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INSTALMENT SELLING IN THE
AUTOMOBILE INDUSTRY

THESIS FOR THE DEGREE OF M. A.

E. L. Cross

1931

THESIS

Automobile industry + trade
Installation plan



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INSTALMENT SELLING IN THE AUTOMOBILE INDUSTRY.

INSTALLMENT SELLING IN THE AUTOMOBILE INDUSTRY

THESIS

SUBMITTED TO THE FACULTY OF MICHIGAN
STATE COLLEGE IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE DEGREE
OF
MASTER OF ARTS

BY

M. I. CROSS

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INTRODUCTION.

Statement of the Problem.

Four parties are involved whenever an automobile is sold on the instalment plan. They are the manufacturer who produced the automobile, the dealer who sold it, the purchaser who bought it, and finally, the finance company that bought the contract thus supplying the purchaser with the money indirectly to obtain the car. Therefore, the problems involved in instalment selling of automobiles may be examined from at least four points of view, namely, the point of view of the manufacturer, the point of view of the dealer, the point of view of the purchaser, or the point of view of the finance company.

A great deal has been written on the subject of instalment selling in general. A considerable amount of material is available on this topic as it applies to the automobile industry. However, upon examination, one notes that most of this has been written from the point of view either of the finance company, or the manufacturer, or of a composite of both. From the perspective of both the dealer and the ultimate purchaser, the subject has been dealt with but slightly.

The problem of this study has developed out of the conditions mentioned. In this thesis, the methods, practices, and the effects of

instalment selling in the automobile industry will be examined. Although the subject is studied mainly from the point of view of the automobile dealer, the true costs the purchaser is obliged to pay for his instalment credit will be shown. Likewise the relation of the automobile finance companies to the subject will be developed in detail chiefly for comparative purposes. The connection of the automobile manufacturer to the topic will not be emphasized.

Plan of the Study:

By way of introduction, a statement of the problem has been made. A somewhat detailed account of the sources explored and the references used will follow.

The next part of the study indicates briefly the historical development of instalment selling in general, the origin of the automobile finance company, the number of finance companies now operating in the United States, and an estimate of the total annual instalment debt.

The "technique" of instalment selling as it applies to the automobile industry is the central theme of the next section. Various terms on which automobiles are sold to purchasers on the time-payment plan are discussed. Attention is then given to the methods used by automobile dealers in discounting the purchasers' contracts with the automobile finance companies. Relative figures

are given for contracts discounted according to each method, as the method is discussed individually, insofar as statistics are available.

When the cost of instalment buying is next studied, tables show the amounts and rates charged by finance companies operating on both "recourse" or "non-recourse" bases for new car, as well as used car, contracts. Some comment is made on deceptions often practiced to obscure the real cost of instalment buying, and a few relevant conclusions are drawn.

The new car study includes an examination of the various risks inherent in instalment selling, different kinds of losses possible, factors operating to restrict the various types of losses, and the methods used to keep them at a minimum.

The used car study is divided into two parts. The first part deals with the kinds of used car contracts the automobile dealers discount with the finance companies. Types of risks and their distribution, resulting losses and their incidence constitute the nucleus of this discussion.

The second part of the used car study is concerned with the types of contracts which dealers do not discount, in other words, those contracts which the dealers themselves hold. The extent of losses sustained by dealers on this paper is compared with the losses resulting on paper discounted with the finance companies.

Up to this point, evidence which has been accumulating indicates that the greater share of the risks involved in installment selling of automobiles is borne by the dealers and not by the finance companies. To verify this conclusion, a study is made of the losses experienced by automobile finance companies in the past, their experience with losses during the current business depression, and some comment is made on their present financial status.

By way of contrast, the rate of failures occurring among automobile dealers during the current depression is indicated. An examination of their financial status is also made.

A summary of the conclusions which have developed out of the study completes the thesis.

Sources from which this Material was Derived.

But little has been taken for granted as to what the reader may or may not know about the technique in current use among automobile dealers in their relations with the finance companies and the people who constitute their clientele. In discussing the terms on which automobiles are sold in order that the purchase-contracts may be eligible for discount to the finance company, as this is common knowledge to every automobile dealer, it was necessary to draw on personal experience. The writer has been an automobile dealer in both the new and used car

fields, with experience extending over the country territory as well as in small towns and large cities. As nothing has been published on much of the trade-practice which is discussed, personal experience had to supply the deficiency. This is particularly true where methods of financing purchasers' contracts are discussed. Throughout this study, when what is common knowledge "in the trade" is discussed, in the absence of published information, this was necessarily done.

The data on which the true costs of instalment selling of automobiles are based was taken from the actual rate-charts in current use by representative finance companies. These companies typify both the "recourse" and the "non-recourse" organizations. When "Costs of Instalment Buying" are discussed, full information as to the sources from which the data are taken will be given.

The National Association of Finance Companies maintains its own statistical organization. Much of the material used in this study was furnished directly by Milan V. Ayers, "Analyst" of this association. Many (if not all) of the largest finance companies in the United States are members of this organization. In his report of October 20, 1930, Mr. Ayers indicates that while members of the National Association of Finance Companies "constitute only 65.5% of the number of companies, they did 94.8% of the business

in 1929." (1) Obviously statistical studies of instalment selling based on the experience of these members are very valuable.

Additional information was obtained from magazines, various books relevant to the subject, newspaper articles, and certain special bulletins.

The information relative to the part played and risks carried by the dealers, was obtained from the sources mentioned above, and from a personal survey. The survey was carried out among a representative group of automobile dealers, all of whom are located in Michigan. This group was composed of dealers located in fifteen small towns of from 1,000 to 5,000 population; four cities of from 5,000 to 20,000; and three cities of from 50,000 to 175,000 inhabitants. Eastern Michigan was represented by Saginaw, Bay City and various smaller towns north to, and including Alpena. Although Charlevoix was surveyed, western Michigan was not covered. The central part of the state from Petoskey, south to Lansing was canvassed.

The purpose of this survey was to secure only data relating to the used car sales where the dealer had "carried" the notes himself - in other words - where the dealer had not sold the purchase-contracts to a finance company. The reason was that complete

(1) M. V. Ayers - Report to "Members of the National Association of Finance Companies" - October 20, 1930.

information relating both to new car instalment sales, as well as to the more expensive used car sales, had already been furnished by the National Association of Finance Companies.

The facts desired were not hard to gather. An examination of the "Used-Car Record" which every dealer is required to keep by the Department of State, Division of Motor Vehicle Registration, gave much of the desired information. The "Used-Car Inventory Control" where it was in use was a valuable source of information. The accounting systems of the dealers in most cases aided in obtaining necessary details. Wherever the records of the dealer would not reveal the facts desired with accuracy, this dealer was omitted.

Similar data apparently have never formed either the basis for, nor have they been made a part of, any study of instalment selling. The information so gathered has been tabulated, and forms an essential part of this study.

BRIEF HISTORY OF THE DEVELOPMENT AND THE EXTENT OF
INSTALLMENT SELLING IN THE AUTOMOBILE
INDUSTRY

"Instalment selling is not new. Furniture has been sold that way in this country for over 100 years, and pianos nearly as long. All encyclopedias, beginning with Chamber's Encyclopedia, about 1750, have been sold on instalments. With the introduction of the McCormick reaper about 1836, there began the sale of agricultural implements on instalments, which has continued to this day. The instalment method was adopted for the sale of sewing machines, by the Singer Company, 1856; seventy-four years ago. More recent articles in the list are automobiles, washing machines, automatic refrigerators, oil burners, radios, and domestic stokers.

"It was the demand of the prospective customer for the privilege of buying an automobile on the instalment plan, which necessitated the creation of automobile finance companies. Automobile dealers generally did not have the capital required to carry any great number of instalment contracts, and the banks would not loan them the money. Finance companies, therefore, were formed to finance these sales. At first the automobile manufacturers opposed the idea of instalment selling. It was brought about by the demand of purchasers and dealers."

"By 1919, it had become evident that the instalment plan was substantially increasing sales, and General Motors Corporation therefore decided to reverse its attitude of opposition and to foster that method of selling. Feeling that there were not in existence enough companies to handle the financing of its sales properly, it decided to establish its own finance company, which it did in that year, 1919. This action determined the attitude of the entire industry.

"At the present time there are believed to be about 900 finance companies buying automobile paper, and perhaps 200 engaged exclusively in other fields.----" (1)

The common belief that instalment selling is comparatively new is dispelled by the above statements. The extent of purchases made on the time-payment plan, however, cannot be stated so definitely. Mr. Ayres estimates the total annual sales of instalment goods at six billion dollars, of which amount, about 25% is paid down, leaving four and one-half billions of dollars owing on instalment contracts. Of this sum, he further estimates, finance companies buy two and one-half billions, the remaining two billions being financed through banks, individual dealers, and other sources. (2)

(1) M. V. Ayers - "Instalment Selling and Federal Reserve Policy" An Address at the Institute of Public Affairs, University of Virginia, Charlottesville, Virginia, August 6, 1930. Distributed by the National Association of Finance Companies, 333 North Michigan Avenue, Chicago, Illinois.

(2) M. V. Ayers - "A Six Billion Turnover" - Chicago Commerce Daily - September 20, 1930.

To determine what portion of the total instalment debt handled by finance companies went to finance the purchase of automobiles, a study was made of the instalment contracts handled by 139 companies. Considering the total volume of these contracts bought during 1929 as 100%, it was discovered that "automobile retail paper constituted 54.9%." (3) If this figure is representative of the annual instalment debt of four and one-half billions of dollars, it would indicate that \$2,468,500,000.00 represented the amount of the debt created yearly by the purchase of automobiles at retail on the time-payment plan.

The technique used in the creation of this debt; the means and methods by which this sum is made available to the general public by the automobile finance companies through the medium of the automobile dealers will be treated next.

(3) National Association of Finance Companies - "Special Bulletin to Members" - Dated October 20, 1930

INSTALMENT SELLING TERMS AND METHODS OF
FINANCING USED IN THE AUTOMOBILE
INDUSTRY.

"Standard Terms" in Current Use.

Until recently, the methods used by automobile finance companies were matters of individual preference. It soon was discovered that a "hit and miss" policy was fraught with danger. Terms too lenient, such as small down payments, unusually long periods of time on the balance, or both, were found to be provocative of defaults on the part of the buyers. In many cases, losses resulted to the finance companies, and out of such experiences certain "standard terms" have been developed. Such terms are now in common use by the great majority of automobile finance companies.

The standard terms are the conditions under which an automobile must be sold to render the purchase-contract eligible for discount with a finance company. In the case of a new car, the dealer must secure a minimum down payment (which may consist of either a used car or a cash payment) of 33 1/3% of the retail price. The time limit on the balance must not exceed twelve months.

To accommodate farmers and other classes of people whose incomes are not received on regularly recurring pay-days, the

"Farmers' Plan" has been developed. In this case, the minimum down payment is 40% of the retail price of the automobile. The remainder may be paid in two equal instalments, one-half of which falls due in four months, and the remaining one-half due in eight months. If the purchaser prefers, he may have this remainder divided into three equal payments due in three, six and nine months from the date of purchase.

Standard terms on used cars are more exacting. A minimum down payment of 40% is usually required, and a maximum time limit of twelve months is customarily allowed on the remainder if the buyer can make payments monthly. If his income is not received in such a way as to make payments monthly feasible, the "Farmers' Plan" is open to him. The "Farmers' Plan" for the purchase of used cars is identical in all details with that in use for the purchase of new cars, as previously mentioned.

If an impression has been created that terms other than standard are never acceptable to a finance company, it is false. If a purchaser desires to pay more than the minimum down payment required, or if he wishes less than the maximum time allowable on the balance, his contract will be the more desirable to the finance company as a "risk." Standard terms are stipulations, which, if violated in favor of leniency only, will render the contract ineligible for discount.

Financing Methods: The Recourse Plan.

Having examined the terms under which a dealer must sell an automobile to the buyer to have the contract eligible for discount, it will now be of interest to see on what basis he may dispose of this contract to an automobile finance company. There are three possible methods open to him. He may discount it "with recourse", "non-recourse", or on a "re-purchase" basis. These methods will be discussed in the order mentioned.

By "recourse" is meant that the dealer must indorse the contract, thus binding himself to pay the balance remaining if the purchaser defaults. This remainder includes not only the amount unpaid on the car itself, but the unpaid portion of the finance company charges as well. If the dealer pays this remainder before it is due, a refund of a small amount is allowed him - usually the rebate is figured at a rate not to exceed 7%.

Under the recourse method, the finance company undertakes all the work of collections. Payments are expected to be made promptly when due. If they are not, usually a series of letters is written to the purchaser and notice of his delinquency is sent to the dealer. Obviously it is to the dealer's interest as well to have these payments made. If no response results from the letters, either a collection-man from the finance company contacts personally with the delinquent buyer, or perhaps the dealer, because of his liability as indorser of the contract,

makes the visit. If this contact does not bring forth fruitful results, then either "repossession" or an "extension" is in order.

By repossession is meant "taking back" the car in accordance with the terms of the sales-contract. The task of repossessing the automobile is one of the duties of the finance company. After securing possession of the car, it is turned over to the dealer, who is then liable for the unpaid instalments.

By extension is meant the setting back of the due-date of the payments for a consideration of an extra fee - commonly amounting to a flat charge of ten dollars. This extension is not granted unless the purchaser has made a number of payments previously so that he has an equity in the car sufficiently great to render his subsequent default very costly to him.

From the preceding explanation, it can be seen that the finance company operating on a recourse basis bears but little of the risks of the instalment selling process. First, the purchaser must default; he must prove uncollectable, and then repossession takes place. Second, when this has occurred, the dealer is liable. Before the finance company can suffer a loss, the dealer also must be uncollectable. Third, should these contingencies all occur, the finance company still holds a lien on the repossessed car.

The position of safety occupied by the finance company operating on a recourse plan is reflected in the smaller charge made for their services. (1) The "carrying charges" paid by a purchaser when his contract is discounted on a recourse basis, are considerably smaller than would be the case were his contract to be discounted on a non-recourse or re-purchase basis. This will be evident as further progress is made in this study.

Finance companies are well aware of the advantages of having the dealers' endorsements on their "paper". The dealer-indorser not only acts as an additional security against any loss to them, but he serves as a medium on whom to "dump" the repossessed cars. One of the common arguments of the recourse company is that the function of the finance company is not to sell used cars. They are not set-up to merchandise automobiles. The dealer is - and they are not disinclined to let him fulfill this function. (2)

Obviously, the experienced dealer is well aware of the risks he assumes as indorser on recourse contracts. However, there are many circumstances which induce him to use such a method of discounting. Among the more common of such circumstances are: The automobile manufacturing company under whose contract he operates may be a unit of a great holding-company that likewise controls a recourse finance company. If so, this manufacturer

(1) See Tables I, II, III, and IV for a comparison of the charges made by companies operating on a recourse and a non-recourse basis.

(2) E. R. A. Seligman - "The Economics of Instalment Selling" Vol. I. Pages 305-312 - give a full discussion of this point.

and the finance company jointly "expect" the dealer to use this particular finance company in his discounting operations. A second reason that is very influential has already been mentioned - the rate charged the purchaser is less than companies operating on a more "risky" (non-recourse) basis charge. This acts as a "selling-point" on prospective buyers. Still a third reason lies in the ineligibility of a great many used car contracts to conform to non-recourse company stipulations. This point will be discussed in detail next, when the matter of non-recourse financing is examined.

So the dealers, while realizing the liabilities they assume in recourse discounting, especially of used car contracts, nevertheless use this method in the great majority of cases. To just what extent the recourse method is utilized, is indicated by the following excerpt:

"50% of all companies reporting require indorsements by the dealer of 100% of the used car paper handled. 44% require indorsements on part of their used car paper, that is to say, 94% of all the reporting companies require partial or full indorsement of used car paper." (3)

Statistics are not available to show the extent to which new car contracts are discounted on a recourse basis. These figures were sought from the National Association of Finance Companies by letter. The reply stated:

(3) C. C. Hanch - President of the National Association of Finance Companies - "Safety-Zone of Automobile Financing" - Special circular to members - undated.

"Much of the statistical data for which you ask is unavailable. You will not be able to obtain definite figures from us or from any other sources. They have never been collected." (4)

An opinion would be that a greater portion of the new car paper than of the used car paper is discounted on a non-recourse basis, if for no other reason than that such paper is always eligible for this type of financing.

(4) Personal letter from M. V. Ayers - Analyst of the National Association of Finance Companies. - February 10, 1931.

Financing Methods - The Non-Recourse Plan.

When a finance company purchases an automobile contract "without recourse" or "non-recourse", (both terms are used interchangeably) the company assumes all liabilities which may arise thereafter. The dealer is not required to indorse the contract. From that point on, he is completely "out of the picture". Direct relations exist between the purchaser of the automobile and the finance company. All collections must be followed-up by finance company representatives. In case of default, all collection proceedings in law must proceed from the finance company, and in case of repossession of the automobile the dealer is under no liability to pay the outstanding balance. The essential difference lies here. The finance company must dispose of the repossessed car and must depend on such sale for the recovery of the outstanding balance due on the defaulted contract and costs of repossession. It cannot look to the dealer.

In non-recourse financing, the company bears all the risks of instalment selling. This assumption of liability is clearly reflected in the rates charged for their services. These rates tend to reflect the risks involved by the finance companies in both types of paper purchased, being higher for used cars than for new cars. Specific illustrations are given for each case in Tables I, II, III and IV.

This lack of liability on the part of the dealer makes this type of financing very desirable to him. Unfortunately, the handicaps mentioned in the previous discussion of recourse financing tend to restrict the volume of non-recourse financing. Especially the higher rates charged make a wide use of this method difficult. Then too, many of the larger automobile finance companies operate entirely with recourse. The General Motors Acceptance Corporation is the best illustration of this.

Unquestionably the greatest obstruction to a more wide-spread use of non-recourse methods, is to be found in the requirements which a contract must meet before it is eligible for discount. First, the automobile covered by the contract in question must be either new or not more than "three years old", if used. In determining "three years", the finance company counts the current year as one, last year as two, and the year preceding as three. So a car which was built in December of 1929 is "three years old" in January of 1931! An automobile manufactured in 1928 is declared ineligible now (May 1931). The second requirement is that the unpaid balance must not exceed the "blue book" or "red book" appraisal valuation. To appreciate the full significance of this, let us take an example: Suppose we take a new automobile that sold for one thousand dollars July 1, 1930. Referring to the "blue book" appraisal list, we find it valued in May 1931 at three hundred sixty dollars. This means that

the dealer will be able to sell the purchase contract covering this automobile to the finance company on a non-recourse basis only if the amount to be financed is not in excess of three hundred and sixty dollars. In other words, the dealer must take-in this car, recondition it and resell it for a figure not to exceed six hundred dollars. He must obtain the required forty percent down-payment of two hundred and forty dollars, which leaves a balance of three hundred and sixty dollars. Both of these books are published quarterly, each subsequent issue containing lower evaluations than the former with a view of allowing for added "wear and tear" on the car for the additional time it has been in use.

The "three years old" clause eliminates the greater number of used cars from eligibility for non-recourse financing. The "blue book" or "red book" evaluation basis further restricts the number of used car sales that may be so financed. When the dealer has assured himself that a contract meets with the above requirements, he must then be certain that the purchaser is a desirable credit risk. Before purchasing any contract, the finance company operating on a non-recourse basis will check the purchaser's credit thoroughly, either thru a credit bureau, or by means of a representative who makes regular visits to their dealer-clientele for the express purpose of purchasing these contracts. In case of any question, the dealer will be asked to endorse the contract. If he does not do so, it is

refused. Once the finance company accepts the contract, as previously stated, all liability on the part of the dealer immediately ceases.

These various requirements and restrictions allow but a relatively small percentage of the entire number of used cars sold to be financed on a non-recourse basis. Referring to a previous quotation, it will be remembered that "94% of all the reporting companies require partial or full indorsement of used car paper". (5)

In conclusion, this remark seems justified: Non-recourse financing is so surrounded by requirements and restrictions that only paper bearing a minimum of risk is accepted by the finance companies. Where there is any factor of potential danger, the dealer must endorse the contract. The finance company usually safeguards itself.

(5) C. C. Hanch - loc. cit.

Financing Methods - The Re-Purchase Plan.

The re-purchase plan is a hybrid which has evolved from the two previously discussed. It provides a means of financing the sale of used cars when the amount of the unpaid balance is in excess of the "blue book" or "red book" appraisal valuation. Under this plan, the finance company will give the dealer a check for the amount of the evaluation, and not require the dealer's endorsement. For the sum in excess of this, the dealer is given a conditional note which is transferable into money only if, and when, the purchaser has completed his instalment payments. In case of default, the finance company repossesses the car. The dealer has no liability - but his conditional note in terms of money is worthless. He may exercise the doubtful privilege of turning over the note to the finance company to apply as a part payment on the repossessed car (which will be sold to him or anyone else for the amount of the unpaid instalments plus costs of repossession) but if he does not do this, his note is a total loss.

This method of automobile financing has never had any great popularity among automobile dealers. It will be noted that the finance company and the dealer jointly carry the risk. However, the dealer is advanced only a part of the amount of the contract. For this amount, the company assumes the liability. Above this, the dealer occupies a position of some risk. Should the purchaser

not complete his payments the finance company secures the automobile. Unless the dealer wishes to purchase the used car, he has a worthless piece of paper for his share.

The rates charged by finance companies where the repurchase plan is in use are identical with those charged on the non-recourse basis. The reason for this is obvious. They assume full liability for a similar amount - i. e. - the amount of the "book" valuation - in each case.

No figures as to the extent of this method of financing are available. From personal experience with many automobile dealers in Michigan, an opinion would be that its use is extremely limited. Because of this and the impossibility of getting any data on this scheme of financing, it is given no emphasis in this study.

THE TRUE COST OF INSTALLMENT BUYING

The terms on which a dealer must sell his automobiles to have the contracts acceptable to a finance company, and the methods available to him in discounting these contracts have been discussed. Casual mention was made of the rates charged for finance company services. These rates will now be examined to determine the answers to these questions:

May the rates charged for loans from finance companies, in comparison with customary bank rates, be called excessive?

What additional consideration does the purchaser receive when he pays the higher rate for having his contract discounted on a non-recourse basis, than he would be charged if it were discounted on a recourse basis?

Are the buyers of automobiles cognizant of the true rates they are obliged to pay for the instalment buying privilege?

To determine the amount of the "carrying charges" - meaning the amount the purchaser has to pay in order to buy on time - is rather a complex procedure when a dealer sells an automobile on the instalment plan. In effect, the purchaser borrows a sum of money for a certain length of time from a finance company with which to pay the dealer for his purchase, and he pledges the automobile as security for the repayment of the loan, usually on a monthly basis. The amount the dealer must charge him for this loan depends on:

Whether the car being purchased is new or used.
 The length of time over which the loan extends.
 The amount of the loan.
 Whether the contract is to be financed on a recourse or a non-recourse basis.

To bring out the essential points, assume that a Chevrolet

dealer operating in Flint, Michigan, sells a new car for a price of \$675.00 on the standard terms, one-third down, and the balance payable on a monthly basis over a period of 12 months. First, the down-payment of \$225.00 is subtracted, leaving \$450.00. Every finance company demands that the purchaser insure his purchase against fire and theft. A buyer may want insurance against public liability, property damage, and collision. The dealer will gladly write into the contract the charge made for this additional insurance as a part of the balance to be financed, and thus it will be paid in instalments just like the amount of the principal due on the car. However, this additional insurance is optional with the buyer. The fire and theft insurance is not. In the case at hand, as the dealer handles the Chevrolet automobile, he will probably discount this contract with the General Motors Acceptance Corporation which operates its own insurance branch, the General Exchange Insurance Corporation, whose rates form an integral part of the finance company's rate-chart. On a car which sells for \$675.00, the fire and theft insurance charge will vary from \$4.00 in small country towns, up to \$9.00 for a city like Detroit, where the risk is considered much greater. For Flint, Michigan, the charge is \$6.00. Adding this to the unpaid balance of \$450.00, gives a total amount of \$456.00 to be financed. By referring to the General Motors Acceptance Corporation's new car rate-chart, the charge on \$456.00 for 12 months is \$38.00. The deferred balance is the sum of

these two amounts, \$456.00 and \$38.00 or \$494.00. This will be paid in instalments of \$42.00 for the first eleven months. The remainder of \$32.00 will constitute the last payment. ($11 \times \$42.00 = \462.00 . $\$462.00 \text{ plus } \$32.00 = \$494.00$)

In all cases, the procedure is the same. If the dealer is selling a used car, he first determines the insurance charge, adds it to the unpaid balance, and by referring to his "Used Car Chart" he locates the charge on the total of these two items for the six, eight, ten or twelve months over which the instalments are to be paid. The total of these three items; unpaid balance, insurance charge, and financing charge is then divided by the number of months over which the loan is to extend, to secure the amount of each payment. The last payment is often for a lesser amount, as this payment is made to equalize the sum of the payments with the entire amount due.

It will be seen that the dealer has four sets of rates, one of which he must apply. On new cars, he may use either a recourse or a non-recourse chart. On used cars, he may do likewise - if the used car is eligible for non-recourse financing.

Four tables have been constructed which portray the amount of the finance company charges as well as the actual percentage these charges bear to the amount borrowed. These show in turn the above items for:

- 1 - New cars sold retail - financed on a recourse basis.
- 2 - New cars sold retail - financed on a non-recourse basis.
- 3 - Used cars sold retail - financed on a recourse basis.

4 - Used cars sold retail - financed on a non-recourse basis.

On the new car tables, \$250.00 and \$1,000.00 have been taken as unpaid balances to show how the charges range from a smaller to a larger amount. \$591.00 has also been used because this figure represents the average unpaid balance due on new cars purchased during the year 1929. (1)

On the used car tables, the amounts of \$237.00, which was the average unpaid balance on used cars purchased for the same year, (1) and \$500.00 were chosen arbitrarily to show the range of the charges as the amount financed increased. On all tables, the charges are computed on the basis of 8 months, 10 months, and 12 months, for comparative purposes. Fire and theft insurance has been entirely omitted from the tables; the reason being to obtain a percentage rate that would represent "pure" financing costs.

(1) National Association of Finance Companies - "Chart of Composite Experience of Finance Companies and Automobile Dealers" - covering the years 1925 - 1929 inclusive - sent to members and others by special request.

Table I.

RATES CHARGED BY AUTOMOBILE FINANCE COMPANIES.

New Cars Sold at Retail - Financed on a Recourse Basis.

Time of Loan in Months.	Actual Amount of the Loan.	Amount Charged by the Finance Company.	Charge Figured in Per- centage.
8	\$ 250.00	15.00	15.99 %
10	250.00	17.00	14.83
12	250.00	20.00	14.77
8	591.00	34.00	15.33
10	591.00	40.00	14.77
12	591.00	46.00	14.36
8	1,000.00	53.00	14.13
10	1,000.00	62.00	13.52
12	1,000.00	74.00	13.66

(The data on which this table is figured are contained in the "G. M. A. C. Payment Chart for New Cars" - of October 15, 1928 - in current use at this time - May, 1931.)

Table II.

RATES CHARGED BY AUTOMOBILE FINANCE COMPANIES.

New Cars Sold at Retail - Financed on a Non-Recourse Basis.

Time of Loan in Months.	Actual Amount of the Loan.	Amount Charged by the Finance Company.	Charge Figured in Per- centage.
8	\$ 250.00	28.00	29.86 %
10	250.00	31.00	27.04
12	250.00	32.20	23.77
8	591.00	63.60	28.69
10	591.00	72.70	26.83
12	591.00	79.00	24.68
8	1,000.00	106.20	28.31
10	1,000.00	121.50	26.50
12	1,000.00	131.00	24.18

(The data on which this table is figured are contained in the "A. I. C. Automobile Discount Plan - for New Cars Only" - of the Associated Investment Company, South Bend, Indiana - in current use at this time - May, 1931.)

Table III.

RATES CHARGED BY AUTOMOBILE FINANCE COMPANIES.

Used Cars Sold at Retail - Financed on a Recourse Basis.

Time of Loan in Months.	Actual Amount of the Loan.	Amount Charged by the Finance Company.	Charge Figured in Per- centage.
8	\$ 287.00	28.00	26.02 %
10	287.00	33.00	25.08
12	287.00	37.00	23.85
8	500.00	40.00	21.33
10	500.00	48.00	20.94
12	500.00	55.00	20.31

(The data on which this table is figured are contained in "G. M. A. C. Payment Chart for Used Cars Only" - of July 15, 1930 - in current use at this time - May 1931.

Table IV.

RATES CHARGED BY AUTOMOBILE FINANCE COMPANIES.

Used Cars Sold at Retail - Financed on a Non-Recourse Basis.

Time of Loan in Months.	Actual Amount of the Loan.	Amount Charged by the Finance Company.	Charge Figured in Per- centage.
8	\$ 287.00	\$ 42.44	39.42 %
10	287.00	48.62	36.95
12	287.00	53.20	34.22
8	500.00	76.80	40.95
10	500.00	86.50	37.73
12	500.00	94.00	34.70

(The data on which this table is figured are contained in the "A. I. C. Automobile Discount Plan - for Used Cars Only" of the Associated Investment Company, South Bend, Indiana - in current use at this time - May, 1931.)

On Table 1, percentage rate ranges from	13.66 - 15.99
" " 2, " " " "	24.18 - 29.86
" " 3, " " " "	20.31 - 26.02
" " 4, " " " "	34.70 - 39.42 (1)

Accustomed as people are to thinking of loans in terms of banks' rates of interest, the rates charged by the finance companies seem very high.

- (1) The method used in computing the percentage rates in the tables is the same as that used by Professor Seligman in his book - "The Economics of Instalment Selling" - Volume 1, page 288.

The first step is to determine what the percentage rate would be for the amount of the loan on an annual basis, which is obtained by dividing the amount of the finance company's charge by the amount of the loan.

Provision must be made for the monthly reduction of the loan by reason of the instalment payments. "Suppose for instance, that the note is for two months. In order to obtain the coefficient - (meaning a number by which the rate discussed in the preceding paragraph must be multiplied to allow for the monthly reduction) - it would be necessary to multiply the 12, which represents the number of months in the year by 2, which represents the 2 months outstanding. This would then have to be divided by 3, since one of the payments has already been made at the end of the first month, and since therefore, one instalment was outstanding one month and another 2 months, or both together 3 months. In other words, the coefficient would be arrived at by ascertaining the following fraction:

$$\frac{12 \times 2}{1 \times 3} = 8.$$

Utilizing the same method for each successive period, we arrive at the following scale of coefficients:

8 months	- - - - -	2.666
10 "	- - - - -	2.181
12 "	- - - - -	1.846

or

$$\frac{12 \times 12}{(1 \ 2 \ 3 \ 4 \ 5 \ 6 \ 7 \ 8 \ 9 \ 10 \ 11 \ 12)} = \frac{144}{78}.$$

By using this coefficient therefore, the discrepancy between the percentage rate per annum and the true cost will be apparent." (2)

The mathematics used in the tables have been checked

A second conclusion seems warranted: Purchasers are often charged a higher rate, in consideration for which they get nothing they would not receive if they were to pay the lower rate.

To prove this assertion, refer to table III. Note that a purchaser borrows \$500.00 for 12 months, for which he pays charges amounting to \$55.00 or 20.51%. Now refer to table IV and observe that the same loan, for the same period of time costs him \$94.00 or 34.70%. In each case, the consideration received is identical. In one case, the dealer has discounted the contract on a non-recourse basis, while in the other, he has discounted it on a recourse basis. This means nothing to the purchaser. He is not aware of what basis has been used in discounting his contract. Yet he has been charged an additional \$39.00, or in terms of percent - 14.39%.

Speaking before the Second Annual Automotive Financing Conference in Chicago, November 16 - 17, 1923, C. C. Hanch, General Manager of the National Association of Finance Companies called attention to this obvious injustice to purchasers.

"I know that there is a difference of opinion on the subject of endorsement or non-endorsement of contracts, but notwithstanding this, there is a principle involved. Regardless of whether the dealer does or does not endorse the paper is of no consequence as far as the retail customer is concerned. Finance companies should not employ

With use of actuarial interest tables.

two sets of rates that the user must pay for the same service." (3)

The rate-charts used to illustrate the costs of instalment credit are in current use in Michigan today - proving that this practice has not been corrected up to the present time.

In view of the more costly method of borrowing from automobile finance companies, why do not purchasers secure loans from banks? Seligman, who made a detailed study of the economics of instalment selling states two major reasons. (4) In many cases, the buyer has nothing to offer the bank as security on which to obtain a loan. A second reason is that the purchaser is usually unaware of the rate he is actually charged by the finance company.

When a dealer or a salesman is asked the rate it costs to borrow on the time-payment plan, "he has three well-known methods he resorts to:

- 1 - He computes the rate of charge without allowing for the monthly reduction of the principal.
- 2 - He figures the rate on the entire selling price of the car without allowing for the down payment.
- 3 - Or he makes no allowance if the contract runs for less than a full year." (5)

Finance companies often aid in such deceptions. On the rate-chart of one of the largest automobile finance companies in the United States, are these words: "Multiply unpaid balance by 7 $\frac{1}{2}$ %

3 - C. C. Hanch - loc. cit., page 16.

4 - E. R. A. Seligman - op. cit., Vol. I, page 292.

5 - Ibid., page 228.

to obtain the charge." (6) In no case is the charge as shown by the above tables less than 13%.

"In the attempt to make their rates compare favorably with bank interest, a number of finance companies have resorted to the plan of stating their rates in the form of an interest, but in a way that does not reveal the 'true rate.' " (7)

The primary concern of the dealer and the salesman is in making sales. Obviously, neither of them will jeopardize a sale by saying to a buyer: "The rate we must charge you is only 35%." A deception is necessary. Another writer on this subject infers that the buyer seldom if ever knows the true rate of the charges he pays. (8)

In summarizing this discussion, it seems the following points deserve mention:

First, the real cost of instalment buying, at least viewed from bank loan standards, is very high.

Second, the amount the buyer pays varies for the identical consideration he receives, depending on whether his purchase-contract is discounted on a recourse or a non-recourse basis - a matter over which he has no control.

Third, the purchaser of an automobile on instalment credit is usually deceived as to the true rate of interest charge he is obliged to pay.

(6) General Motors Acceptance Corporation's Rate Chart for New Cars - October 15, 1928.

(7) E. R. A. Seligman - op. cit., page 292.

(8) Ralph Borsodi - "The Distribution Age." - page 171.

In this, and the preceding parts of the study, the technique employed in the selling and financing processes, and the costs paid by the purchasers who exercised the instalment buying privilege have been discussed. The next part of the study deals with the instalment sale of new cars; the part following that with used cars.

NEW CARS: RISKS ASSUMED AND LOSSES INCURRED

This discussion will be confined to the subject of instalment selling as it effects new cars only to determine just what risks are involved in the time-sale of new cars, who assume these risks, what losses result and to whom these losses accrue.

To determine what risks might result from the time-sale of a new car, the actual situation must be borne in mind. The purchaser who has bought the new car has a paid-in equity equal to at least 33 1/3% of the retail price. The finance company that holds the contract, has the remaining equity of 66 2/3%. In addition, it also holds a lien on the car, which is legally enforceable immediately upon the buyer's default.

Now, what might happen to the automobile, to endanger their claim? Experience has shown six potential happenings which may affect either the automobile or the purchaser and thus endanger the claim of the finance company either wholly or partly, as the case may be. They are listed as follows:

Case 1 - The automobile may catch on fire.

Case 2 - It may be stolen and not recovered.

Case 3 - The purchaser may "skip" - leave the locality and not be found.

Case 4 - The automobile may be confiscated for violation of law.

Case 5 - The automobile may be "wrecked" thus rendering it less valuable or even wholly worthless.

Case 6 - The purchaser may be unable to meet his payments, and thus necessitate repossession.

Both recourse and non-recourse companies assume losses resulting from the contingencies mentioned in Cases 1 to 5 inclusive. If the company operates on a non-recourse basis, it also assumes the risk involved in Case 6. If the contract has been discounted with a recourse company, the dealer is liable in this case.

Cases 1 and 2 above require no discussion. As previously pointed out, every car sold on the instalment plan is covered by fire and theft insurance paid for by the purchaser. This insurance covers the car up to 80% of its valuation for one year - (the time during which the instalment debt is being liquidated) - and the loss-payable clause runs to the finance company. The finance company thus protects itself against any loss should either of these contingencies occur.

In Case 3, where the purchaser "skips" with an automobile, which carries an unpaid balance, the finance company that holds the lien suffers the loss. However, in practice this seldom occurs. A Michigan statute makes this a criminal offense, (1) and many of the states of the union have enacted similar laws. (2) This legislation acts as a deterrent toward such removals of property under mortgage. Then too, in the case of new car paper discounted to a non-recourse finance company, the credit investigation of the purchaser by the company is quite exhaustive. "Properly organized finance companies cause a lengthy and careful investigation to be made of every applicant. He signs a purchaser's statement, attesting to the permanency of his

(1) Charles H. Hulvey - "Uniform Conditional Sales Law" - Commercial Law - Appendix B - Page 593.

(2) Ibid., Page 589.

occupation, the amount of his monthly income, the number of his dependents, his past credit record, the moral hazard, the amount paid in cash and balance due to show the proper equity in the collateral. The applicant must first prove his right to ownership before the sale is approved." (3) In addition, the names and addresses of several of the buyer's relations and employers are a part of this credit statement, as are the addresses for several years past of the purchaser himself. So in order to "skip" with the automobile, the purchaser must do so in such a manner as to block attempts at tracing him through these many sources. If he has been habitually moving around the country, his contract is ineligible for non-recourse discounting. If he has not, then leaving for an unknown destination with the automobile amounts to making of himself an exile thereafter.

It is impossible to estimate just what deterrent effects the foregoing have toward preventing these illegal removals of mortgaged property. The fact remains that the total number of "skips" constitute a minor item. No records of them were kept until 1928, but in that year the total number involved in each one thousand contracts financed amounted to only 4.7. In 1929, skips per thousand contracts purchased increased to 5.2. (4) It is impossible to say what part

(3) H. L. Braham, - "Consumers' Credit in America and Its Relation to Present and Future Prosperity" - an address before Institute of Public Affairs, University of Virginia. (undated)

(4) National Association of Finance Companies, 333 North Michigan Avenue, Chicago, Illinois. "Composite Experience of Finance Companies and Dealers" - covering the years 1925-1929 inclusive.

of these numbers were new cars. Nevertheless, it would be a very small item. Losses accruing from this source, in comparison with the total amount of the new car contracts financed, are bound to be small.

Losses resulting from Case 4, confiscation, are of a minor nature. The law of Michigan provides that the party holding a mortgage on personal property is protected from confiscation, if a copy of this mortgage has been duly filed with the proper authority. (5) In this state, the proper authority is the clerk of the city, village, or township where the purchaser resides. Purchase contracts contain as a part thereof a "filing copy" of the mortgage which the dealer is obliged to record. The finance company as mortgagee mentioned in the purchase contract may, and does, secure possession of automobiles confiscated by governmental agencies for various violations of law. In all cases of confiscation, therefore, where the mortgage has been filed, losses sustained are obviously small. (6)

(5) Personal conference with Dr. Thrun at Michigan State College, East Lansing, Michigan, May 6, 1931.

(6) In the "Composite Experience of Finance Companies and Dealers" published by the National Association of Finance Companies, Chicago, Illinois, previously referred to, no mention is made of any losses from this cause.

The preceding cases dealt with total loss of the automobile. Case 5, known in the trade vernacular as "collision losses" never result in a complete loss. Even though it may be impossible to rebuild the new car, still it has considerable value to a dealer who may sell it piece-meal through his "Parts Department".

A great number of collisions result in comparatively minor damages, which may be readily repaired either in the repair shop of the automobile dealer, or by some specialist. Where these collisions occur, the owner invariably has the car repaired, and thus the finance company and the dealer are in no way affected.

In the event of serious wrecks, the situation is somewhat different. If the purchaser is prudent, he has some form of insurance coverage. Invariably the dealer, or at least some of his salesmen are agents for an insurance company. The purchaser, who is susceptible to the instalment buying habit, may have any kind of an automobile insurance policy written into his contract. If the dealer is not successful in making the sale, certainly insurance salesmen are not lacking who may be more fortunate. However, even they may be unsuccessful. Then, if this purchaser's car is seriously damaged, he must have the repair work done, and pay the bill. Or if it is not feasible to have it rebuilt, then he is legally obligated to make his instalment payments just the same. This is rather hard to do. It is human nature to dislike to pay for a thing from which we are not receiving the services or value con-

templated when it was purchased. In case this buyer attempts to avoid payment, if there is any likelihood of collecting, the finance company will enter suit for his contractual breach. In those cases where they cannot, or do not collect, then the "wreck" will be disposed of to the highest bidder, and the finance company stands the resulting loss.

Notice however, the "lines of defense" which must be disposed of before a loss accrues to the finance company. 1st - The car must be damaged seriously or completely wrecked. 2nd - There must be no collision insurance covering it. 3rd - The purchaser must default in his payments, and even then the finance company has the law on its side. 4th - He must prove uncollectable - which is quite unlikely or he would not have been a good risk in the original sale. If all these contingencies occur, the finance company whether operating on either a recourse or non-recourse basis, must assume the loss.

However, in the absence of any figures to prove the point, it seems a logical assumption that all of these contingencies would seldom occur. If this assumption is accepted, then it follows that losses mentioned in case 5 do not constitute a serious item. The fact that all finance companies regardless of their recourse or non-recourse status, accept liabilities resulting under the "Three C's" as the trade terms it - meaning losses resulting from

Collision, Conversion (Ships) or Confiscation - is in itself indicative of small losses.

A study of Case 6, repossession, offers something more definite on which to work. Too well known studies have been made, which follow.

TABLE V.

NEW CAR REPOSSESSIONS - - - - -

(Repossessions reported by dealers
representing all automobiles of
General Motors manufacture.)

Year	Percent of Total Number Sold.
1921 - - - - -	.76 $\frac{2}{3}$
1922 - - - - -	.33
1923 - - - - -	.84
1924 - - - - -	-1.25
1926 - - - - - (Covers first half of year only) - - -	.98

TABLE VI.

(Repossessions reported by finance
companies, handling contracts
representing all makes of new
cars.)

Year	Percent of Total Number Sold.
1925 - - - - -	-1.7 $\frac{2}{3}$
1926 - - - - -	-2.1
1927 - - - - -	-2.7
1928 - - - - -	-2.8
1929 - - - - -	-2.8

Data for Table V. from - E. R. A. Seligman, "Economics of Instalment
Selling" - Page 437 - Vol. II.

Data for Table VI. from National Association of Finance Companies,
"Composite Experience of Finance Companies and Dealers".

From these tables, two observations are in order: First, the number of new cars repossessed in any one year has not constituted as much as three percent. Second, the trend of repossession is apparently upward. A third inference that new car repossessions are less in case of General Motors cars than others is hardly warranted as the data do not cover corresponding years.*

Table VII. has been constructed based on actual practice which will throw some light on the situation. In this case, a down payment has been used of 55.6%, which is not out of line with actuality.

*These studies do not reveal the losses resulting from repossessions. In a letter to the writer, dated February 10, 1931, Milan V. Ayers, analyst of the National Association of Finance Companies, states: "You will not be able to obtain definite figures on repossessions either from us or from any other concern. They have never been collected."

TABLE VII.

ILLUSTRATING PURCHASER'S INCREASING EQUITY AS
HIS INSTALLMENT DEBT IS LIQUIDATED

(An automobile of medium price
is taken for illustrative pur-
poses only.)

Cash price of the automobile is	\$1,500.00
Finance charges (including Fire and Theft Insurance) are	<u>84.00</u>
Total Time Price is	1,584.00
Down payment (35.6%) is	<u>564.00</u>
Leaving a Deferred Balance of	<u>1,020.00</u>
To be paid in 12 instalments of	85.00

At the end of:	Purchaser's paid-in equity is:	Percent of total he has paid in is:	Leaving an unpaid balance of:
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1st Mo.	\$ 649.00	40.3%	935.00
2 "	734.00	46.3	850.00
3 "	819.00	51.7	765.00
4 "	904.00	56.4	680.00
5 "	989.00	62.4	595.00
6 "	1,074.00	69.9	510.00
7 "	1,159.00	73.2	425.00
8 "	1,244.00	78.5	340.00
9 "	1,329.00	83.9	255.00
10 "	1,414.00	89.3	170.00
11 "	1,499.00	94.6	85.00
12 "	1,584.00	100.	.00

In the retail automobile trade, the customary practice is to depreciate a new car 40% for the first year of its life. In other words, assuming ordinary "wear and tear" of usage, a car which came out the year previous is given an evaluation by dealer of approximately 60% of its new car price. The "blue book" is constructed on this basis.

By referring to table VII, it will be observed that by the time the purchaser has had his car in excess of one month it is 40% paid for. It is now clear why the finance company operating on a non-recourse basis, or the dealer when he discounts on a recourse basis, suffers no loss through the repossession of new cars. The purchaser has paid for a full year's ordinary depreciation in the first month of his ownership. The automobile can be resold usually at a figure greater than 60% of its original selling price.

The points made in this discussion may be summarized as follows: There are six potential sources of loss in selling new cars on the time-payment plan: Fire, theft, conversion, confiscation, collision, and repossession. All finance companies bear the risks of losses from fire and theft. Actually such losses are kept at a minimum to both finance company and dealer by requiring fire and theft insurance in every new-car contract.

Losses from conversion, confiscation and collision are

assumed by the finance companies regardless of whether they operate on a recourse or a non-recourse basis. Laws declaring conversion a criminal offense, and an exhaustive "purchaser's statement" apparently act in such a way as to have caused losses resulting from "shipping" to be almost a negligible item. Great care is taken to insure against losses by confiscation, which seldom occur in the case of new cars. Before a finance company is required to bear a loss as a result of a collision, the car must be seriously damaged, there must be a total lack of any kind of collision insurance, the purchaser must default in his payments, and he must prove uncollectable. When a new car is repossessed, neither dealer nor finance company is compelled to stand a loss. In this case, the purchaser is the loser.

In conclusion, it appears that the risks incident to selling new cars on the instalment plan are of a minor nature, the resulting losses constitute a small fraction of the total volume of new car paper financed, and work no severe hardship on either the dealer or the finance company.

USED CARS - A:

TYPES OF USED CAR CONTRACTS DEALERS SELL TO FINANCE COMPANIES -
 RISKS ASSUMED BY EACH - LOSSES INCURRED.

The registration figure for 1930 of the automobiles in the United States given out by the National Automobile Chamber of Commerce totaled 26,718,000. All of these are used cars! Included in this figure are all different makes, and body types, representing all the different stages of "wear and tear." The dealer, as they come to him through the channels of trade, finds that each one presents its problems. Here is one that will warrant a complete overhaul; this one would not repay such an additional outlay and so must be "touched up" just enough so it will sell; this battered old wreck is only fit to junk. Each one presents a problem of financing in the same manner.

If a used car is "three year old" or less, and can be sold to a good credit risk on a basis to conform with "blue book" value, the contract will be acceptable on a non-recourse basis. If the used car is "three year old" or less but the purchaser is not an acceptable risk to a non-recourse company, or if the unpaid balance is in excess of the "blue book" appraisal, this car must be financed on a recourse plan. Or, if the car is over the three year limit, but a valuable automobile nevertheless, it is only eligible for recourse financing.

There are a great many cars that are not included in either of the classes mentioned, yet are always a part of the dealer's used car stock. These are the cheaper automobiles ranging from the "junkier" up to what has been termed in the preceding paragraph as the "valuable." Just where should the line be drawn between the "cheap" and the "valuable" classes? The answer is important. Obviously a "cheap" used car is eligible only for financing on a recourse basis, if it is wise to discount a contract on such an automobile at all.

It will be remembered that when an automobile is repossessed, if it has been financed on the recourse plan, the dealer-endorser is liable not only for the unpaid balance on the car itself, but for the unpaid portion of the "carrying charges" as well. A dealer dislikes to repossess a used car at any time. When he is compelled to pay not only the balance due on the car, but also for the charges equivalent to those shown on Table III, it proves expensive to the dealer. After a few experiences in which this has happened, he safeguards himself by discounting only his safest paper. This is the paper secured by a down payment of at least forty percent, sold to "good risks," and on cars that are unlikely to produce dissatisfaction to buyers because of mechanical defects. If the dealer adheres to this policy, he is minimizing his losses from repossession of financed cars, and he avoids paying the high carrying charges.

So it is only on the more "valuable" types of used cars that a dealer is likely to discount the contracts. What he does with his

paper covering cars of the "cheaper" kinds will be clear from the following example. In this case, a dealer has sold a used car at a price of \$140.00:

Used car selling price	\$ 140.00	
Charge for fire and theft insurance	4.00	
Financing charge	<u>20.00</u>	
Total time price		\$164.00
Down payment (40%)	56.00	
Deferred balance	<u>108.00</u>	164.00

Payments: \$20.00 per month for 5 months.
8.00 for the sixth month.

The buyer in this case is actually borrowing \$88.00 from the finance company to be repaid on the instalment plan over a period of six months. In other words, if the purchaser had this \$88.00 in addition to the \$56.00 which he paid down, he would save the \$20.00 carrying charge.

Just what does the percent paid by the purchaser for his loan? On a principal of \$88.00 on which \$20.00 is charged, it equals 22.72% on an annual basis. For a period of six months, it is equivalent to 45.44%. Now allowing for the monthly reduction due to payments, the true charge is 77.88%! (1)

Obviously no prudent dealer will endorse such a contract as this. The potential dangers are too many. A car which sells for only \$140.00 is apt to give "grief" resulting in a defaulting buyer because of its many functional weaknesses. Second, a purchaser

(1) - The method used to compute this rate is given in detail in the footnote on page 32.

who buys a car of this type, and price class, is quite likely to be of limited purchasing power, possibly of less steady income, with a small (if any) bank account in reserve against a sudden emergency. A possible third danger lies in the fact, that on the basis of his down payment, the buyer may hold off making his first monthly payment and drive the car for a second month. Thus he secures use of the automobile for a period of about eight weeks, which is equivalent to a modest rental of \$7.00 per week on the basis of his original investment of \$56.00. Then, if anything goes wrong with his vehicle (which isn't altogether unlikely) rather than pay the \$40.00 now due by reason of his delinquency, then he is certain to welcome repossession. A fourth danger, perhaps, is that the purchaser may, after the excitement of the sale is over, figure out the rate he has been charged for his instalment loan and decide he has made a questionable bargain.

The dealer is familiar with all of these dangers. In the face of this knowledge, and from his past unpleasant experiences, there is only one thing left for him to do with contracts of this kind: That is to carry them himself. So every automobile dealer is a "miniature finance company."

The survey among the fifty dealers of Michigan was aimed to determine this point: To what extent do automobile dealers hold their own paper, and with what results? While the results of the survey form the basis for the next section of this study, nevertheless, the following table is of interest at this time.

Table VIII.

Extent to which Michigan dealers "carry" their own
automobile contracts.

(Based on the practice of fifty dealers
studied.)

Retail price of used car.	Number dealers who hold this paper.	Number dealers who discount this paper.
Up to \$ 100.00	50	0
100 - 150.00	50	0
150 - 200.00	46	4
200 - 250.00	17	33
250 - 300.00	2	48

The table indicates considerable uniformity among dealers in holding their own paper covering used cars selling for \$200.00 or less. In the case of the two dealers who held the paper on cars selling up to \$300.00, it was found that these dealers' businesses were well capitalized, and that they carry all their own paper.

From the table, there appears to be two sets of data which should be considered. Now the dividing line between the "cheap" and the "valuable" used cars can be drawn. In class I, are the "cheaper" used cars selling for \$200.00 or less, contracts for which are largely carried by dealers themselves. Class II represents contracts covering the more "valuable" used cars sold at prices ranging from \$200.00 up, which are in the main discounted with the various automobile finance companies. The contracts included in class I will be considered in

the next part of our study; only paper embodied in class II is discussed here.

As in the case of new cars, there are six occurrences in which loss might result: Fire, theft, conversion, confiscation, collision or repossession.

Protection against fire and theft is secured through the usual insurance stipulation. The dealer and the finance company incur no loss should either of these contingencies arise. Both the recourse and the non-recourse finance company assume responsibility for losses resulting from the "three C's." These losses seldom occur. The same causes that were effective in preventing such losses in the case of new cars are also operative here.

"The essential point in the credit risks ascribable to installment selling is connected with repossessions and the used-car problem."

(2) This is but logical. It has been shown that conversions or "skips" occur only four or five times out of a thousand cases. (3) Repossessions occur every day. The following quotation indicates that the real crux of installment selling lies in this matter of repossessions, and it also indicates that the party who assumes the repossession-risk assumes the real risk of the installment plan.

"When asked as to the causes of the dealers' failures that were responsible for the losses (to the banks resulting from loans extended to dealers who became insolvent) the great majority of the

(2) - E. R. A. Seligman - op. cit., page 305.

(3) - National Association of Finance Companies - 333 N. Michigan Ave., Chicago, Ill. - "Chart of Composite Experience of Finance Companies and Automobile dealers" - page 1.

bankers gave as the chief explanation of failures, the sad experiences of the dealers with repossessions and too large allowances on used cars." (4) The questionnaire from which this information was derived was sent to 4,500 banks in cities of various sizes and in every state of the Union.

In the remainder of this discussion, the extent of repossessions resulting from used car contracts discounted to finance companies will be examined; secondly, the amount of loss sustained on used cars repossessed; and finally, for how many of these used cars, the finance companies assumed the losses resulting, and how many were turned over to the dealers so that the losses would accrue to them by reason of their endorsements.

Table IX.

USED CAR REPOSSESSIONS - (5)

(When contracts have been discounted with finance companies - In percentage of total number of used car contracts purchased.)

Year	Where down payment was 40% - (Standard terms.)	Where down pay- ment was 35% or less.
1925	3. %	6.2 %
1926	4.3	8.6
1927	5.2	6.9
1928	5.3	10.9
1929	5.3	9.0

(4) E. R. A. Seligman - op. cit. pages 301-302.

(5) National Association of Finance Companies - op. cit. page 1.

From this table, two observations are in order: Where the standard down payment of 40% has been made, repossessions have increased every year over this period with the exception of 1929, during which year they remained the same. Secondly, where the down payment was only 35% or less, repossessions increased considerably. The exact amount of this increase over the standard terms, would be as follows:

Table X.

Percentage of increase in used car repossessions where down payment was 35% or less over percentage of repossessions where 40% had been paid down.

1925	showed an increase of 105% over standard terms.					
1926	" " "	"	101%	"	"	"
1927	" " "	"	31%	"	"	"
1928	" " "	"	93%	"	"	"
1929	" " "	"	70%	"	"	"

Unfortunately, an average loss per used car repossessed has never been obtained. (6) The two detailed studies made of this subject have figures on the losses accruing to new and used cars jointly, but a separate average loss for each has not been secured. Both Professor Seligman (7) working with data furnished him by the General Motors Acceptance Corporation, and C. C. Hanch (8) General Manager of the National Association of Finance Companies, have calculated the loss per repossessed car to be \$50.00 for the year 1925.

(6) See page 17.

(7) E. R. A. Seligman - op. cit., page 304.

(8) C. C. Hanch - op. cit., page 2.

It has already been shown that losses on new cars repossessed were a negligible item, so it follows that almost the entire loss per car repossessed is the result of used car operations. Both of these studies were based on operations over the year 1925. Milan V. Ayers, the official statistician of the National Association of Finance Companies accepts the same figure for the year 1925, and offers the following in addition: (9)

Table XI.

Loss Per Car Repossessed.....

1926	\$65.00
1927	43.00
1928	56.00
1929	60.00

This establishes an idea at least of the loss per repossessed car. It is of interest to find out the proportionate shares borne by the finance companies and the dealers. The table below will be helpful: (10)

Table XII.

	June 30 1929.	June 30 1930.
Value of repossessed cars in finance company possession.....	\$ 172,000.00	\$ 297,000.00
Value of cars repossessed for dealers with dealers' liability to finance company.....	\$1,314,000.00	\$2,382,000.00

(9) Chase Nat'l. Bank Bulletin - "Instalment Credit Experience"
August, 1930.

(10) National Association of Finance Cos.- op. cit., page 1.

It is regrettable that these amounts are not separated into new and used cars. They do indicate however, one important thing: That on June 30, 1929, repossessed cars valued at \$1,486,000.00 were on hand. Of this amount, the finance companies would collect from their dealer-clientele by reason of dealers' endorsements, a total of \$1,314,000.00, or 87% of the total worth of their repossessed cars. On June 30, 1930, the total value of all repossessed cars was \$2,679,000.00 of which amount \$2,382,000.00 or 87.5% was chargeable back to the dealers.

In a concluding summary of this discussion, the following points seem to deserve mention:

- 1 - Dealers discount with the finance companies only the paper covering the more "valuable" used cars, which our survey indicate to be used cars selling for \$200.00 up. The greater likelihood of repossession and the high carrying charges the dealers would be required to pay in addition to the unpaid balance on the car itself make it unwise to discount contracts on cars of the "cheaper" class - selling for \$200.00 or less.
- 2 - On contracts discounted to the finance companies, the companies assume risks of conversion, confiscation and collision. Losses from these causes do not occur often. In relation to total value of used cars financed, they would amount to a very small percentage.
- 3 - The great source of loss in the sale of used cars is repossession. It has already been shown that 94% of the finance companies reporting to the National Association of Finance Companies "require partial, or full endorsement of used car paper." (11) The fact that 87% of all repossessed cars were charged back to the dealers by reason of dealers' endorsements, prove the quotation correct. (12)
- 4 - This conclusion follows: As repossession is the chief cause of loss in the instalment sale of used cars, then as the dealers assume 87% of the repossessions, and the finance

(11) C. C. Hanch - op. cit., page 4.

(12) See table XII.

companies only 13%, it seems that by far the greater share of the risks and resulting losses incident to the instalment sale of used cars is borne by the automobile dealers - not by the finance companies.

- - - - -

The facts on which these conclusions are based apply only to contracts discounted. It was shown that repossessions tend to increase greatly when a down payment of less than 40% is made. (13) The next discussion deals with paper held by the dealers - not discounted - where there are no standard terms or fixed down payments to which they must conform.

(13) - See table X.

USED CARS: B TYPE OF CONTRACTS DEALERS "CARRY"

THEMSELVES. INSTALMENT RISKS AND RESULTING

LOSSES ON THESE CONTRACTS

In the preceding section of this paper, it was seen that there were two classes of paper resulting from selling used cars on the instalment plan. In one type, were included contracts secured by used automobiles selling for \$200.00 and more. It was found that such contracts were usually discounted to the various finance companies. The other type of paper, secured by automobiles selling for \$200.00 or less, was carried by the dealers themselves. To appreciate the nature of this paper, it might be well to examine the security behind it.

Let us take as an example an automobile that will sell for a price of from \$150.00 to \$200.00. People who are in the market for a car of this price usually expect a "bargain". The experienced dealer endeavors to cater to such desires. Naturally he cannot afford to recondition it by way of new pistons, bearings, and the more expensive work, as he cannot raise the price sufficiently to cover these extra costs. He will probably "bump" it to take out the dents, give it a cheap "paint-job", have one of his mechanics do such work as is necessary to make the car salable, then possibly set-back the speedometer, and the result is a bargain! It will look "like new", start readily, and its "knocks" will be inaudible to the layman.

Now let us examine a car that will bring to the dealer a sum of from \$75.00 to \$150.00. This should be another bargain. Very little will be spent in getting it into salable condition. It will be washed, polished, and top-dressed. The car will present a pleasing appearance to the uncritical eye.

Automobiles that sell from \$25.00 to \$75.00 are known in the trade as "junkers". The reason for this term is because a dealer, if he has the space available to store it, may sell it out by "parts" and dispose of the remainder to the "junk-man". In this way, he ordinarily will secure as much for it as though he would sell it retail. If he decides to sell it retail, then the tires must be kept inflated, and it must start. It might be washed - and here is another bargain.

Cars such as these constitute the security of the paper carried by the dealers. The class of people who buy cars of this kind are the dealers' "risks".

Contracts of this kind have never been considered in previous studies of instalment selling in the automobile business. Yet cars of the types discussed here are invariably sold on the instalment plan. Therefore these contracts should not be ignored in any study of instalment selling.

A survey had to be made to obtain the necessary data. (1)
The territory included in the survey, the sources from which material was secured, the purposes in mind when securing the information have already been mentioned. (2)

The present discussion is divided into two parts. In the first, matters such as the down payments required, time over which the payments extend, and the types of buyers who constitute the automobile dealers' market, are considered. In the second part of the discussion the results of the survey are examined.

(1) The president of the Saginaw Financing Corporation was interviewed. He thought the information desired might be obtained from the National Association of Finance Companies, 333 North Michigan Avenue, Chicago, Illinois. Upon inquiry, the statistician of the National Association of Finance Companies stated that such data have never been collected, so a personal survey was necessary.

(2) See "Sources from which the Material was taken".

As to the amount of the down-payment required, considerable variation existed among the dealers. In every case, the dealer admitted that "he got all he could", but under the pressure of competition, he was loathe to lose a sale. The general policy seemed to be that on cars retailing from \$150.00 and up, the dealers tried to get one-third down, but in very few cases would they turn down the sale if a payment of 25% down was offered. With cars selling from \$25.00 up to \$150.00, no general policy seemed to predominate. It seemed to be purely an individual matter, with a few dealers holding-out for from one-fourth to one-third down, and other dealers who would take as little as \$10.00, if they thought the risk fairly safe. Local competition and the volume of used cars on hand apparently determine the policy employed in selling the cheaper types of used cars. With those more expensive, the practice of the finance company with its standard terms seems to influence the dealers' policy.

The time for which these contracts run was also variable. The general policy with the more expensive cars in this study, was to allow a maximum time of twelve months, but to require a minimum monthly payment of \$20.00. Less than this amount, the dealers seem to think, was to put an automobile "into circulation" for less than a rental figure, and therefore, encourage default if the car should prove unsatisfactory. Thus a car with

a deferred balance of \$120.00 would have to be paid for in six months. It can be seen that few used cars of this kind would allow a time for the payments to extend twelve months.

With the cheaper cars, the time allowance is extremely variable. Usually the dealer ascertains the time when the purchaser receives his income. If he is a factory worker and receives his wages twice per month, his payment falls at those times. Often, where he is paid weekly, his contract is written calling for payments accordingly. Dealers' experience have taught them that restriction of time on car payments insures against delinquency and default.

Although there are purchasers of "strong buying power" who buy cars such as those concerned in this discussion, dealers generally agreed that the people who comprise the buyers of such automobiles are those of the "lower buying power", day-laborers, young men often under twenty-one, those whom we generally conceive to be "the poorer risks".

TABLE XIII

1930

EXPERIENCE OF FIFTY MICHIGAN DEALERS STUDIED IN SELLING USED CARS BY
THE INSTALLMENT METHOD.

(Pertains Only to Sales for Which Dealers Carried Notes.)

Retail Price	Number Sold.	Actual Repos- sessions.	Percent of Total sold.	Losses from Other Causes.	Not paid for and Not Re- possessed.	Total Re- faults.	Percent of To- tal Sold.
\$200-							
250	905	111	12.26	6	0	117	12.93
150-							
200	2360	357	15.13	24	0	381	16.14
75-							
150	3043	464	15.22	60	52	576	18.93
25-							
75	2280	366	16.05	26	158	550	24.12
	8588	1298	15.12	116 [#]	210	1624	18.91

[#] "Losses from Other Causes" included losses suffered as a result of confiscation, conversion or serious collision of the automobile, as well as losses because of fire or theft, from all of which the dealer suffers a complete loss. In the cases listed, the dealers did not secure repossession of the automobile, nor were they paid the balance remaining due on them.

TABLE XIV.

1929

EXPERIENCE OF FIFTY MICHIGAN DEALERS STUDIED IN SELLING USED CARS BY
THE INSTALLMENT METHOD.

(Pertains Only to Sales Where Dealers Carried Notes.)

Retail Price	Number Sold.	Actual Repos- sessions.	Percent of Total sold.	Losses from Other Causes.	Not Paid for and Not Re- possessed.	Total De- faults.	Percent of To- tal Sold.
\$200-							
250	1106	109	9.855	5	0	114	10.31
150-							
200	2812	421	14.94	14	5	440	15.65
75-							
150	3581	583	16.28	31	68	682	19.05
25-							
75	2564	330	12.87	38	171	539	21.03
	10063	1443	14.34	88	244	1775	17.63

TABLE XV

1928

EXPERIENCE OF FIFTY MICHIGAN DEALERS STUDIED IN SELLING USED CARS

BY THE INSTALLMENT METHOD

(Pertains Only to Sales for which Dealers Carried Notes.)

Retail Price	Number Sold	Actual Repos- sessions.	Percent of Total Sold.	Losses from Other Causes.	Not Paid for and Not Re- possessed	Total De- faults	Percent of To- tal Sold.
\$200-250.	781	70	8.96	3	0	73	9.35
150-200	1892	256	12.47	11	0	247	13.05
75-150	2623	405	15.44	Not # Avail.	42	447	17.04
25-75	1876	244	13.00	" #	108	352	18.77
	7172	955	13.32	14	150	1119	15.59

The lack of figures would not materially affect the final computations.

The column headed "Losses from Other Causes", in the tables may need some elaboration although explained in a foot-note. Previously in this paper, it was found that there were six possible sources of loss; fire, theft, conversion, confiscation, collision, and repossession. (3) In the case of contracts to be discounted, fire and theft insurance were obligatory on the part of the buyer. He did not have to pay cash for it, or even increase his down-payment to secure it. It was written into the contract, and paid for on the instalment plan. In the case of these cheap used cars, however, the purchaser would have to pay cash for such insurance. In addition, the cost of insurance for a used car in many cases is just as high as it would be on a new one, if it is purchased from insurance companies not connected with an automobile finance company. The result of these factors is: These cheap cars are almost never insured. And the result of this is, the element of danger to the dealer is increased.

Conversion and confiscation losses will require no discussion. The same causes that operate to prevent them that have hitherto been discussed, work in the same manner here. In the case of collision, however, there are additional dangers. Damage to a cheap used car usually costs as much to repair as it would cost to repair a new one. So in the case of a collision, the car will be discarded more readily.

(3) Discussed in the "NewCar" Study.

A second factor that increases the danger element to the dealer is that fewer cheap used cars carry collision insurance. The cost of this insurance is too high relative to the investment in the car. A possible third element of risk lies in the fact that if the car is wrecked and the purchaser refuses to make further payments, quite often he is not "strong" enough financially to warrant the necessary law-suit. These "danger-factors" are jointly included in the column of "Losses from Other Causes".

The next column headed "Not Paid for and Not Repossessed" requires some explanation. Many times a cheap used car is partly paid for and the purchaser defaults. The car may not be worth the work to re-habilitate it, and incurring the necessary costs of re-selling it. Dealers often leave these "junkers" on the hands of the defaulted buyers in the hope that at some future time they may collect through legal or other means. This is a very common practice as the tables denote.

A study of the tables indicates that in 1928, the total defaults amounted to 15.59% of the total cars sold. This percentage increased in 1929 to 17.63% and in 1930 to 18.91%. The increase of defaults for 1929 over 1928 was only 2.04%, while the increase for 1930 over 1928 was 3.32%. When we recall that the current depression in business began in the summer of 1929, one would naturally look for a greater increase than these figures show. The probably explanation of the situation lies in the added

caution exercised on the part of both the buyers and the dealers during the "hard" times.

Interesting results are noted from a comparison with the repossessions experienced where used car paper was discounted to the finance companies:

TABLE XVI

Year	Repossessions experienced on Contracts sold to Finance Companies (In % of total number sold.) *	Total Defaults on Dealer-Held Paper (In % to total number used cars sold.)
1928	5.3%	15.59%
1929	5.3%	17.63%

In 1928, the ratio of defaults on dealer-held paper to total repossessions on paper discounted was 2.9 to 1. In 1929, this ratio increased to 3.4 to 1. There is no way of knowing what the average loss per used car was, but where from 15 1/2% to almost 19% of a dealer's paper "back-fires" the total loss to him must be considerable. -----

This concludes a rather detailed discussion of instalment selling as it is practiced in the automobile business. When the financing of new car contracts was examined it was shown that losses could not result from repossession, as the purchasers' equity in the car after he had made his first payment was slightly

* See Table IX - Page 53

greater than the value of the car until it was one year old.

The only losses that could occur would be the result of conversion, confiscation or collision, and various factors were pointed out that tended to keep these down to a small amount.

When the financing of used car paper with the discount companies was examined, it was found that the only losses of a serious nature, resulted from repossession. Figures were introduced to prove that 87% of the cars repossessed on this paper were charged back to the dealers. The finance companies assumed the losses resulting from the remaining 13%.

An examination of the paper held by the dealers showed that from 15 1/2% to almost 19% of these sales resulted in defaults. All these facts seem to justify this conclusion: The risks of instalment selling in the automobile business are carried largely by the dealers and not by the finance companies. If this conclusion is correct, one would expect to find that the losses experienced by the finance companies in the past have been small. With a view of justifying this conclusion, the past experience and the present status of various automobile finance companies will be considered.

LOSSES EXPERIENCED BY FINANCE COMPANIES IN THE PAST -
 EXPERIENCE DURING THE PRESENT AND PAST
 DEPRESSIONS - THE "SAFETY" OF FINANCE
 COMPANY PAPER.

It remains to be seen if the past experience of finance companies will justify this statement: The risks assumed and losses incurred in the instalment sale of automobiles are borne almost entirely by the dealers and not by the finance companies. One piece of evidence is to be found in the following:

"Let us look at the result of General Motors Acceptance Corporation's operations over the past seven years. During the years 1922, 1923, and 1924, it purchased consumers' obligations aggregating \$278,223,000.00. All of these have been paid except \$238,073.00, representing bad debt losses. This is under 1/2 of 1%. It is true that these cover three years of prosperity, but few banks loaning money for producers' credit can point to as good a loss record for the same period. -----

"From its inception in 1919 to October 1, 1926.....if we estimate possible losses on obligations not yet fully matured at \$375,000.00 (which is estimated in line with our experience to date) we have total bad debts of \$1,492,706.00 on a volume of purchases of \$819,203,000.00 which is less than 1/5 of 1%." (1)

(1) John J. Raskob - "The Development of Instalment Purchasing." Proceedings of the Academy of Political Science of New York. Vol. 12 (1927) No. 2.

Inasmuch as the General Motors Acceptance Corporation does now, and always has purchased contracts on a recourse basis only, its dealer clientele has consistently stood between it and losses. Only through bankruptcy of its clientele can this finance company suffer any considerable loss.

A second point which appears to prove the contention that but a small fraction of the risks and losses of instalment selling is borne by the finance companies follows:

"Confidential figures from one of the large finance companies shown to 'The Business Week' demonstrate that the porportion of investment in repossessions to total outstandings which ran between 1% and 1 1/2% in 1926 and 1927, has kept near to 1/4% during 1929 and 1930, and on May 31, 1930 was 2/10 of 1% -

"The more prosperous the times, the more careless becomes the extension of credit, according to all statistical reports. In bad times both seller and buyer become more cautious by their commitments."

(2) The following excerpt seems to prove the statement conclusively. There figures should warrant attention because they represent the composite experience of many of the largest finance companies operating in the United States, among which are such companies as: The Central Acceptance Corporation, the Long Island Bankers' Corporation, General Motors Acceptance Corporation, the Motors' Acceptance Corporation,

(2) - "Instalment Plan Stimulates Sales, Steadies 1930 Business" The Business Week. July 30, 1930.

Northern Illinois Finance Corporation, Commercial Credit Company, Union Acceptance Company, Marion Finance Company, Industrial Acceptance Corporation, Automobile Banking Corporation, and many others.

"An extensive survey completed during 1924 showed a loss ratio of slightly less than 1/5 of 1% on aggregated new and used car paper.... It should be borne in mind that this survey does not show the loss sustained by the dealers.

"Early in 1925 another survey was made to show the loss ratio on used car paper, both with and without endorsement by the dealer. This survey showed a loss ratio of a little less than 1/6 of 1% on used car paper with guaranty and a loss ratio of a little less than 3/4 of 1% on used car paper without guaranty. In this survey, 95% of the paper was with guaranty and 5% of the paper was without guaranty." (3)

From such assertions as these as to the exceedingly small losses the automobile finance companies have suffered in the past, and in the absence of any data published to the contrary, it appears that the conclusion stated is justified.

Two questions that are often asked, and are of unusual interest at this time when the country is in an economic depression are: How do finance companies "stand-up" under the depression-phase of the business cycle, and how safe is the paper in the hands of the finance companies? The remainder of this study will be devoted to a discussion of these questions.

(3) C. C. Hanch - op. cit., page 2.

1. The first part of the document discusses the importance of maintaining accurate records of all transactions and activities. It emphasizes that this is crucial for ensuring transparency and accountability in the organization's operations.

2. The second part outlines the various methods and tools used to collect and analyze data. It mentions the use of surveys, interviews, and focus groups to gather information from stakeholders. Additionally, it discusses the application of statistical software to process and interpret the collected data.

3. The third part describes the results of the data analysis. It highlights the key findings and trends observed, such as the increasing demand for certain services and the declining interest in others. It also notes any significant differences between different groups or segments of the population.

4. The fourth part provides a detailed discussion of the implications of the findings. It explains how the results can be used to inform decision-making and strategic planning. It suggests ways to leverage the strengths and address the weaknesses identified in the analysis.

5. The fifth part concludes the document by summarizing the main points and reiterating the importance of ongoing monitoring and evaluation. It encourages the organization to remain flexible and responsive to changes in the environment and to continue to refine its processes and practices based on the latest data and insights.

Instalment selling has been criticized often as a potential source of danger during a time of depression. It is obviously true that if unemployment exists, purchasers will be obliged to "let their cars go back." The survey indicates that repossessions increased during the depression years of 1929 and 1930. This is likewise true of the experience of the finance companies. But that it has not proven serious to them is evident.

"Our members are nearly all finance companies dealing in automobile paper. They do not tell us that repossessions are very bad. They say that they are above normal, but not at all alarming, in some industrial cities where there has been a large amount of unemployment, and that elsewhere they are no more than usual." (4)

To determine the safety of finance company paper during a depression, a careful study was made of a strike in the anthracite regions of Pennsylvania which occurred there from September 1, 1925 to February 14, 1926 which approximated depression-times. It was found that "Dealers and finance companies were forced to take losses higher than in normal times" (5) but not sufficiently alarming to disrupt confidence in the instalment method of merchandising. This same conclusion has been drawn as a result of finance company experience of the past:

"In 1924 we had a very decided recession of business. Factory

(4)
M. V. Ayers - "1930 No Test of Instalment Selling" - The Business Week. May 28, 1930.

(5) Wilbur C. Plummer - "Social and Economic Consequences of Buying on the Instalment Plan." University of Pennsylvania (1927) page 49.

output decreased nearly 15%, unemployment was a national problem; and yet the partial-payment financing of \$4,270,000,000.00 of goods gave us no credit problem in 1924." (6)

"It is generally assumed that practically all the finance companies doing business now have come into existence since the depression of 1921, but the facts are otherwise. In a recent study made by the National Association of Finance Companies, data were secured in regard to 302 companies doing business at the close of 1928. Of these, 64 companies began business prior to the end of 1920. These 64 companies at the end of 1928 had 78% of the total number of employees of the entire 302 companies. Inasmuch as all the large companies are included in the returns, it appears probable that more than three-fourths of the finance company business in 1928 was done by the companies which had operated during the big depression of 1921.

"It is unfortunate that no figures are available relative to finance company failures during the depression period; we know only that these 64 companies passed through it without failure, and that inquiry has brought to light no evidence that any failed.." (7)

A popular economist writes as follows: "It was a common prediction of those who questioned the wisdom of extended retail instalment purchasing that the first real test of depression would see a breakdown of that system, with purchasers unable to keep

(6) - Glen. Griswold - "Partial Payment Plan of Financing Appears Fundamentally Sound." Chicago Journal of Commerce, Jan. 9, 1930.

(7) - M. V. Ayers - "Instalment Selling and Industrial Recession" The Journal of Commerce, New York. April 21, 1930.

up their payments on motor cars, radio sets, washing machines and other household appliances. But this nation-wide check on credits shows that while people have been buying between \$4,000,000,000; and \$5,000,000,000 worth of instalment goods for the year, and some \$15,000,000,000 worth of goods on open-credit, the average loss from bad debts on instalment sales has been only 1.2%...." (8)

Milan V. Ayers, the mouthpiece of the National Association of Finance Companies, sees no cause for concern during the present business depression. "Instead of waiting with anxiety the outcome of the 'severe test of instalment selling' we, who are in close touch with the system have been harboring a feeling of regret that the ordeal is so slight that it will probably be claimed hereafter that it really proved nothing after all." (9)

To date, even during this depression, automobile finance companies show a favorable profit. "Only 91 companies reported the amount of their profits. These included the larger companies, so that although they constitute only 65.5% of the number of companies reporting, they did 94.8% of the business. The net profits of these 91 companies for the year amounted to \$33,674,563.00 which is 1.23% of their volume and 11.04% of their capital and surplus." (10)

A conservative conclusion appears logical: Finance company paper is safe, finance companies' profits continued during the first year of the depression at least, and automobile finance companies seldom fail.

(8) - Irving Fisher - "Instalment Payments Kept Up." Detroit Free Press. December 1, 1930.

(9) - M. V. Ayers - "1930 No Test of Instalment Selling" The Business Week. Chicago, Ill. - May 28, 1930.

(10) - "Operations of Finance Companies in 1929" - National Association of Finance Companies. Bulletin sent to

PROFIT STATUS OF AUTOMOBILE DEALERS

"The year 1929 was the record year to date for both automobile production and automobile sales. It would naturally seem to follow that it must have been a year of maximum prosperity for all elements of the industry. Unfortunately, it was not. It was a year of competitive warfare between the factories, in which the dealers bore the brunt of the fighting and suffered most of the casualties. The great output was made possible largely by forced sales. The dealers were driven by their factory commanders to make sales regardless of cost, chiefly by the expedient of making over-allowances on trade-ins.....Dealers generally ended the year with small profits or none, and with excessive stocks on hand of both new and used cars, the latter held at the inventory value in excess of their possible selling price....." (1)

The writer (Chevrolet dealer at that time) remembers well the memorable "Gold Rush Campaign" of 1929. Chevrolet factory representatives, sales-promotion men, and managers constantly pushed the dealers for more sales and larger quotas. Managers of distribution sent new cars with or without orders for them to the dealers. The entire country was divided by zones into "battle-fronts". Chevrolet dealers in each "sector" were aligned against each other as "enemies". The above mentioned factory men were "lieutenants", "captains", and the higher ranking officers. Dealers were forced on penalty of losing

(1) M. V. Ayers - "Banks Financed \$468,000,000 in Automobile Instalment Financing Paper in 1930" - The American Banker - August 26, 1930.

Their contracts to take cars far in excess of their ability to sell them wisely. They were forced to "take in" used cars at prices in excess of their resale value. The slogan was "More Sales for Chevrolet;" the goal "One Million and One-quarter for 1929!"

When the "war" was over, and the "Gold Rush" had passed into history, several dealers were on the way to bankruptcy and all possessed too many used cars with which to face the winter. One gold rush victim naively remarked: "The Gold Rush is over. The factory got the gold - we got the iron!" (old used cars.) He closed out that winter.

This experience of dealers going out of business was not peculiar to 1929 or to Michigan. "There has never been any systematic collection of statistics on dealers' failures, and consequently, it is very difficult to form any definite conclusions as to the increase in dealer mortality during recent months. The Chilton Class Journal Company, publishers of automotive trade magazines, report that in the first six months of 1930, 3,844 automobile dealers were dropped from their mailing list because of going out of business. This list contained 52,588 names of automobile dealers at the beginning of the year. Thus 7.2% discontinued during the six months period, or at the rate of 14.4% annually.....". (2). When one bears in mind that the annual failure rate of all businesses, as compiled by the Bradstreet Company is nearly always less than 1%, this

(2) M. V. Ayers, "Banks Financed \$438,000,000 in Automobile Instalment Financing Paper in 1930." American Banker - August 26, 1930.

mortality, even though all are not failures, is certainly alarming.

In an article published in a current magazine in May of 1930, (3) a writer in close touch with the automobile business, strongly intimates that the automobile dealers of the United States were bankrupt at that time! Their assets consisted of open credit accounts for repair work, customers instalment notes for used-cars sold, and a stock of used cars, automobile parts, an assortment of machines, equipment, tools, and some real estate. At a glance, one can see these assets are largely frozen! On the other hand, dealers must pay cash for their new cars before delivery to them; parts must be paid for by the 10th of the month following or their credit connection at the factory immediately ceases! And every contract sold to finance companies (with a few exceptions sold on a non-recourse basis) requires the dealer's endorsement on which he is contingently liable. Almost every new car sold means another used car, little if any cash, and when this used car is sold, another note-receivable, and usually still another cheaper used car!

The most convincing argument for the insecure status of the automobile dealer came during a personal interview from the Sales Manager of the Chevrolet Motor Company himself. (4). Every Chevrolet

(3) James Dalton - "What Shall We Do with Used Cars?" Motor Magazine May 1930.

(4) J. D. McLeod, Sales Manager, Chevrolet Motor Company, Flint, Michigan.

dealer is required under his contract to turn in a monthly profit and loss statement, and a statement of financial condition to the Chevrolet Motor Company. A copy of this statement is in the hands of the sales manager. In a personal interview, he frankly told the writer in answer to a question, that Chevrolet dealers in the State of Michigan made no money in 1930! In certain instances, dealers were fortunate. Generally over the state they "did well if they broke even". "Especially in the larger cities dealers suffered considerable losses during the year."

Personal interviews with vice-presidents of two banks in one of Michigan's larger cities brought out the same information. Both of these banks had lines of credit extended to local dealers. Both bankers frankly stated that they dare not call in the loans - as foreclosure proceedings would merely put "the bank in the automobile business". In the city of Lansing alone, 50% of the Chevrolet dealers have closed out as a result of recent operations. And Chevrolet dealers have been selling far more automobiles than the "average dealer" during the current as well as past years.

CONCLUSIONS.

The following conclusions have developed out of the preceding study:

Automobile finance companies operating on a recourse basis can suffer no substantial loss on a contract which they have purchased until the purchaser of the automobile has defaulted and proven uncollectable; the dealer is then liable and he must likewise default and prove uncollectable. The car repossessed, to which they hold a valid claim, must sell for an amount less than the finance company's unpaid balance against it. All of these contingencies seldom occur.

Automobile finance companies operating on a non-recourse basis surround themselves with so many requirements and restrictions that only paper bearing a minimum element of risk may be discounted with them. Otherwise, this type of company will also demand the dealer's endorsement.

The part of the study dealing with the "True Cost of Instalment Buying" reveals the high cost the buyer must pay for his instalment credit. It was pointed out that he pays considerably more for the same consideration if his contract is discounted on a recourse basis, than would be the case were it discounted on a non-recourse basis. The matter of how his contract is discounted is of no value whatever to him. It was also found that the buyers were usually deceived as to the true rate they are obliged to pay for their consumers' credit.

The New Car Study developed the information that losses incurred by either the finance companies or the dealers by reason of the instalment sale of new cars are almost negligible.

Used Car Study - A - revealed that the great source of loss in the sale of used cars, contracts for which had been discounted with finance companies, was repossession. 94% of the contracts discounted to finance used car sales are endorsed by automobile dealers and 87% of the used cars repossessed by finance companies are charged back against the dealers by reason of their endorsements. Therefore, it appears that the risks and resulting losses incident to the instalment sale of used cars are borne by the automobile dealers - not by the finance companies.

Used Car Study - B - indicated that the defaults on contracts ineligible for discount to finance companies, and consequently held by the dealers, were from about three to three and one-half times greater, than defaults on the contracts discounted. This further substantiates the conclusion that the risks of instalment selling are borne by automobile dealers and not finance companies.

An examination of the present status, and past experience of the finance companies leads to the conclusion that finance company paper is safe, even during depression times; the profits of automobile finance companies during the year of 1929 were very gratifying; and that failures among these companies during and since the depression of 1920 have been notably few.

Automobile dealers during 1929 ended the year with small profits or none at all. Estimated figures on mortality among automobile dealers over the United States for 1930 are placed at about 14%.

A general conclusion emerging from the study as a whole seems inevitable; The profits derived from the instalment selling process adhere to the finance companies; the risks and losses are borne by the dealers.

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