undertake to make their decisions according to more or less mechanical rules.

The usual credit application form contains a blank table which is used in ranking the purchaser as a credit risk. Various items are listed, such as income, permanence of employment, reserve assets, down payment, length of contract, past payment record and so on. Sometimes a general rating of good, fair or poor is entered for each item, and the credit man puts down a final rating which strikes, according to his best judgment, as fair an average of favorable and unfavorable indications as can be made. In other cases a specific grade is entered opposite each item, and the sum of the grades serves as the index of credit risk.

Details are available regarding one such method of risk

TABLE 25

INDEX OF IMPORTANCE ATTACHED TO VARIOUS CREDIT STANDARDS BY 688 RETAIL ESTABLISHMENTS[a]

Credit Standard	*All Establishments*	*176 Department Stores*	*134 Furniture Dealers*	*116 Clothing Dealers*	*56 Automobile, Tire and Accessory Dealers*	*45 Jewelry Dealers*	*43 Lumber Dealers*	*37 Coal and Wood Dealers*	*81 Miscellaneous Stores*[b]
Occupation and permanence of employment	100	100	100	100	100	100	100	100	100
Past payment record	98	93	111	97	78	98	109	97	104
Terms conveniently adjusted to customers' income	48	45	59	40	55	43	51	51	44
Additional instalment obligations to other stores	42	44	47	38	25	49	40	32	48
Terms that will secure largest down payment and fastest liquidation possible	33	31	36	31	42	32	34	20	35
Maturity of contract	16	15	16	15	18	17	15	11	20

[a] Based on a survey conducted by the National Retail Credit Association in cooperation with the National Bureau of Economic Research (Financial Research Program), July and August, 1939. Answers were received from 688 retail establishments situated in 157 cities in the United States and Canada, representing 38 states. These answers were graded by giving 5 points to the credit standards that were ranked first, 4 points to those ranked second, 3 points to those ranked third, 2 points to those ranked fourth, and 1 point to those ranked fifth. Since each type of establishment is represented by a different number of stores, these point-rankings have been converted into an index (with "occupation and permanence of employment" equaling 100), in order that the policies followed by the various types of establishments may be more easily compared. The number of points for "occupation and permanence of employment" was as follows: all establishments 2,906; department stores 803; furniture dealers 497; clothing dealers 510; automobile etc. dealers 257; jewelry dealers 193; lumber dealers 167; coal and wood dealers 152; miscellaneous stores 327.

[b] Comprising 19 hardware, 13 home appliance, 13 music, and 36 shoe, florist, food and stationery establishments.

evaluation employed in automobile financing.[1] This method provides for the analysis of various factors according to a point system, an applicant being a "perfect credit" if he receives 10 points. If he receives from 6 to 10 points the finance company will agree to buy his instalment paper from the automobile dealer without recourse. If his grade is 5 points or less the company will purchase only with recourse or under the repurchase agreement of a responsible dealer. Points are allocated on the following basis: 2 points on previous credit record with others; 2 points on the collateral in the deal; 1 point if the name and address of a relative are provided; 3 points on the record of employment; 2 points on permanence of residence. The system provides for even greater detail. For example, in grading employment record, 1 point is given if the customer's employment in his present job has been longer than six months and less than one year, 2 points if it has been more than one year but less than two years, and 3 points if it has been more than two years. No points are allotted if the employment has been less than six months, and an individual who is self-employed is given no more than 1 point on employment record.

It is particularly significant that employment record is given greater weight than any other factor. The company which developed the system explains and justifies this emphasis on the ground that 53 percent of its repossessions had resulted from loss of employment, and that in three-fourths of those cases the customer had been employed six months or less at the time the contract was purchased.

CONTRACT TERMS

Among the various standards that are used in judging an application for instalment credit, down payment and length

[1] Owen L. Coon, *An Analysis of Automobile Repossessions and the Credit Quotient Method of Credit Analysis*, American Finance Conference, Special Bulletin no. 27 (February 7, 1938) pp. 21 ff.

of contract occupy a rather anomalous position, for although they are dependent to some extent on what the customer will agree to, they are dependent also on the general practice of the finance company and the type of financing that is in question. As has already been emphasized, what the customer will agree to in this regard is an important factor not only in evaluating creditworthiness, but also in determining collateral security. Therefore in fixing its practice concerning contract terms the finance company has an interest in making the range of choice as narrow as competitive requirements will allow.

The terms laid down in the contract include stipulations concerning the finance charge as well as those governing down payment and the length of time over which the payments may be spread, but finance charges involve a different set of questions and they will be discussed in a separate chapter. Down payment and contract length are singled out for consideration here because they both affect and are affected by the customer's ability to fulfil his obligation.

Down payment, which is the amount paid by the instalment buyer to the dealer at the time the sale is made, may consist only partly of cash, the remainder consisting of an allowance made for a trade-in. Such a large percentage of transactions involve a trade-in that it may be said with some truth that the typical instalment sale is not only a sale of a commodity but is also a purchase, by the seller, of another commodity of less value, the purchase price of the second (the trade-in allowance) serving as part payment for the first. Customarily the trade-in allowance is considered as immediate cash and is accepted as, or applied to, the down payment, but in some cases in which the commodity given in trade has little or no resale value the seller insists on cash for the entire down payment, and the trade-in allowance merely reduces the gross price of the article sold.

The trade-in type of sales transaction is most prevalent in the automobile field. Data assembled by the National Association of Sales Finance Companies show that in recent years (1935-38) nearly nine out of ten new-car, and more than half of all used-car, sales—both cash and instalment—have involved a trade-in of another car.[2] Data for cars financed during the same period by a national sales finance company show that in retail instalment transactions eight out of ten new-car sales and more than six out of ten used-car sales involved trade-ins. While total down payments averaged about 45 percent of new-car sales prices and 40 percent of used-car sales prices in trade-in transactions financed through this company, cash payments averaged only about 9 percent for both new and used cars; the balance was trade-in allowance. The instalment transaction is less commonly complicated by the trade-in problem in other types of commodities, but trade-ins are accepted in many furniture and electric appliance deals.[3]

Contract Terms in Automobile Financing

In automobile financing, what came to be known as standard terms with regard to down payment and length of contract were adopted by the executives of 291 finance companies—national, regional and local—at a meeting held in Chicago on December 10 and 11, 1924. The formulation of such terms was suggested by a group of leading bankers in order that the business might be kept on a sound basis from

[2] National Association of Sales Finance Companies, *Composite Experience of Sales Finance Companies and Automobile Dealers, 1938.* The data were obtained by questionnaires sent to dealers with the cooperation of the National Automobile Dealers Association.

[3] A questionnaire to retail furniture dealers, circulated by the National Bureau of Economic Research (Financial Research Program), with the cooperation of the National Retail Furniture Association, indicates that trade-in practice varies widely but that a few stores make trade-in allowances in as many as 75 percent of all deals.

the standpoint of all concerned—individual dealer, finance company, bank, manufacturer and consumer.

For new cars the down payment was set at one-third of purchase price, with the balance payable in 12 equal monthly instalments; for used cars it was set at 40 percent of purchase price, with the balance payable in the same way. During a number of years there was substantial adherence to these standards,[4] but in 1934, during recovery from the depression, considerably easier terms appeared. The relaxation of terms varied in different regions, but was more pronounced in metropolitan areas than in country districts. In some sections terms were frequently 25 percent down, with 24 to 30 months time on new cars and 18 to 20 months on used cars.

Various reasons may be adduced for the increased proportion of substandard automobile paper purchased by sales finance companies during this period of business expansion. Manufacturers and dealers pressed for easier terms in order to stimulate the recovery of automobile sales, and instalment paper tended to go to the finance companies most generous in accommodating them. It is likely that the competitive easing of terms was fostered by the acute rivalry between the recourse companies—factory-controlled or factory-affiliated—and the non-recourse, independent finance companies, which resulted in the formation of a separate association by the latter in 1934 (the American Finance Conference). The comparatively favorable credit experience of sales finance companies during the preceding depression years was still another factor encouraging them to modify standards, and also they were induced to expand volume, even at the competitive sacrifice of standards, by the relative ease and decreased cost of obtaining from commercial banks the funds

[4] According to the National Association of Sales Finance Companies, *op. cit.*, 19 percent of paper had substandard down payments in 1925, and 19 percent ran more than 12 months; by 1927 the figures had fallen to 5 percent and 12 percent respectively; after 1927, however, they gradually increased, and in 1932 were 14 and 22 percent respectively.

needed to carry the instalment paper that they discounted. Finally, rising used-car prices, accompanying the business upswing, tended to increase repossession values and reduce losses, thus encouraging the granting of more liberal terms. This development was rationalized in the trade by the contention that mechanical improvement and increased durability of automobiles, extending their period of usefulness and raising their value as collateral, justified a modification of terms.

During 1936 the rapid expansion of instalment selling, and particularly the easing of terms which had taken place since 1934, began to cause general concern. In November 1936 the American Finance Conference adopted a resolution favoring another standardization and tightening of terms on sales of passenger cars and light delivery trucks east of the Rocky Mountains. On new cars a minimum down payment of one-third of cash selling price, a maximum contract length of 18 months, and equal monthly instalments were proposed. The same terms were suggested for used cars not over two years older than current models; for all other used cars the same down payment was suggested but no more than 12 months was to be allowed for payment. These proposals were reaffirmed by resolution in 1939. In September 1937 the National Association of Sales Finance Companies made the same proposals, and they were reaffirmed by resolution in November 1938.

The trends since 1933 in automobile instalment terms are indicated in Table 26. Of all cars financed during 1933 (dollar volume), only 12 percent involved substandard down payments, but by 1935 the proportion had risen to 34 percent, though it declined thereafter to 21 percent in 1938. The trend toward longer contracts continued through 1937; of all cars financed the proportion granted contracts of more than 12 months' duration rose consistently from 13 percent

TABLE 26

SUBSTANDARD PAPER AS PERCENT OF ALL AUTOMOBILE INSTALMENT PAPER HELD BY REPORTING SALES FINANCE COMPANIES, 1933–38[a]

Year	*Substandard Down Payments*[b]			*Contract Lengths Over 12 Months*[c]		
	New	Used	All	New	Used	All
1933	..	..	12	..	..	13
1934	17	21	18	38	15	30
1935	29	43	34	62	24	48
1936	26	27	26	72	35	59
1937	23	24	23	78	53	68
1938	19	23	21	72	51	62

[a] Sales finance companies reporting to the National Association of Sales Finance Companies. See the Association's leaflet, *Composite Experience of Sales Finance Companies and Automobile Dealers, 1938,* covering about 20 percent of the dollar volume of automobiles financed by all automobile sales finance companies.

[b] For new cars less than one-third of cash selling price. For used cars less than 40 percent, up to and including 1935; in 1936-38 one-third applied also to used cars.

[c] The terms established in 1924 set the maximum contract length at 12 months, for both new and used cars. The new standard terms established by the American Finance Conference (1936) and the National Association of Sales Finance Companies (1937) set the maximum at 18 months on new cars and at 12 months on used cars, except for used cars under two years of age, to which the 18-month length applies. In the years 1936-38 the proportions of new-car paper having more than 18 months' duration were 27, 44 and 25 percent respectively.

in 1933 to 68 percent in 1937. Table 27, showing the distribution of automobile instalment paper according to length of contract, gives the picture more exactly for the years 1936-38.

The figures in these two tables reveal a change toward more conservative terms, evident on down payments after 1936 and on contract lengths after 1937. Tabulations based on consolidated reports of twenty leading finance companies reveal the change even more strikingly. Data for these com-

TABLE 27

PERCENTAGE DISTRIBUTION OF AUTOMOBILE INSTALMENT PAPER OF REPORTING SALES FINANCE COMPANIES, 1936–38, BY LENGTH OF CONTRACT[a]

Length of Contract (in months)	New Cars			Used Cars			All Cars		
	1936	1937	1938	1936	1937	1938	1936	1937	1938
1–12	28	22	28	65	47	49	41	32	38
13–18	45	34	47	32	48	49	40	40	48
19–24	25	39	25	3	4	2	17	25	14
Over 24	2	5	[b]	[b]	1	[b]	2	3	[b]
TOTAL	100	100	100	100	100	100	100	100	100

[a] Taken from the leaflet of National Association of Sales Finance Companies, *Composite Experience of Sales Finance Companies and Automobile Dealers, 1938,* covering about 20 percent of the dollar volume of automobiles financed by all automobile sales finance companies.
[b] Less than 0.5 percent.

panies show that between June 1937 and June 1938 the proportion of contracts bearing a less than one-third down payment declined from 30 to 17 percent for new cars and from 36 to 23 percent for used cars. On new cars contracts extending longer than 18 months declined from 35 to 17 percent, and on used cars contracts of longer duration than 12 months fell from 48 to 45 percent.[5] These changes were due partly to the contraction of business that occurred in the latter part of 1937 and the first half of 1938. Possibly they also reflected the actions of the American Finance Conference in November 1936 and the National Association of Sales Finance Companies in September 1937, formulating new standard terms and advocating strict adherence to them. Recent information indicates, however, a renewed tendency toward more liberal terms since the end of 1938.[6]

[5] Arthur W. Newton, "The Future of Finance Companies" in *Banking,* Journal of American Bankers Association (January 1939) p. 23.
[6] Fred V. Chew, "From Where—To Where," address before the sixth annual convention of the American Finance Conference, November 8, 1939.

Contract Terms in Private Diversified Financing

For instalment purchases of other commodities, such as furniture, household appliances and jewelry goods, there are no standard terms like those for automobiles. This is perhaps to be expected, since for these various goods there is no great uniformity either in the type of retail outlet which sells them or in the type of agency which finances them.

In recent years, however, attempts have been made by different retail associations to check the extension of too liberal terms and to recommend certain sets of standard terms for different commodities. Individual sales finance companies and public utilities sometimes set up their own standard terms, announcing on the rate cards which they give to dealers the minimum down payment and maximum period of contract acceptable to them. They may offer a choice of arrangements, one of which is designated as "standard terms." The rate cards on household appliances, for example, may contain such statements as: "Standard terms for refrigerators —minimum down payment 10 percent; maximum time 30 months. Alternative terms—minimum down payment 5 percent; maximum time 24 months. In no case may down payment or monthly payment be less than $5."

Usually, as in this example, the maximum length of contract varies directly with down payment, that is, the larger the down payment the longer the contract may run. Down payments, expressed as a percent of cash selling price, are on the average very much smaller for diversified than for automobile financing, according to the available statistical material. On this point information from the United States Department of Commerce,[7] although of limited scope and coverage, checks with that available from other sources. It indicates that although automobile dealers (47 establish-

[7] Assembled by M. L. Merriam, Marketing Research Division, Bureau of Foreign and Domestic Commerce, in connection with the *Retail Credit Survey, 1937,* but not included in the published survey.

ments) received down payments averaging 42 percent of cash price in 1936 and 44 percent in 1937, the dealers in other commodities received far less, as follows: department stores (37 establishments) 16 in 1936 and 14 in 1937; furniture stores (47 establishments) 10 in 1936 and 10 in 1937; household appliance stores (8 establishments) 9 in 1936 and 7 in 1937; and jewelry stores (20 establishments) 11 in 1936 and 11 in 1937. There is no way of knowing how much of these down payments was in the form of cash and how much in the form of trade-in or other allowance.

There are necessarily wide variations in contract lengths offered to instalment purchasers of diversified commodities, depending on amount of original cash selling price. For example, time-payment buyers of radios generally place 10 percent of the cash price as a down payment, and pay off the balance in 12 or 18 monthly instalments, whereas refrigerator buyers, although typically placing 10 percent down, usually take as long as 24 to 36 months, perhaps even 48 to 60 months, to pay off their instalment obligation.

It has already been pointed out that contract terms in the automobile field held fairly steady from 1925 until 1934, but that considerably easier terms developed in the expansion period 1934-37. There are no comprehensive data indicative of the course of terms in other lines, but trade reports indicate that they showed a corresponding trend. Table 28, based on different sources, compares the typical down payment and length of contract prevailing in the instalment financing of seven different commodities in 1925 and in 1938. Down payment percentages are shown to have been considerably smaller in 1938 than in 1925; for furniture, sewing machines and jewelry-store goods contract length remained much the same, but for four commodities—radios, refrigerators, vacuum cleaners and washing machines—contracts were considerably longer in 1938 than in 1925, in spite of notable reductions in the unit prices of these goods.

TABLE 28

TYPICAL CONTRACT TERMS IN THE FINANCING OF SEVEN DIFFERENT COMMODITIES, 1925 AND 1938

	1925[a]		*1938*[b]	
Commodity	Down Payment (in percent)	Length of Contract (in months)	Down Payment (in percent)	Length of Contract (in months)
Furniture	15	18	10	12 & 18
Jewelry-store goods	20	10	10	10 & 12
Radios	25	6	10	12 & 18
Refrigerators	15	18	10	24 & 30
Sewing machines	10	18	10[c]	18[c]
Vacuum cleaners	15	9	10	12 & 18
Washing machines	10	12	10	12 & 18

[a] From Milan V. Ayres, "Installment Selling and Its Financing," unpublished pamphlet (1926).

[b] From M. L. Merriam, *Retail Credit Survey, 1938,* Marketing Research Division, Bureau of Foreign and Domestic Commerce, U. S. Department of Commerce.

[c] From J. Anton Hagios, "Credit Terms as an Element in Merchandising Competition," address before American Marketing Association, December 28, 1939.

For the period of business expansion, 1934-37, during which automobile contract terms showed the greatest liberalization, detailed information on other commodities is available only for one organization—a large sales finance company whose diversified financing consists mainly of refrigerator paper. It may fairly be assumed that these contract terms, shown in Table 29, substantially reflect the main trends in diversified financing. The proportion of articles for which the down payment was less than 10 percent of cash price increased steadily from 14 percent in 1934 to 31 percent in 1937 (though it dropped to 14 percent in 1938). The proportion of articles for which the length of contract was over 18 months increased from nearly 70 percent in 1934 to 84.5 percent in 1936, but fell slightly in 1937 (and again in 1938).

TABLE 29

PERCENTAGE DISTRIBUTION OF NEW RETAIL DIVERSIFIED FINANCING OF A LARGE SALES FINANCE COMPANY, 1934–38, BY DOWN PAYMENT AND LENGTH OF CONTRACT[a]

Year	*Down Payment*											
	Under 10 Percent			10–20 Percent			20 Percent and Over			Total		
	Length of Contract											
	0–18 Months	Over 18 Months	Total	0–18 Months	Over 18 Months	Total	0–18 Months	Over 18 Months	Total	0–18 Months	Over 18 Months	Total
1934	1.6	12.5	14.1	10.9	40.6	51.5	17.9	16.5	34.4	30.4	69.6	100.0
1935	2.1	22.6	24.7	8.9	36.5	45.4	14.8	15.1	29.9	25.8	74.2	100.0
1936	1.3	25.9	27.2	5.4	43.3	48.7	8.8	15.3	24.1	15.5	84.5	100.0
1937	1.5	29.2	30.7	5.6	38.6	44.2	9.7	15.4	25.1	16.8	83.2	100.0
1938	.9	13.1	14.0	6.4	46.8	53.2	11.5	21.3	32.8	18.8	81.2	100.0

[a] Based on data supplied by the company. The number of contracts financed ranged in these years from approximately 65,000 to nearly 118,000. Information on the kinds of articles and number of each is not available, but it is known that the great bulk of the diversified financing of this company is for mechanical refrigerators.

Various reasons may be adduced for the easing of instalment contract terms which is indicated in Table 29 and which seems to have occurred generally in diversified financing. In this field, as in automobile financing, the most obvious reason was the post-depression effort to stimulate a recovery of sales. A special factor in the appliance field was the merchandising promotion of the larger utility companies with the object of increasing the use of appliances and therefore the domestic consumption of electricity and gas. Ten years ago utilities offered very liberal terms on the more expensive appliances, and in this expansion period they extended these terms to lower-priced appliance items and further liberalized terms on the more costly items. A third competitive element arose from the establishment of the Electric Home and Farm Authority in 1934, as an appliance financing agency, and from its introduction of sales finance plans for electric appliances on the basis of three to five years in which to pay. The creation of the Federal Housing Administration in 1934, and its insurance from June 1935 to April 1936 of loans for the purchase of chattel equipment, provided an additional stimulus to the easing of credit terms in diversified financing.

As was mentioned above, however, various retail associations have taken active steps within the last few years to restrict the terms offered in diversified financing. At their annual conventions in the summer of 1937 the National Retail Credit Association, the Credit Management Division of the National Retail Dry Goods Association and the National Retail Furniture Association all adopted resolutions calling for shortened contracts and a minimum down payment of 10 percent. Typical of this movement was the recommendation by the National Retail Credit Association of maximum contract lengths, as follows: electric refrigerators, 24 months; furniture, 18 months; radios, 12 months; washing machines, 12 months; stoves and ranges, 18 months. In September of

that same year the major sales finance companies, and also some of the smaller companies, announced a schedule in which refrigerator terms were changed from 36 to 30 months and terms on other appliances were also restricted. A number of these sales finance companies favored a reduction from 36 to 24 months, but the 30-month maximum was decided upon in order not to curtail sales.

Contract Terms in Electric Home and Farm Authority Financing

The Electric Home and Farm Authority does a very small volume of business in comparison with the total volume of diversified financing, but its practices with regard to down payment and length of contract deserve special attention because its entrance into the field of sales financing is alleged in the trade to have been partly responsible for the liberalizing of terms by private agencies, and also because data on its operations are much more complete than available data on private agencies.

The minimum down payment in EHFA financing was at first expected to approximate the monthly payment, and consequently it was frequently under 5 percent of the cash selling price of the merchandise. The percentage was gradually revised upward, without altering, however, the principle of a small down payment. In July 1938 the minimum down payments permitted on the various types of consumer appliances which EHFA had approved for financing at that time were 5 percent for refrigerators, ranges, water heaters, clothes ironers, washing machines, vacuum cleaners, dishwashers and waste disposal units, and 10 percent for attic ventilating fans, radios and portable space heaters.[8] The trend toward down payments of 10 percent and more is in-

[8] From EHFA Form no. 248, revised, July 28, 1938. A 5 percent minimum down payment was required on such farm equipment items as water pumps, milk coolers, cream separators, farm motors, and a 10 percent minimum on feed grinders and milking machines.

dicated in Table 30. But although the proportion of down payments of 2½ (the minimum) to 10 percent decreased sharply between 1934 and 1938, for the entire period 45 percent of all contracts had down payments within this range; 35 percent had down payments between 10 and 20 percent. During the entire period 1934-38 less than 4 percent of the contracts had down payments of 40 or more percent, and it may be surmised that in many cases these were associated with trade-ins. On all commodities financed during this four-year period the average down payment was 15 percent; the average increased each year, from 12 percent in 1934-35 to 16 percent in 1937-38.

The maximum length of contracts financed by EHFA is determined by the type and number of appliances bought, although requirements as to minimum amount of note ($40)

TABLE 30

PERCENTAGE DISTRIBUTION OF CONTRACTS FINANCED BY ELECTRIC HOME AND FARM AUTHORITY, FISCAL YEARS 1934–38, BY DOWN PAYMENT[a]

Down Payment[b]	*1934–35*[c]	*1935–36*	*1936–37*	*1937–38*	*All Years*	*Cumulative Percent*
2½–10	61.5	54.9	51.4	36.7	44.6	44.6
10–20	28.1	30.3	31.9	37.6	34.5	79.1
20–30	6.2	8.4	10.1	14.6	12.1	91.2
30–40	2.4	3.5	4.0	6.9	5.4	96.6
40–75	1.8	2.9	2.6	4.2	3.4	100.0
TOTAL	100.0	100.0	100.0	100.0	100.0	
Average Down Payment	12%	13%	14%	16%	15%	
Number of Contracts	4,886	7,648	22,460	39,101	74,095	

[a] Based on data supplied by EHFA.
[b] Expressed in percent of cash selling price. Each level is inclusive of the lower figure and exclusive of the higher.
[c] Includes 142 contracts purchased in June 1934.

and minimum monthly instalment ($1.50) affect duration slightly. As is shown in Table 31, the average length of contract tended to decrease somewhat between June 1934 and June 1938, although it showed a slight rise in 1935-36; the average for the entire period was 30.6 months. In the first two years of the Authority's activities considerably more than half of its contracts were for 36 months, but by 1937-38 only about 37 percent were of this length and nearly one-fourth were for 24 months. Throughout the period there was a consistent increase in the proportion of contracts running for 6 to 18 months.

Before July 1938, as this table indicates, a maximum con-

TABLE 31

PERCENTAGE DISTRIBUTION OF CONTRACTS FINANCED BY ELECTRIC HOME AND FARM AUTHORITY, FISCAL YEARS 1934–38, BY LENGTH OF CONTRACT[a]

Length of Contract[b]	*1934–35*[c]	*1935–36*	*1936–37*	*1937–38*	*All Years*	*Cumulative Percent*
6	.3	.4	.5	3.1	.7	.7
12	3.3	4.6	7.7	13.1	9.9	10.6
18	2.7	5.0	6.1	9.6	7.6	18.2
24	20.2	14.6	23.8	23.8	22.7	40.9
30	7.2	5.8	2.7	6.6	5.4	46.3
36	61.1	64.1	47.0	37.2	44.5	90.8
48	5.2	5.5	5.8	4.0	4.8	95.6
60	..	..	6.4	4.6	4.4	100.0
TOTAL	100.0	100.0	100.0	100.0	100.0	
Average Length of Contract	32.4	34.4	32.1	29.2	30.6	
Number of Contracts	4,886	7,648	2,460	39,101	74,095	

[a] Based on data supplied by EHFA.
[b] Expressed in months. Approximately 98 percent of the contracts had the exact length indicated; those with other lengths have been included in the next higher level.
[c] Includes 142 contracts purchased in June 1934.

tract length of 60 months was permitted on some purchases, but at that time maxima for different types and combinations of consumer appliances were formulated as follows:[9] 18 months for radios, attic ventilating fans, portable space heaters; 24 months for washing machines, vacuum cleaners, dishwashers, waste disposal units; 36 months for refrigerators, ranges, water heaters, clothes ironers; 48 months for combinations of two or more appliances. These terms apply only to new commodities; used commodities, otherwise eligible, have maximum terms of 12 to 24 months, but used ventilating fans, radios and portable space heaters cannot be financed.

The minimum monthly payment permitted by EHFA is $1.50. In the calendar year 1937, when 33,089 contracts were purchased, 90 percent called for monthly payments of less than $8 (34 percent for payments of $1.50 to $4, and 56 percent for payments of $4 to $8). Of the total number 7 percent were in the $8-12 range, 2 percent in the $12-16 range and only 0.9 percent carried monthly payments of $16 to $20.

Comparative Contract Terms in Diversified Financing

For a comparison of the terms of different organizations in the field of diversified financing, the best available standard is mechanical refrigerators. Table 32, giving the distribution, according to terms allowed, of refrigerators financed during 1937, shows that EHFA granted both smaller down payments and longer contracts than did the large private company cited above. Of the latter's contracts only 33 percent, but of EHFA contracts 51 percent, allowed down payments of less than 10 percent of cash price. This difference

[9] Maximum lengths of contract for farm equipment items were: feed grinders, 24 months; milking machines, 30 months; water pumps, milk coolers, cream separators and farm motors, 60 months.

TABLE 32

PERCENTAGE DISTRIBUTIONS OF REFRIGERATOR INSTALMENT CONTRACTS FINANCED BY ELECTRIC HOME AND FARM AUTHORITY AND BY A LARGE PRIVATE SALES FINANCE COMPANY, 1937, BY DOWN PAYMENT AND BY LENGTH OF CONTRACT

Down Payment[a]	*Distribution of Contracts*		*Length of Contract*[d]	*Distribution of Contracts*	
	EHFA[b]	Private Co.[c]		EHFA[b]	Private Co.[c]
Under 10	50.9	33.2	1–12	5.8	8.5
10–20	30.3	45.8	13–24	16.3	26.8
20–30	11.8	12.6	25–30	4.5	15.4
30–40	4.3	5.3	31–36	73.4	49.2
40 & over	2.7	3.1	Over 36	..	.1
TOTAL	100.0	100.0	TOTAL	100.0	100.0

[a] Expressed in percent of cash selling price. Each level is inclusive of the lower figure and exclusive of the higher.
[b] Based on data supplied by EHFA, covering 14,632 contracts.
[c] Based on data supplied by the company, covering 101,111 contracts.
[d] Expressed in months.

was almost compensated, however, by the difference between the two organizations' contracts with 10-20 percent down payments: 46 and 30 percent, respectively. Thus the respective proportions of contracts calling for down payments of more than 20 percent were about the same.

The differences in regard to contract lengths were more striking. Of EHFA contracts 73 percent were for more than 30 months, whereas only 49 percent of the private company's contracts exceeded that length. For each classification of contract length up through 30 months EHFA had a smaller proportion of paper than did the private company.

Table 33 gives available averages on refrigerator terms from 1934 through 1938 for these two agencies and also for another large private sales finance company (B); it shows a rising tendency in the down payments extended by EHFA

TABLE 33

AVERAGE DOWN PAYMENT AND LENGTH OF CONTRACT IN REFRIGERATOR INSTALMENT CONTRACTS FINANCED BY ELECTRIC HOME AND FARM AUTHORITY, AND BY 2 LARGE PRIVATE SALES FINANCE COMPANIES, 1934–38[a]

Year	*Average Down Payment*[b]			*Average Length of Contract*[c]		
	EHFA[d]	Co. A.	Co. B.	EHFA[d]	Co. A.	Co. B.
1934	8.8	18.7	..	33	21	..
1935	11.3	16.2	..	33	23	..
1936	13.0	14.4	..	32	29	25
1937	14.0	14.4	13	32	29	26
1938	15.6	16.8	17	31	25	23

[a] Based on data supplied by EHFA and by the two companies.
[b] Expressed in percent of cash selling price.
[c] Expressed in months.
[d] Averages for 1934, 1935 and 1936 are for all types of appliances, and therefore are not precisely comparable with those of Company A; about half of these contracts, however, were for refrigerators, and the trend that they show is the same as that for refrigerator contracts alone. Averages for 1934 are for the last half of the year, and those for 1938 are for the first half of the year.

and a falling tendency in those extended by the first private company (A). During 1937 and 1938, the only years for which down payment data from all three agencies are available, the averages do not differ substantially. In length of contract EHFA averages show a declining tendency throughout the period, and those of the two private agencies show a rising tendency through 1937 but a sharp contraction in 1938. The tightening of terms in 1938, evident also in Table 29, reflected the mounting sentiment among dealers and finance companies that liberalization of terms had been carried too far. That it also reflected the relatively poor business conditions prevailing in 1938 is indicated by the similarity of tendencies evident in EHFA contract terms and in those of private companies, for the former agency made no change in this year regarding down payments and contract lengths.