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Volume Author/Editor: Ralph A. Young and associates

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Chapter Author: Ralph A. Young

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## Relations Among Lenders

It is broadly true that in all lines of business common interests provide grounds for the development of cooperative relations among individuals and firms. In the personal finance business the special statutes that exempt licensed lenders from the usury laws, and the possibility of change in the provisions of these statutes, have given a particular impetus to the development of cooperative relations of the trade association type. In order that small loan statutes which will enable licensed lenders to operate on a profitable basis may be initiated and maintained it is very desirable that the business present its case to public opinion through some kind of cooperative association. This need for joint effort; and also the undeniable public concern about the subject of consumer indebtedness and the institutions immediately connected with it, necessitate a certain degree of self-policing which further encourages the establishment of cooperative relations in the small loan business. On the other hand, the nature of the business is such that a high degree of competition has developed among licensed lenders themselves. Also, they find themselves, singly or collectively, in increasing competition with other kinds of consumer financing agencies.

### COOPERATIVE RELATIONS

Cooperative relations among personal finance companies have arisen primarily from attempts to foster the demand for small loans, to protect the interests of lenders collectively, and to supply to individual lenders those services that can best be

provided by concerted action. There are three general types of association, national, state and local in scope, that have been organized to meet these needs.

The need for some national organization to facilitate cooperative relations among lenders was recognized fairly early, doubtless from contacts established at frequent legislative hearings, and in 1916 the American Association of Small Loan Brokers was formed for this purpose. The first important activity of this body was its cooperation with the Russell Sage Foundation in drafting the Uniform Small Loan Law.<sup>1</sup> Subsequently the name of the organization was changed to American Industrial Lenders Association, and in 1929 the present name, American Association of Personal Finance Companies, was adopted. The Association is located in Washington, D. C., and is the only national trade association in the personal finance industry.

The constitution of this group provides that all persons, firms and corporations extending credit subject to regulation by small loan laws are eligible to join as "regular members," those operating more than one loan office being eligible for one regular membership for each office. In addition any person, firm or corporation not acceptable as a regular member but "subscribing to and advocating" the purposes of the Association is eligible for associate membership. About one-third of all reported licensees are members, the number having increased from 951 in 1929 to 1,417 in 1938, but members of the group hold approximately three-quarters of the total volume of outstanding loans. Only regular members have voting privileges, each being entitled to one vote for each membership held. Dues, levied on each regular membership, are determined every year by the Board of Directors as a percentage of average loan balances outstanding during the previous year. Associate members are charged \$10 a year.

<sup>1</sup>L. N. Robinson and Rolf Nugent, *Regulation of the Small Loan Business* (1935) pp. 111-17.

The main object of the American Association of Personal Finance Companies is to elevate the standards of business conduct in the trade and to develop a more favorable public attitude toward licensed lending. The importance of these functions derives from the history of the small loan business, which, as has been pointed out, had its genesis in illegal lending. Even after the advent of legislation the attitude of the public and the actions of certain lenders were still reminiscent, in some ways, of conditions that prevailed formerly.

In order to give direction to its policing functions the Association adopted in 1931 a code of ethics setting forth certain standards of business conduct. The code declares that the purpose of the industry is to extend loans for constructive and emergency purposes, and that members of the industry are to cooperate with authorities responsible for the enforcement of small loan laws. In addition, it is required that "members will explain fully to customers the actual cost, terms and contractual obligations of loan transactions," and "will use written instruments as simple, lucid, and unambiguous as circumstances will permit." It is further stated that foreclosures are to be kept at a minimum and that members are to "adhere to generally accepted standards of business deportment in competitive relations, in advertising, and in their dealings with the public."

The public relations activities of the Association consist mainly of issuing pamphlets explaining the operations and economic functions of the industry, and in publicizing the point of view of the lenders when their interests are attacked. The Association also publishes a monthly magazine (*Personal Finance News*) covering matters of interest to members, and in various ways it serves in an advisory capacity on matters of lending practice.

A *Roster of Personal Finance Companies*, published annually by the Association, contains the name and address of every known licensee, thus enabling lenders to avail them-

selves of an indirect kind of collection service: if a customer moves out of the state a licensee can request a lender in the region where the borrower is newly settled to collect the account. Members provide this service for one another without charge. A list of credit information exchange bureaus, which is also included in the *Roster*, enables lenders readily to locate possible sources of information about loan applicants.

Another activity of the Association is the maintenance of an advertising committee for information and advice to members. This committee also maintains a watch on the advertising activities of other consumer credit agencies in order to see that the small loan industry is not adversely affected.

The American Association of Personal Finance Companies provides in its constitution for a National Council, the function of which is to maintain contacts between the national association and the various state associations. The National Council consists of the officers and chairmen of the national association's standing committees, and also representatives of the state associations. National Councilors keep the Association informed on the general condition of the personal finance industry in their respective states, and on the important policies and actions of their state associations, at the same time keeping state associations informed as to the policies and actions of the national association.

In August 1938 there were 27 voluntary state cooperative associations of licensed personal finance companies. With the exception of the Ohio association these do not employ paid officers, and their function is to carry out, on a state-wide scale, activities similar to those of the national association.<sup>2</sup> The state association represents the licensed lenders at legislative hearings in the event of a proposed reduction in the maximum legal rate, the national association leaving this responsibility to the association of the state directly involved.

<sup>2</sup> They are often assisted in their association activities by the paid public relations workers of the larger chain lenders.

The state association also acts to police its members, and lenders who violate the code of ethics drawn up by the national association are subjected to considerable pressure, both from the association and from its individual members.

The third type of cooperative body, the local organization, is made up of licensed lenders who act together mainly for the purpose of establishing and maintaining a credit information exchange bureau. This is a service of particular importance to lenders, not only because of its bearing on the maintenance of adequate credit standards but also because the spirit of the Uniform Small Loan Law is that no borrower should be indebted to personal finance companies at any time for more than \$300. At times the local groups also serve as collection agencies when the customers of licensees move from one city to another.

### COMPETITIVE RELATIONS<sup>3</sup>

Of the many forms in which competition expresses itself in this business, the most important from the consumers' viewpoint is probably the rate charged for credit services. In the personal finance business the upper limit to rates that can be charged by licensees is set by the provisions of the various state small loan laws. There is a tendency for rates charged by lenders to approach the legal maximum, but competition among lenders is reported to bring rates below this level in some localities and to ease certain other terms of the loan contract.<sup>4</sup> For example, in a state with a maximum  $3\frac{1}{2}$  percent flat rate a company may be found to be charging 3 percent on

<sup>3</sup> For a more detailed discussion of competition in the field of consumer credit, with particular reference to personal finance, see T. O. Yntema, "The Market for Consumer Credit: A Case in 'Imperfect Competition,'" *American Academy of Political and Social Science, Annals*, vol. 196 (March 1938) pp. 79-85.

<sup>4</sup> The Pennsylvania Banking Department *Report on Small Loan Companies* (February 1937) states that in 1935, although the Pennsylvania maximum legal rate was  $3\frac{1}{2}$  percent per month on unpaid principal balances, the average rate charged was 2.89 percent (p. 20).

the first \$100 of each balance, 2 percent on the second \$100, and 1 percent on the remainder. Price concessions may be made also on preferred risk loans, the most frequent example of this type being teacher loans, on which the rate may be a flat 2 or 2½ percent although the legal maximum is 3 or 3½ percent. The general willingness to make price concessions of this kind is indicative of the lower cost incurred on such loans, and of the desire of licensees to increase the proportion of their funds invested in these directions.

Competition may also take the form of concessions on the non-price conditions of the loan contracts; easier periods of payment, waiving of security demands, less burdensome collection procedures and other inducements may be adopted. The speed with which loans are made, and the confidential character of the lending arrangements, are often cited by companies as differential advantages that borrowers should take into consideration in choosing a lender.

Another form of competition is the amount of money that will be advanced to any one borrower. In general, the larger the loan carried by any given individual the greater the chance of default, unless the borrower's income is relatively high, but some lenders are willing to take the additional risk in order to increase their loan volume, and thus they will offer a larger loan, relative to the borrower's income, than will other lenders. Other less direct forms of competitive effort manifest themselves in advertising practices, including efforts to gain the most convenient and attractive location for loan offices.

Competition between personal finance companies and other similar agencies, such as industrial banking companies, the personal loan departments of commercial banks, and sales finance companies, is becoming increasingly important. In most states commercial banks and industrial banking companies are allowed to make larger loans than personal finance companies, but they have actively entered also into the lend-

ing of amounts up to \$300. The credit services extended by sales finance companies are also in many ways comparable with those offered by the personal finance companies, although the form of the borrower-lender relationship may tend to hide the similarity.

In all agencies engaged in consumer lending the trend of development seems to be toward greater diversification of credit activities. Thus a company making cash loans may in addition encourage borrowing to finance a commodity purchase, or may operate a sales finance affiliate or subsidiary; a sales finance company, through special offices or affiliated companies, may actively engage in the small cash loan business; and commercial banks are likely, if they set up a personal loan department, to diversify their business as far as possible. As a result there is a complicated competitive situation among the agencies supplying consumer credit: companies that might operate in fairly distinct markets, if it were not for this general diversification of activities, find themselves offering, in effect, the same services to substantially the same market.

Finally, where maximum legal rates are low there is a certain amount of competition between licensed and unlicensed lenders—particularly in regard to middle-size loans, since the licensed lenders cannot afford to grant many smaller loans and the high rates of the unlicensed lenders cannot attract many borrowers of larger sums. And in such states the licensed lenders may also have to face the competition of licensed lenders in neighboring states where the laws permit higher rates; after the rate reduction in New Jersey, for example, many lenders, as was mentioned above, moved to nearby towns in Pennsylvania and continued to make loans to New Jersey customers in competition with the small loan companies that had remained in that state.

Certain characteristics of the personal finance business doubtless serve to limit the degree of competition prevailing



in this field. The loan office itself is distinctly local in its operations, serving a necessarily limited market; it is impossible for a large number of licensees to operate in one locality and thus create any high degree of competition. The number of offices in a single community is also influenced in certain states by small loan legislation that instructs supervisory authorities to limit the granting of licenses to suit the "convenience and advantage of the community."

It is questionable, however, whether rate competition among many offices in a community would be as likely to lead to lower rates as would competition among only a few offices. If the number of offices in a community is small, and hence the average size of office relatively large, the resultant economies of operation may stimulate a more severe rate competition than would be the case if offices were of relatively small size. In some states the legal limitation as to number of offices in a community makes it possible for the average size of office to increase rapidly without recourse to aggressive competition.

It is not possible, however, to make statements of general validity on these points. The form and extent of competition, or the lack of it, are determined by the special circumstances attending specific situations. The effects of rate competition depend on the amount of the rate cut, the extent to which the cuts are met by other lending agencies, the amount of advertising and general sales promotion effort which accompany the rate change, and the period of time over which the lower rates are maintained. From the point of view of business profits the desirability of rate cutting depends on the resultant changes in total receipts and in costs of operation; and the nature of the market is such that a short-run rise in total receipts from increased borrower demands at lower rates is not to be expected. In certain circumstances, such as a situation of impending legislative action aimed at further regulation of the small loan business, rate cuts might be considered advan-

tageous even if they did not result in an increase in total business receipts.

The character of the borrower-lender relation is such that small changes in rates are unlikely to cause borrowers to shift from one lender to another,<sup>5</sup> although a substantial rate cut may have this effect, increasing the volume of business done by the rate cutting firm at the expense of its competitors. It might be noted that the shifting of borrowers from one lender to another does not necessarily wait upon the normal paying out of a given borrower's account over the contractual period. There is apparently a good deal of paying off of loans from one lender by means of funds borrowed from another lender, but there is no evidence to indicate the extent of this practice.

The method of quoting rates on small loans often confuses borrowers and renders difficult a comparison of terms offered by different licensed lenders, particularly in those few states where it is permissible for small loan companies to charge fees. Borrowers have even greater difficulty in comparing terms offered by different types of consumer credit agencies, and competition would doubtless be increased considerably if all agencies quoted terms on a uniform basis, either in dollars or in percent.

A final aspect of the competitive situation in the small loan market is the interchange of credit information among various lenders. Undoubtedly, both from the social point of view and from that of the individual lender, a complete interchange of information on the instalment-debt position and record of the individual borrower is greatly to be desired. Under such conditions the costs of investigation and the risks of lending would be reduced substantially, and the likelihood of any given borrower receiving a total of credits in excess of his capacity to pay, thus involving himself in severe financial straits, would largely be obviated. The possession of credit information, however, is sometimes viewed by individual lend-

<sup>5</sup> See T. O. Yntema, *op. cit.*, p. 83.

ers and by groups as an important asset, not to be shared with competitors. In fact, personal finance companies publicize widely the private or confidential treatment they accord all loan applications, implying that borrowings will not be disclosed to any agency, employer or other person who might use the information to the borrower's detriment, at least in the latter's judgment. Consequently the growth of an adequate interchange of credit information between personal finance companies and other agencies has been inhibited, though such interchange has developed to a certain degree among personal finance companies themselves. Moreover, the intensification of competition among various types of consumer credit agencies during recent years has tended to the breakdown of previously well-established credit information agencies. The situation varies, of course, in different communities; some have very complete agencies while others are almost entirely lacking in such facilities.