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The installment credit market- an analysis of consumer goods sold on the installment plan with emphasis on the credit phase

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THE INSTALLMENT CREDIT MARKET —
AN ANALYSIS OF CONSUMER GOODS
SOLD ON THE INSTALLMENT PLAN
WITH EMPHASIS ON
THE CREDIT PHASE

A THESIS
SUBMITTED TO THE FACULTY OF ATLANTA UNIVERSITY
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR
THE DEGREE OF MASTER OF ARTS

BY
CLAUDIUS A. TURNER

DEPARTMENT OF ECONOMICS

ATLANTA, GEORGIA
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CHAPTER I
INTRODUCTION

The Hypothesis

Production, says one writer, constitutes "those processes by which human effort is expended in order to increase the sum of goods and services capable of satisfying the desires of men". From the point of view of economics no commodity is completely produced until it reaches the consumer. For the purpose of analyzing an important part of production economists distinguish between the productive process itself and distribution. The productive process is concerned with creating form utility. Distribution is the process of creating time, place, possession and service utilities. Distribution is commonly termed the marketing.

Consumption is defined as the use of economic resources by the ultimate consumers. Consumption as a field of research may be divided into two fields: (1) the study of standards and levels of living and; (2) that of consumer buying in the market. The consumer is the one who uses his resources, time, energy, purchasing power, and choice making to satisfy his wants. The consumer-buyer is the one who performs the technological function of selecting and purchasing goods and services to satisfy his wants on the basis of the limited resources. The consumer and the consumer-buyer may be the same. The consumer-buyer performs his functions in the market. He is the connecting link between consumption and distribution. Distribution is directly connected with production.

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Marketing includes among other functions the process of buying and selling. In this study we shall attempt to explain the installment plan of selling and buying certain goods. Emphasis will be given to the effect of this plan of selling on the consumer resources of purchasing power and choice making in the market. A basic assumption of this study is that an exposition of the selling methods is a fruitful means of studying objectively the interests of consumers. This basic assumption has certain corollaries. First, a study of the extent and causes of the spread of installment selling and buying will shed light on the consumer interests. Secondly, the origin and practices of finance companies provide information. Thirdly, an analysis of the legal phases of buying and selling gives important information. Fourthly, the analysis of perfect and imperfect competition provides a fruitful means of explaining many of the abuses of the installment plan of selling. Fifthly, an explanation of the cost factors and price policies of retailers and finance companies afford objective means of appraising the plan from the point of view of fair prices. They also provide information as to the results of consumer preferences being kept irrational. The consumer loses money from lack of information in three important ways, (1) high prices, (2) repossessions and (3) wage assignments.

The Problem

The plan of installment selling seems to be sound but, there are many abuses of the plan which endanger the interest of consumers. The problem of this study may be stated in a form of questions. What are the practices and policies of retailers and finance companies that foster practices contrary to criteria "good" consumer goods markets, i.e. fair
prices and adequate information to consumers? What are the policies and
practices of retailers and finance companies that seem to harmonize with
consumer interests?

Limitations Of The Problem

This study is limited to the investigation of the installment selling-
buying process of those goods that go to ultimate consumers. It is not
concerned with such goods and services as farm implements, tractors, homes,
stocks and bonds, and life insurance, nor is it concerned with that method
of selling goods where the buyer is loaned the money by a personal finance
company with which to pay cash for the commodity and then repays the loan
in installments. From the point of view of the two criteria of (1) fair
prices and (2) policies and practices that reduce mistakes in selection
of installment credit services the writer will investigate:

a. The extent of installment selling-buying in the United States.
b. Mechanics and agencies of the credit services in the market.
c. The goods sold on this plan as they are connected with the
credit services and agencies.
d. The cost factors and pricing policies.
e. The information and lack of information given.

Methodology

The sources of the materials of this study are books by recognized
authorities, articles from periodicals, publications of private foundations
of research and government research publications. No field work has been
done. The method of study is essentially deductive.
The first step was to find out what had been written in the field and to collect a bibliography of writings in the specific field. The articles and books that gave the most fundamental economic interpretation of the installment plan of selling were read first. From them notes were taken on cards on the phases of the plan that were of use to the writer. Then books on general phases of economics which provided a theoretical basis for sound interpretation of the installment plan of selling were added to the bibliography. These were read next and notes were made from them. From the books and articles read the final interpretative outline of the study was made. After this was done the factual material of the plan was read and notes were taken on cards. The next step was that of classifying the cards by chapters. Then the serious business of writing the first draft was begun. Before each chapter was written the cards in the particular chapter were arranged in their logical order.
The installment plan is a connecting link between producers and consumers through the market for certain durable consumer goods. It is a producer invention. It has been aptly defined by Wilbur C. Plummer. He says:

An installment sale or purchase is one in which the price of the goods is to be paid for in fixed portions at stated intervals. Aside from the cash or down payment...the transaction is simply a credit or deferred payment transaction and does not differ in its nature from any other credit transaction ... It is a sort of funded debt in contrast to a demand obligation which is payable at the request of the creditor or to the open account, which was payable in whole or in part at the convenience of the debtor. It also stands in contrast to the kind of debt which runs for a stated period and which is paid in a lump sum at the end of the period.

In buying on the installment plan, the goods are delivered to the buyer, but the title to them generally remains in the seller and does not pass to the buyer until all the installments are paid. In some cases the title passes immediately to the buyer, and he gives a mortgage on the goods as security for the balance due. Default in payment in almost all cases gives the seller the right to the possession of the goods; it also quite frequently forfeits all previously paid installments.¹

Goods that are usually sold on the installment plan are automobiles, household furniture and appliances, pianos, sewing machines, phonographs, washing machines, radio sets, jewelry, clothing, tractors, gas stoves, electric refrigerators, vacuum cleaners, farm equipment and electric stoves. Besides these are books, life insurance, stocks and bonds, homes, and improvements on homes and buildings which are sold on the installment

plan. In this study we are not concerned with the latter nor are we concerned with tractors and farm equipment which are listed above. This study, then, is concerned with consumer goods. It will be noted that the outstanding characteristic of the goods in the list is their durability as compared with other consumer goods such as food. Another characteristic is their relatively high unit value. The terms of payment are so fixed that the debt outstanding can be liquidated faster than the value of the good depreciates.

Nature Of Installment Credit

It was stated above that installment credit, as a kind of credit, does not differ from any other form of credit. However, installment credit is also consumer credit for it is a means of financing the transference of commodities to the person who uses them directly in the satisfaction of his wants. It is therefore different from producer credit which is used primarily in the financing of the production and the distribution of goods which is expected to bring an income sufficiently large to repay the loan with interest and to net the borrower a profit. Credit, however, is not granted primarily on the basis of what it will be used for. It is granted on the basis of the three C's -- character, capacity and collateral. For the amount of credit desired these three C's are almost as common among consumers as they are among producers.

An important difference between producer credit and consumer credit is that the latter is smaller in individual amounts granted. The monetary value of a consumer good tends to be much smaller than that of a producer good. Besides the consumer purchases one or at the most only a few commodities at a time while the producer usually buys in large quantities.
The method of liquidating installment credit is different from that of producer credit also. The enterpriser pays his loan in a lump sum as a rule and after a period of 30 days to 120 days if it is short term credit. On the other hand the installment buyer repays his loan in stated portions of the sum loaned ranging over a period of three months to five years.

Seligman lists what he considers the essential characteristics of installment credit as a form of consumer credit. The first is the comparative durability of commodities sold on the installment plan. "The essential characteristic of installment credit, so far as the element of durability is concerned, consists in payment for the goods before utilization as compared with payment after utilization." Thus the amount due, in view of the down payment and the terms of payment, is always arranged so that it will be less than the value of the commodity. By the nature of the arrangement of payment as fitted to the durability of the commodity, the necessary collateral is provided. Again the utility or value does not vanish when the loan is liquidated. While the terms of payment may extend over a period of one to two years in the case of automobiles and furniture, the commodities themselves are likely to last from seven to 20 years.

Another characteristic of goods sold by way of installment credit is their relatively high price. While they are desirable, the cash purchase of such goods usually constitutes an immediate strain on the family budget except for groups of the highest income classes.

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2Ibid., p. 198.
A third characteristic is the interval of time between contract of the debt and the liquidation. This interval ranges from a few months to five years. However in most instances it is from 12 to 24 months. There are several methods of payment such as the three payment plan, two payment plan, ten payment plan, weekly payments, monthly payment, and others according to the convenience of the buyer and the policies of the seller.

The last characteristic of goods sold on installment is that they are to a large extent of recent origin, designed to satisfy new wants of the buyer.

Seligman writes, in reference to the four characteristics, the following:

The sale in question is apt to represent a single transaction, not likely to be duplicated, at least in the immediate future. Just because it is a single transaction, it usually has no predecessor, at least not in the immediate past.

Because of the relatively greater expensiveness of the article, the amount of credit to be granted to the purchaser is larger than in ordinary consumer credit. It brings with it a considerably greater degree of hazard.

As a corollary of the protracted period between downpayment and final payment, we have an increasing necessity on the part of the seller to bridge the interval and to meet the risks of non-payment. 1

What takes place within these intervals will be the subjects of later discussions. We may say that, when debts become delinquent, the occasion is at hand for extensions of terms, threats and repossessions on the part of sellers.

The three C's of credit were noted above and it may be stated at this point that inasmuch as producers are also consumers they can just as well carry their (attributes) of character and capacity over to consumer credit.

1Ibid., pp. 202-3.
Character is not possessed by the producer to the exclusion of the consumer. However, in the early history of installment credit in America the type of people who availed themselves of it were not always of the highest integrity. The effort of dealers to protect themselves from the great losses by charging high prices caused the plan to fall into early disrepute.\(^1\) Capacity refers, of course, to the adequacy of the income to support and service the credit given. Compared with the income of a corporate enterprise the income of an individual consumer is small. But compared with the amount of credit granted a corporate enterprise at any one time the amount of credit granted and desired by the consumer is also small. All that is demanded is an income large enough and of sufficient regularity to guarantee the liquidation of the loan on time in view of the other demands on the income. The essential thing, therefore, in the granting of credit is the credit standing of the individual.\(^2\) "Installment selling may indeed need a technique of its own, and may require a more careful and detailed examination into the solvency and reputability of the individual; but at bottom the problem is one affecting the grant of any kind of credit."\(^2\)

After the desire for a durable high priced consumer good has become a decision in the mind of the consumer to act, the consumer may weigh the convenience and cost of other methods of purchasing the desired commodity against the installment plan. He may get the money from the bank or personal finance company. At any rate he will usually consider the "real costs".\(^3\)

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The unwillingness of the purchaser either to execute a mortgage on his home or to ask a friend to endorse his note, and even the inconveniences and loss of time necessitated in obtaining bank credit, present barriers to its use — barriers that are as real as the higher charges made for installment credit.¹

The characteristics of the commodity of durability, of relatively high price, of the interval of time between the contract of the debt and its liquidation, and of their recent origin and their stimulation of new wants may all be looked at as a whole. As a whole they may be explained as a theory of consumer credit which recognizes the important relations of installment buying to installment selling. Of this N. R. Danielian, writing in the American Economic Review, says:²

The interest rate on consumers’ loans, statistically considered in a state of pure competition, would measure both the marginal lenders’ and the marginal borrowers’ preference of present over future utilities. In the actual state, however, there is a difference between the marginal lenders’ and the marginal borrowers’ estimation of this preference of present over future enjoyments. This difference will be greater as the disadvantage in the position of the borrowers compared with that of the lenders is more pronounced. Then there will be a wider separation between the upper limit which the interest rate may reach (set by the marginal borrowers’ point of indifference, where they consider the alternative of waiting) and the lower limit, which is determined by the opportunity the marginal lenders’ have of using their funds differently. In this difference between the borrowers’ and lenders’ margin of transference all additional charges for cost, risk, and profits of financing find their place.

Assuming a desire for the commodity, the consumer weighs the utility of the article on the basis of his limited time, energy and purchasing power against the future disutilities of sacrificing other future more or less close substitutes to make payment on his debt.


Says Danielian on this point:

When credit is obtainable, the comparison is not between present utilities and future utilities, but between two future utilities - those of the durable good on the one hand, and those others which will have to be abandoned when payments are made on installment purchases... The future utilities of the durable good purchasable on credit are apt to be more vividly perceived than the utilities of those alternative commodities of the same period; and the discount of future utilities bought on credit may be smaller, and the discrepancy greater, the smaller the ratio of down payments and of the subsequent installments to the total value of the commodity. 1

It is, therefore, important that the consumer in deciding to purchase goods on the installment plan, weigh anticipated future utilities from durable goods against future utilities of other goods or services. Such weighing requires imagination on the part of consumers but it is necessary if they are to get maximum satisfaction from given resources.

1Ibid., p. 395.
CHAPTER III

CONCENTRATION AND DISPERSION OF GOODS SOLD ON THE INSTALLMENT PLAN

Extent Of The Use Of The Plan

According to Seligman the installment plan of selling was introduced in America in 1807. It spread rather slowly in its early history going from low priced to medium priced articles. However, "within the last ten years (preceding 1927) installment selling has undergone enormous expansion in both volume of sales and number of industries affected. About 1915 installment selling was introduced into the automobile business, where it experienced a somewhat gradual growth for several years, and then after 1920, it suddenly expanded, reaching great volumes within a few years' time."2

It has been estimated that the total annual amount of installment debt is around $6,000,000,000. At any one time the amount of installment debt is about $2,750,000,000. This is a more significant figure than the $6,000,000,000.2 The installment debt was estimated in 1931 to be $2,500,000,000 by A. W. Ayres.3 He claims that this amount was 75 percent of the total installment debt at the end of 1929. All of this was new installment debt which was contracted after the 1929 debts had been liquidated.

However, the total amount of credit of all kinds, including installment credit, outstanding at a given time in this country, not counting funds borrowed for the purpose of re-loaning, is very greatly in excess of a $120,000,000,000 or a $130,000,000,000.4

1Ibid., p. 14.
2Plummer, W. C., op. cit., p. 2.
4Plummer, W. C., op. cit., p. 2.
Goods sold on installment plans in 1929 amounted to 13 percent of the total value of retail sales in that year, 10.9 percent in 1935, 11.8 percent, 1956, 12.25 percent in 1937.¹

In the early use of installment credit, it found its widest reception among the poor. Even today it is claimed that it is used more generally by people of the low income groups. In a recent study made of a town with a population of 60,000 it was found that 40 percent of the families canvassed in the poorer sections used the plan, 25 percent of those in the middle class section used the plan, and five percent of the families in the wealthy section bought goods on the installment plan.² In a study of the installment buying of federal employees in Baltimore, Boston, Chicago, New Orleans and New York reported in the Monthly Labor Review in November, 1929 it was found that approximately 40 percent of the families studied with incomes of less than $1,500 a year bought on the installment plan. However the largest percentages of families using the plan were in the income classes of $1,500 to $1,800 and $2,700 to $3,000 — the respective percentages being 51.7 percent and 50 percent. The lowest percentage of families was found in the class of $3,600 or over.³ The report concluded from its figures that installment buying was not a matter of income for those federal employees but that it seemed to have been determined by family inclination or necessity. The largest number of families was making payments on furniture and house furnishings. They were making payments on from one to five articles at one time


²Plummer, W. C., op. cit., p. 11.

which included automobiles, furniture, radios, musical instruments, washing machines, vacuum cleaners, and sewing machines. It can be seen, therefore, that today installment buying is not by any means confined to the poor. The plan is not confined to any one region nor to the cities although city people make more repeated and extensive use of it than country people.¹

Causes Of The Spread Of Installment Selling And Buying

Many reasons are advanced for the rapid spread and extensive use of the installment plan. It was first employed on a wide basis in the automobile industry which was young (in 1915), and manufacturers wished to increase sales and thus expand output which would lower costs. Easier terms were granted and the industry has since been subject to the law of decreasing costs. Plummer lists the following causes: excess capacity of industry after the close of the World War and war orders had ceased to come in, competition between the same kind of goods and between different goods where competitors were forced to adopt the same kind of selling policies that a rival used with success, rise in the real income of laborers, high pressure salesmanship, and advertising.² Of advertising it is interesting to note what another writer has to say:³

²Ibid., pp. 7-10.
³Billkopf, Jacob, Survey Graphic (April 1925) quoted is Plummer, op. cit., p. 11.
Did you ever think of the strain to which people with small incomes are subjected by our continual pursuit of them to spend their money? Every newspaper, every magazine, every street, every railroad track, every street-car, every country road is lined with advertisements carrying suggestions intended to be subtle, though often they are blatant, to buy, buy, buy. Every human impulse, good and bad, is played upon. Not only do we advertise publicly, but we send letters and agents to the homes to try to extract from any and everyone what money he has. In every way we set about deliberately to make a person feel that life will be a failure unless he or she uses this soap or shaving cream, drives this automobile, owns this radio, sees this movie or play, eats this food, etc. This continual pressure relentlessly applied subjects our working class population to a strain which they cannot withstand, nor could we in their places.

Foster and Catchings give a somewhat different interpretation to the rapid and wide spread of installment selling. They say:

In a period of increasing productivity, industry turns out more consumer's goods than consumers can buy with their incomes. The deficiency in income comes about because industry does not pay consumers as much money as consumers must pay if business is to expand and prosper. As the flow of goods into consumers' markets increases, the flow of money into consumers' pockets does not long increase proportionately. Presently there are more goods on hand than the people can buy and pay for out of income at the going price level. Besides, consumers, under the necessity of saving, do not spend even as much as they receive. Since, therefore, consumers cannot buy the goods with their current income, and will not buy the goods out of saved income, industry has resorted more and more to the device of handing them the goods to be paid for out of future income.

They conclude with a criticism of the plan. They say that, assuming consumer income to be constant from year to year, an increase in purchasing power by use of the installment plan the first year, when the debts must be paid the next year, cuts down the purchasing of the consumers in the second year by the amount of the increase in installment debt contracted the previous year. It is necessary therefore to double the installment

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debt in the second year over the previous year in order to maintain the total purchasing power that the first year's installment debt increased it to. Therefore, they contend, there will be no permanent increase in consumer purchasing power by use of the installment plan.

Seligman answers this criticism by stating that as a result of the contract of the installment debt for a desired commodity, the individual may be stimulated to greater productivity. He continues:

If installment credit is a part of consumption credit, and if consumption credit is a part of credit in general, what reason is there for denying to installment credit some of the characteristics that we must ascribe to all credit? ... If the credit to the producer normally increases his productive capacity, why should not credit to the consumer normally increase his consumptive capacity, that is, his purchasing power? ... The fact that installment credit puts such potentially productive goods at the disposal of the consumer at an earlier date than would otherwise have been possible implies an increase of his efficiency which will soon be translated into an increasing flow of income.

Although there is not complete agreement as to the causes of the spread of the installment plan nor as to its soundness, the fact that it is used extensively by all classes of people in the United States and in all sections of the nation indicates that the pay-as-you-use idea has been thoroughly established in the minds and habits of the people. Thus the idea of thrift in America has been revolutionized.²

Marketing Agencies For Installment Goods And Credit

The goods that are sold principally on the installment plan are automobiles, pianos, phonographs, sewing machines, washing machines, radio sets, etc. 

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¹Ibid., pp. 282-3.

jewelry, clothing, vacuum cleaners, gas stoves and mechanical refrigerators. In order that these goods move from the manufacturer to the ultimate consumer certain important functions must be performed. In a general way the marketing process creates for the consumer time, place and possession utilities. Through its functions of exchange, market news, grading, transportation, storage, financing and risk taking, the producer and the consumer are brought together. In the ordinary installment transactions the following classes are affected: the consumer buyer, the retailer, the wholesaler, the finance company, the manufacturer, and the banker. There are variations from this, of course. In some cases there is no finance company, in others no wholesaler, and in others still there is neither wholesaler nor finance company. What makes the finance company necessary or the function performed by the finance company necessary is that the manufacturer, unable or unwilling to finance his products until they are sold and paid for by the ultimate consumer, requires cash from the dealers when they receive the goods or shortly thereafter. The usual procedure is that the manufacturer mails to the dealer a sight draft which is payable by the dealer upon receipt of the product. The dealer stores the commodities until they are sold. When the product is sold on the installment plan, the buyer signs a contract agreeing to pay a specified amount each month or week according to the terms of the agreement. Since the dealer or retailer must pay cash for the cars for an example and the installment plan of payments may run for three months to five years the strain on the retailer's capital is often more than he can bear. The banker will not very often give him any assistance because installment credit entails more expense — relatively small size of the loan bookkeeping, investigating, etc. — than the income allowed from the existing
maximum legal rate of interest. These limiting forces call for a new and specialized type of economic institution. The situation is met by the finance company. Of course banks and other agencies buy installment paper but it is estimated that probably 60 percent of all installment sales are handled by finance companies. In most cases the finance companies deal with the customer only indirectly through the retailer. The primary relationships of the finance company are to the retailer and manufacturer.

The Marketing of Certain Durable Consumer Goods

Installment credit can be profitably studied in connection with the commodities sold on the installment plan. It is useful therefore to note the concentration and dispersion process of some of the good thus sold. Rhoades says:

Commodities to be consumed by many individuals in small amounts must pass through a dispersion process involving jobbers, retailers, consumer advertising and so on, while commodities purchased in wholesale quantities or on a large scale escape that great complexity of dispersion processes.

Products produced by many scattered individual producers require a system of concentration with various types of middlemen to bring them to the wholesale stage, while those produced in wholesale quantities by large producers are already concentrated and may dispense with such concentrating structures.

Furniture

In the furniture market the wholesalers are independent concerns and

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have no relation either with manufacturers or firms engaged in retail trade. There are a large number of furniture producers especially in states east of the Mississippi River. Many are found on the Pacific coast. The producers specialize in distinct lines such as case goods (bedroom and dining room suites), chairs, tables and cedar chests. Style is important in this industry. Consumers' taste require distinctiveness in appearance. In the construction of furniture a number of different cabinet goods may be used. Often inferior woods are used on the unexposed surfaces and on the exposed surfaces better woods are used. Manufacturers in most instances sell directly to retailers through salesmen. They sell to jobbers only in distant localities.

On account of the multiplicity of style, furniture is a product that does not lend itself to definite standardization either as to material or construction. Its purchase becomes a matter for the judgment of experts with the samples before them.¹

At certain furniture seasons great furniture markets are held where all styles of furniture for the coming seasons are on display. These markets are opened only to wholesalers and retailers who inspect the new styles. Consumers are not invited.

As was said above, furniture is sold largely on credit terms by retailers. In a study made,

Only 78 out of 556 dealers reporting stated that they priced their furniture on the basis of cash at the time of a sale; 21 priced on the basis cash in 30, 60 or 90 days; 384 priced on the basis of installment or long-time credit; eight of them said they carry two prices on the tag--one for cash and one for installments. Out of the 500 stores investigated using some form of installment plan, 100 used the conditional sale contract, 121 used a chattel mortgage, and 182 used a form of contract that

¹Rhoades, op. cit., p. 471.
purports to be a lease and speaks of monthly or weekly payments as 'rentals'. Under both conditional sale and the lease, the stores retain title to the furniture until payment has been completed.

Rugs and carpets are distributed by direct solicitation, by the manufacturer, by selling agents, through jobbers, and through mail order houses. There are two seasons of the year for such goods—spring and fall.

Radio receiving sets reach the consumers through jobbers and wholesalers to the retailers or from manufacturers to chain stores and mail order houses. They are somewhat standardized and require an intensive sale effort.

Having seen how furniture comes on the market we may now look briefly at the relation of total retail sales of furniture to installment sales. In the report of the Retail Credit Survey of 1937 installment sales of furniture stores increased 4.3 percent but the proportion of installment sales to total sales declined from 69.4 percent to 68.1 percent as compared with the previous year. The study reveals the general tendency toward an increasing proportion of open account sales in 1937 and its corresponding decreasing in proportion of cash and installment sale.

The lowest size group, annual sale of $25,000 or less proved exceptional. This group of six stores averaged a smaller proportion of open credit sales in 1937 and increased the proportion of installment sales. The same size classification also had the largest proportion of open credit sales, 9.2 percent. Stores with sales in the range from $25,000 to $50,000 revealed an exceptionally high proportion of cash sales, 31.7 percent in 1937.¹ (See Table I.)

TABLE I
PERCENTAGES OF INSTALLMENT SALES TO TOTAL SALES, OF
MONTHLY COLLECTIONS OF BAD DEBTS LOSSES OF FURNITURE

Stores 1937 by Sizes

<table>
<thead>
<tr>
<th>Size of Store</th>
<th>% of Installment Sales</th>
<th>% of Monthly Collections</th>
<th>% of bad Debt losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>25,000 or less</td>
<td>84.4</td>
<td>13.1</td>
<td>1.9</td>
</tr>
<tr>
<td>25,001 to 50,000</td>
<td>53.1</td>
<td>10.4</td>
<td>2.2</td>
</tr>
<tr>
<td>50,001 to 100,000</td>
<td>71.5</td>
<td>11.7</td>
<td>1.9</td>
</tr>
<tr>
<td>100,001 to 250,000</td>
<td>70.6</td>
<td>10.1</td>
<td>2.1</td>
</tr>
<tr>
<td>250,001 to 500,000</td>
<td>76.3</td>
<td>11.6</td>
<td>1.5</td>
</tr>
<tr>
<td>500,001 to 1,000,000</td>
<td>78.4</td>
<td>10.1</td>
<td>1.6</td>
</tr>
<tr>
<td>Over 1,000,000</td>
<td>68.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All stores</td>
<td>68.1</td>
<td>10.4</td>
<td>1.7</td>
</tr>
</tbody>
</table>

This study was divided into regions — New England, Middle Atlantic, East North Central, West North Central, South Atlantic, East South Central, West South Central, Mountain, Pacific and Territorial Hawaii. Half of the regions revealed decreases in the proportion of installment sales. The East South Central region had a very large percentage of installment sales to total sales — 93.6 percent in 1937 from the 13 stores reporting. The monthly collection of installment sales from the furniture stores revealed a decrease from 10.7 in 1936 to 10.4 percent in 1937.

The average loss from bad debts of installment sales was 1.6 percent in 1936 and 1.7 percent in 1937. Stores with volume of sales ranging from $100,000 to $250,000 had a loss 1.9 percent of total sales in 1937. The loss was 2.4 percent the previous year. Stores in the class from $500,000 and above had losses smaller than the average for the whole group. Bad
debt losses from open accounts were 0.4 of 1.0 percent in 1937.

Automobiles

"The real revolution in American consumption is in large measure a function of the introduction of the automobile."¹ More than 4,000,000 cars and trucks were produced in 1928. Twenty-eight percent of the new cars were sold on the installment plan in 1927; 60.8 percent of new and used cars were sold on the installment plan in 1927 and 75.9 percent of new and used cars were sold on installments in 1926. It is estimated that half of the passenger cars in use (this includes used cars) were purchased at not more than $500 or $600.²

TABLE II

PERCENTAGE OF TOTAL PASSENGER CAR PRODUCTION, BY

PRICE CLASSES, 1913 and 1929³

<table>
<thead>
<tr>
<th>Year</th>
<th>Under $1,000</th>
<th>$1,000 to $2,000</th>
<th>$2,000 to $5,000</th>
<th>Over $5,000</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percent</td>
<td>Percent</td>
<td>Percent</td>
<td>Percent</td>
<td>Percent</td>
</tr>
<tr>
<td>1913</td>
<td>82.7</td>
<td>28.5</td>
<td>5.0</td>
<td>3.8</td>
<td>100.0</td>
</tr>
<tr>
<td>1929</td>
<td>81.5</td>
<td>15.3</td>
<td>2.7</td>
<td>0.5</td>
<td>100.0</td>
</tr>
</tbody>
</table>


Automobiles are in many cases distributed by the manufacturer to regional distributors who in turn distribute them to dealers. In other cases they are sent directly from the manufacturer to the dealer.

The dealer renders many valuable services. He commits himself, in advance, to take a certain yearly quota of cars. These he pays for in cash upon delivery. All of the risk or loss damage, and all the merchandising risks, from the time the cars leave the plant, branch house, or distributor warehouse until sold, fall upon him. He must store the cars, and finance them, the cost of which must be paid by him.

Sometimes there is an associate or sub-dealer. The dealer for a particular automobile manufacturer pays part of the local advertising cost and may use the trade name only so long as he is selling the cars of this manufacturer. He must keep a minimum supply of parts and make reports of sales to the manufacturer and must have a schedule of purchases for a period of a year.

Automobiles are advertised very extensively. Most of this is spent upon passenger cars. In 1929 twenty-three automobile and truck companies appropriated $64,242,000 for national advertising and newspaper advertising.

The financial resources of the dealers were not sufficient to finance the sale of these goods, since they were mostly sold on the installment plan. The banks could not give sufficient credit because the method of sale required long-time financing (from one to two years) and thus the banks did not consider the sales liquid enough. Further, the method of selling requires wide and specialized credit and collection facilities. The rates thus charged were higher than banks could legally charge. This problem

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1 Breyer, op. cit., p. 363.

2 Breyer, op. cit., p. 373.
gave rise to the finance company which first learns the credit rating of a distributor or dealer and then arrange to finance the sale. Often the finance company does its own investigating and collecting after the sale has been made by the dealer and the papers thus sold to the finance company.

Having shown the channels of distribution through which automobiles reach the consumer buyer, we may now consider some facts concerning the sale of automobiles on installments. In 1937 automobile dealers with annual sale ranging from $100,000 to $250,000 showed a decrease in sales of 11.9 percent over the preceding year. On the other hand dealers with sales in excess of $1,000,000 showed an increase of 12.2 percent over 1936. Dealers with sales ranging from $250,000 to $1,000,000 had a very small decline in volume of sales. There was a decline in the proportion of installment sales to open account sales of dealers with sales ranging from $500,000 to $1,000,000. On the other hand dealers with sales of $100,000 or less showed an increase in proportion of installment sales to total sales. The average collection\(^1\) on installment sales was 13.3 percent in 1937. In the South Atlantic and the East South Central region collection ratios were far above the other regions being 38.7 percent and 29.3 percent.

\[^1\text{Installment collection percentage is the percentage of the total annual installment sales collected each month. For instance, if a store sells $50,000 worth of goods on the installment plan a year and collects on the average $5,000 each month, then the monthly percentage of collections is 10%. This monthly percentage is influenced by the size of the down payment and the length of the period of payment. If a large down payment is required, the monthly percentage of collection will be high. This, of course, is true if the length of the period of payment is short. On the other hand, if the payment period is long (say 36 or 48 months) the percentage of collection to total annual installment sales will be small.}\]
respectively. The highest average loss was reported by dealers in the lowest sales class whose sales were $100,000 or less. The loss was .7 of one percent. The loss for the whole group was .2 of one percent.

The sale of installment paper to finance companies on a non-recourse basis, and adequate coverage of unpaid balances by repossession values, are probably important factors in the comparatively low installment losses of automobile dealers. Also installment losses are measured as a percentage of installment sales including down payment which do not enter into the credit transaction.1

Electrical Appliances

The growing use of electricity and of electrical appliances is one of the most typical characteristics of our contemporary industrial civilization. The industry has had a phenomenal growth in a short period. Its value of product of $92,000,000 in 1899 had risen in 1927 to $1,637,307,035. The value of household electrical heating and cooking appliances was in 1914 less than $3,500,000. By 1925 the value of the output had risen to $75,000,000. The appliances included vacuum cleaners, flat-irons, domestic ranges, air heaters, percolators, toasters, waffle irons and grills. The value of electric washing machines reported for 1925 was nearly $61,000,000. The total value of all washing machines, clothes wringers and driers and ironing machines, for domestic use was approximately $70,000,000 in 1925, $57,000,000 in 1923, $43,000,000 in 1919 and $8,000,000 in 1914. It is estimated that 365,000 electrical refrigerators with a value of $82,000,000 were sold in 1927. The value of radio apparatus produced increased to $54,000,000 in 1925 and $177,000,000 in 1925.2

A considerable proportion (about 40%) of electrical household appliances are sold through the retail departments of public utility companies. The goods are usually purchased direct from manufacturers in a highly centralized manner so that the utilities get the advantage in price of large scale buying. This advantage is enhanced by holding company operations in many cases when they can exercise supervision of the appliance buying of the


2Recent Economic Changes, vol. 1, pp. 56-59.
utilities under their control. Many electric companies own upwards of 100 outlets and as a result retail outlets are established in thousands of communities. Sales have been increased by the installment plan. Most utilities offer long terms ranging upward to 30 months. Some terms, however, are as low as three months.

There are some objections raised by many against the sale of electrical appliances by utilities. Some say that it is unnecessary duplication that brings about waste in distribution. Others claim that utilities give preference to some makes of appliances. Some say they sell at such low prices that there is no profit left or that they pay excessively high salaries and commissions to salesmen. Still others contend that the utilities are extending their monopoly from electric power to electric appliances. At any rate it is claimed,

that the efforts of electric companies to market appliances has resulted in the general stimulation of this business, which has increased the sales of both manufacturers and distributors. Furthermore, the electric companies offer ordinarily very generous terms of cooperation with distributors of appliances.¹

Household Appliance Stores

In the Retail Credit Survey of 1937 of the U. S. Department of Commerce² referred to above it was reported that stores with annual sales of $50,000 or less had a decrease in total sales for 1937 as compared with 1936. (See Table III.)

Those household appliance stores with sales above $50,000 increased their sales for the same period. The highest percentage of increase was

¹Breyer, op. cit., p. 420.
²Ibid., pp. 95-98.
reported by stores with sales in excess of $500,000. Most of the stores had a smaller proportion of installment sales to total sales as compared with the preceding year. The proportion of installment sales ranged from 78.4 percent, experienced by the largest stores, to 17.3 percent experienced by the smallest stores. The average monthly collections of all stores reporting was eight percent of sales in 1937. Losses from open account sales were .6 of one percent in 1937 and 1.9 percent in 1936. Bad debt losses from installment sales were 1.1 percent of total sales in 1937 and 1.4 percent in 1936.

### TABLE III

PERCENTAGES OF INSTALLMENT SALES TO TOTAL SALES, OF MONTHLY COLLECTIONS AND OF BAD LOSSES FOR HOUSEHOLD APPLIANCE STORES IN 1937 BY SIZES

<table>
<thead>
<tr>
<th>Size of Store</th>
<th>% of Installment Sales</th>
<th>% of Monthly Collections</th>
<th>% of Bad Debt Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>25,000 or less</td>
<td>17.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>25,001 to 50,000</td>
<td>39.0</td>
<td>6.7</td>
<td>6.9</td>
</tr>
<tr>
<td>50,001 to 100,000</td>
<td>66.1</td>
<td>15.3</td>
<td>.5</td>
</tr>
<tr>
<td>100,001 to 250,000</td>
<td>75.3</td>
<td>7.4</td>
<td>3.3</td>
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<tr>
<td>250,001 to 500,000</td>
<td>75.4</td>
<td>7.5</td>
<td>.5</td>
</tr>
<tr>
<td>500,001 to 1,000,000</td>
<td>65.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1,000,001 to 5,000,000</td>
<td>78.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All Stores</td>
<td>72.2</td>
<td>8.0</td>
<td>1.1</td>
</tr>
</tbody>
</table>

Source: Retail Credit Survey, 1937, U. S. Dept. of Commerce.
Department Stores

In a recent study of department stores in America by Women's Wear Daily, it was found that out of nearly 500 stores canvassed, 223 had departments in which installment selling had been carried on for more than ten years, and 15 had departments in which this plan of selling had been carried on for more than 25 years. On the other hand, 356 departments reported that that method of selling had been adopted by them only within the last year. This latter revelation brought to light the sudden and recent change of policy of a large number of department stores. Since then the spread has increased until it was estimated that the installment sales of department stores reached approximately $650,000,000 for 1937 and $200,000,000 for mail order houses for the same year. The average installment purchase per customer was $79.31 in 1936. In the department store the purchaser has the opportunity to purchase several unrelated articles all under one contract because of the wide variety of goods offered. (See Table IV.)

In the Department of Commerce survey of retail credit it was reported that department stores selling $150,000 or less of goods annually suffered a decrease in total sales in 1937 under the preceding year while the stores with sales of $15,000,000 to $20,000,000 had a decided increase. The highest

1Nystrom, P. H., op. cit., p. 599.


3Ibid., pp. 56-65.
proportion of installment sales to total sales for any of the stores was 24.7 percent of total sales and was experienced by the stores with sales of $250,000 to $500,000. On the other hand the highest proportion of cash sales (67.1%) was experienced by stores with sales of $250,000 or less. From a regional point of view the proportion of cash sales to installment sales decreased in 1937 as compared with 1936. All stores combined had a decrease in the percentage of collections. The percentage of collection ranged from 14.5 percent to 18.9 percent of total sales for the various classes of stores -- these sales being installment sales only. Average monthly collections varied according to regions from 12.7 percent in the South Atlantic area to 22.3 percent in the East North Central area. The losses from bad debts for all the stores averaged .8 of one percent. The largest loss was reported by stores in the sales class of $250,000 to $500,000 -- 3.3 percent in 1937. The lowest loss -- .5 of one percent was experienced by stores with sales of $20,000,000 or over. By regions the highest losses were reported by the East South Central (2.6%) and the South Atlantic areas (1.5%). The highest open credit loss was reported by the latter region.

Jewelry Stores

Jewelry stores averaged for installment sales 36.9 percent of total sales in 1937. The highest proportion being in the stores with the sales class of $250,000 to $500,000 was 47 percent. Average monthly collections was 14.1 percent in 1937. Bad debt losses from open credit sales were .3 of one percent in 1937 and .5 of one percent in 1936 while the percentage of total sales made on open credit was 39.7 percent in 1937 and 40.6 percent in 1936. The bad debt losses from installment sales as reported were four
percent in 1937 and 4.3 percent in 1936. There was little relationship between the losses and the size of store.

**TABLE IV**

PERCENTAGES OF INSTALLMENT SALES TO TOTAL SALES, OF MONTHLY COLLECTIONS, AND OF BAD DEBT LOSSES OF DEPARTMENT STORES IN 1937 BY SIZES.

<table>
<thead>
<tr>
<th>Size of Store</th>
<th>% of Installment Sales</th>
<th>% of Monthly Collections</th>
<th>% of Bad Debt Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>250,000 or less</td>
<td>5.6</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>250,001 to 500,000</td>
<td>24.7</td>
<td>14.4</td>
<td>3.3</td>
</tr>
<tr>
<td>500,001 to 1,000,000</td>
<td>15.2</td>
<td>14.4</td>
<td>1.3</td>
</tr>
<tr>
<td>1,000,001 to 5,000,000</td>
<td>10.6</td>
<td>14.2</td>
<td>1.0</td>
</tr>
<tr>
<td>5,000,001 to 10,000,000</td>
<td>10.8</td>
<td>15.4</td>
<td>.8</td>
</tr>
<tr>
<td>10,000,001 to 15,000,000</td>
<td>10.6</td>
<td>14.9</td>
<td>.8</td>
</tr>
<tr>
<td>15,000,001 to 20,000,000</td>
<td>11.1</td>
<td>18.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Over 20,000,000</td>
<td>8.6</td>
<td>18.9</td>
<td>.5</td>
</tr>
<tr>
<td>All Stores</td>
<td>10.1</td>
<td>16.5</td>
<td>.8</td>
</tr>
</tbody>
</table>

Source: Retail Credit Survey for 1937, U. S. Dept. of Commerce.

**Men’s Clothing Stores**

In men’s clothing stores installment sales are very small compared with total sales and with installment sales in other lines. In 1937 the percentages of cash, open account and installment sales were 41.8 percent, 52.1 percent and 6.1 percent, respectively. There were variations according to regions of installment sales ranging from 1.4 percent in the East South Central area to 14.6 percent in New England in 1937. The average monthly collections were 36 percent of total installment sales in 1936 and 37.3 percent in 1937. Bad debt losses from open credit sales were .7 of one
percent in 1936 and .6 of one percent in 1937. On installment accounts the losses were 2.1 percent of installment credit sales for 1936 and 2.3 percent for 1937. The losses are not so easily explained because of the number of factors entering into the determination of losses. One factor is that stores selling clothes on the installment plan usually raise prices and carrying charges in order to cover most losses.

In the case of women's specialty stores the percentages of cash sales, open account and installment are 30.4 percent, 68.5 percent and 1.1 percent, respectively. Bad debt losses of open credit was .3 of one percent and for installment credit, .7 of one percent in 1937.

Other Retail Outlets

There are many direct sellers of goods that are sold on the installment plan. In the early history of installment selling peddlers went from door to door selling their wares. They usually made their own terms and sold most generally among the poor and ignorant. Much trickery and deception was practiced by these early peddlers. In recent years retail stores have employed direct salesmen to go from door to door to stimulate sales by this plan. Such articles as electric refrigerators and other household equipment are sold in this manner.

1The percentage of losses of clothes from bad debts report above is not in agreement with other studies. One study reveals a loss from the sale of clothes as high as 25% of total installment sales. (See page 74)

2Nyström, op. cit., p. 620.
Installment Collection Percentages

Installment collection percentages are influenced by several factors. One factor is the length of periods. If the terms are adjusted to liquidate the debt in 36 or 48 months, the percentage of collection per month of total installment sales may be much smaller than if the terms ran for three to six months. Again the increase of the down payment will tend to raise the percentage of collection. Besides, when installment sales are increased considerably at any one time the collection percentage per month will decrease. On the other hand if a large number of debts are liquidated at any one period the collection ratio will rise. The rate of installment collection varies according to the line of business. In the case of clothing it was 37.3 percent a month while furniture stores had a percentage of 10.4 percent and household appliance stores had a percentage of eight percent.

Trends

There can be no doubt of the extensive use of the installment plan for most durable consumer goods. Such general use suggests that it is an established part of our commercial system. Moreover, there has been a general upward trend since 1933. Not only have stores commonly selling on the installment plan increased their sales but other stores have adopted the plan. Further, the plan has been applied to goods that had not previously been sold in this manner. In 1936 there was an increase of installment sales over the preceding year of almost 35 percent. 1937 experienced a slight increase of about four percent over 1936. There are various reasons advanced for this trend. More liberal terms in the form of smaller down payments, smaller carrying charges and a longer time to pay have had important influences.
Further, terms have been arranged to meet the needs of farmers whose income is seasonal in nature.

The introduction of the idea of budgeted income by many department stores has had effects on the increase in installment buying. Grimes says:

Sound buying, based on the theory of a budgeted income — purchases with the least strain on finances — to provide for the acquisition of these useful as well as pleasurable things, has had a strong appeal to many thousands of families, and experience has shown that in trying to satisfy these natural desires the extension of installment credit has not been abused.1

Another comment is made of this trend. It follows:

The new flood of installment buying has come upon us because (1) American people have lived thinly in the past seven years and are merchandise hungry and pleasure and luxury hungry, (2) new attractive goods are being offered, (3) the installment plan has been shorn of some of its more obvious greed and excess cost, and (4) it has been applied to many more articles and in new ways such as the four-payment or ten-payment plan of department stores.2

There are trends toward "greater control by government, greater influence by installment selling upon the traditional regular charge business largely through the three-payment and budget account plans".3 Articles of comparatively small value are sold on the installment plan by combining several in one sale so that the transaction will be profitable without the requirement of exceptionally high carrying charges. Some authorities think that §25. should be the minimum value of a sale.4 Some retailers go below this minimum, however.

3Schwalz, C. N., op. cit., p. 85.
4Ibid., p. 86.
Summary

The sale of durable consumer goods has been greatly extended since 1920 as a result of the extensive use by retailers and consumer buyers of the installment plan of selling. Competition among sellers, excess capacity of plants, rise in the real wage of workers, and persuasive advertising are some of the important factors causing its spread. Members of all the income groups, except those of the very rich, make use of the convenience of the plan to some extent. The retail outlets of these durable consumer goods are automobile dealers, furniture stores, household appliance stores, electrical appliance stores, department stores, jewelry stores, and clothing stores. They reach these outlets from the manufacturer either directly or by way of wholesalers, brokers, and/or jobbers. The proportion of installment sales to total sales as shown in the tables above is very large for most articles. In the case of clothing, however, the proportion is very small. The proportions vary according to the total sales of the retailers as well as according to the commodity or type of store. Losses from bad debts vary according to the size of the store. As a rule, with some exceptions, the stores having the smallest total annual sales experienced the highest percentage of losses.
The most common method of financing the sale of goods sold on installments is by the finance company. One of the reasons why banks do not handle much installment credit is found in the factors entering into the cost of such business. In the first place the credit standing of the prospective borrower must be investigated. This investigation is usually more expensive in the case of individual consumers than it is in the case of business men. Secondly, the loan is much smaller. In the third place, the expenses of collecting and of bookkeeping in proportion to the size of the loan made the transaction unprofitable for a bank. Finally, the length of time that the loan runs is longer than the ordinary commercial loan of a bank.

The finance companies are specialized agencies to meet just those problems. They were just getting started when the automobile industry was in its infancy. Today there are numerous such companies throughout the nation. Probably the largest such organization is the one set up by General Motors Corporation to finance the sale of automobiles and other products of that company. Several large companies have branches in many parts of the country. The success of the large companies in the 1920's was one of the main causes for the organization of many new and smaller firms. Competition became keen and in an effort to get business these newer companies offered more liberal terms. The down payment was lowered and the amount payable at each period was smaller making the loan run for a longer period of time.

In order to induce retailers to discount their paper with them, many of the
newcomers introduced the non-recourse plan whereby the retailer or dealer was not held financially liable in case of default of payment by the customer. The older companies were forced to meet this competition in some measure. This new trend made risk much greater than before and the banks which were responsible for part of the finance companies' resources began to insist upon more conservative terms.1

As was stated above the manufacturers demand cash for their products as a rule. The reasons for this, in the case of the automobile, grew out of several factors.

Partly because of the unfortunate experience of investors in the bicycle industry, banks were naturally reluctant to extend credit to this new industry which seemed to be taking its place ... The automobile manufacturers of early days were little more than mechanics with small capital engaged in assembling parts produced by other companies. With their small capital, and weak credit standing they were in no position to extend credit to their dealer. In the third place, manufacturers were reluctant to extend credit, even when they could have done so, to dealers who had not established their own credit.2

Because of the insistence upon cash payment and because, in many instances, the resources of the dealer are very limited, the finance company often is not only the go-between of the dealer and the customer but also is the go-between of the dealer and the manufacturer. The procedure is as follows:

When a shipment of automobiles arrived for a dealer he was notified by the correspondent of the manufacturer's bank in his city that bills of lading were available upon payment of the sight draft attached. If a dealer was unable to finance the shipment from his own capital, he went to an automobile finance

1Seligman, op. cit., pp. 48-51.

company and notified it of the value of the shipment. The latter then drew a check payable to the bank involved for 80 percent to 100 percent of the face value of the draft and the dealer supplied any balance required; paying the draft, the finance company obtained the bills of lading for the shipment.1

In such transactions the finance company had title to the goods and could keep them until they were paid for. Yet the very situation of the dealer that calls for the assistance of the finance company makes it obvious that the dealer cannot pay or make arrangements to pay until he has sold the cars. The problem then arises: how can the dealer be allowed to keep possession of the cars and yet provide the finance company with sufficient security for the loan it has made to the dealer? This is accomplished by use of one of the five instruments: (1) the warehouse receipt, (2) chattel mortgage, (3) the conditional sales contract, (4) consignment sales, or (5) the trust receipt. For this service to dealers in advancing the money to pay the manufacturer the finance company makes very little money.2 The profit comes when the goods are sold to the customer on the installment plan by the retail dealer and the paper is bought at a discount by the finance company.

It should be pointed out that 80 percent of the wholesale price which the dealer gets from the finance company to pay the manufacturer is different in amount from the amount of the note discounted from the retail price. The amount of the note is the net balance after the down payment has been made by the consumer buyer. It is what is discounted. However, in financing

2Grimes, op. cit., p. 204.
the movement of the product from the manufacturer to the dealer and from
the dealer to final payment by the consumer buyer, the finance company does
not pay out money twice. The settlement is made on the net amount.

Credit Aspect

In order that the processes related above may be carried out success-
fully and profitably, an important preliminary step is investigating the
credit standing of a potential buyer. This is a necessary function in all
cases. To minimize the risk as much as possible, it is advisable to know
how well the prospective buyer measures up to the three C's of character,
capacity and collateral. The product itself provides the collateral in
most cases. Attention then is centered on the person's integrity, reputa-
tion, debts, expenses, and income. Sometimes the retailer makes the inves-
tigation; sometimes the finance company does it; and in still other cases
both do it.

The average installment note runs longer than the average commercial
loan. For this reason many claim that installment paper is less liquid than
the ordinary commercial paper and that banks which discount such paper from
stores selling on the installment plan should require in such stores a high
degree of quick assets to the amount of the loan as compared with stores that
don't sell on the installment plan. Bradford says:

The current ratio of quick assets over current liabilities is
important in granting credit. This ratio should be high enough to
insure the payment of the borrower's liabilities, including his
debt to the bank, as they come due. "From this standpoint, it is
clear that an installment furniture house, whose receivables are
payable in installments running over a period of many months and
whose turnover of merchandise inventory is relatively slow, must
have a large amount of quick assets in proportion to current
liabilities to provide a sufficient income of cash to take care of
current maturities among the liabilities. That is to say, the installment house would have to have a relatively high current ratio.\textsuperscript{1}

This high ratio means, of course, that the installment house must have a larger capital outlay than say a firm doing cash business would need in order to get bank credit.

Seligman gives a long-run answer to this direct situation, suggesting that banks may improve their skill in granting such loans to maintain the liquidity of such stores. He says:

Bank technique includes a number of practices \ldots One part of the technique comprises provisions designed to arrange the maturing of obligations in such a way that on any given day payments to be made by the bank should, as nearly as possible, balance the total amount of drafts likely to be presented \ldots

If we recall the fact that a large part of the transactions are consummated through the use of check and bank notes, i.e., of purchasing power created by banks, it is clear that banks can secure, by skillful extension of credit, not only the marketability of the borrowers' goods, but also such a spread between costs and prices as to insure to the borrowers an adequate profit.

Liquidity depends upon maintenance of certain relations between prices, which are themselves affected by the persistence of certain forms of effective demand on the part of consumers and by their relations upon producers.\textsuperscript{2}

So far the banks have as a general thing discounted installment paper in very large amounts. The fact that finance companies handle probably 60 percent of installment paper is proof that banks are not leading the way. In 1929 ninety-one finance companies did a volume of business amounting to


\textsuperscript{2}Ibid., pp. 314-315.
$2,500,000,000 and received a profit amounting to 1.23 percent of the total volume. The number of such companies has increased rapidly, thus swelling the field. Some companies deal exclusively with the purchase of automobile paper. Others deal in all types of paper except those of automobile. Still others deal in both.

When dealers cannot get credit from banks to finance installment sales, the finance companies are in effect intermediaries between the banks and the retailers. The finance company, however, is not a bank for it does not depend upon deposits for its resources. It performs other functions similar to those of a bank, nevertheless. It is an institution dealing in credit just as is the bank. It gets its capital for first organization in the same way that the bank does by selling shares of stock. However, like the bank, its capital alone is not large enough to finance all the paper required. It, therefore, borrows money from the bank with its receivables as security. Banks usually loan to the companies in proportion to the latter's capital.

"In the case of the best and largest companies, the amount of credit is apt to run in the proportion of $5.00 of credit to $1.00 of capital." The banks, thus, have an important influence on such companies and of course indirectly on the dealers and retailers. In cases where the banks don't loan the finance companies sufficient funds they may get the additional amount needed from a bonding house. Again, says Seligman:

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2Seligman, op. cit., p. 85.
3Ibid., pp. 67-69.
The third and most common method of borrowing is that of borrowing on collateral trust notes. The essence of this transaction is the creation of a trust agreement between the borrower and the bank or the trust company. In the case of the finance company, what is deposited with the trustees consists of various kinds of receivables. In the case of the automobile finance companies, these receivables are the notes of the purchasers on installment. The collateral trust notes issued on the basis of these deposits are generally found in multiples of $500, and run for six months or less.

Encouraged by their success in securing credit for the collateral trust notes, not a few companies have found it practicable to issue on the same or similar collateral paper of longer maturity, running for a year or two or for several years. This latest and most interesting development in the field of automobile finance consists in the announced formation of a nation wide reserve system—the American Rediscount Corporation in 1926. The purpose of this corporation is to perform for the finance companies the same service that is afforded to the ordinary banks by the Federal Reserve System.

Other Methods

As was inferred above, finance companies are not the only means of financing installment sales. Banks discount some paper as a part of their policy but they do not go into the field on an extensive basis. Retailers that have large capital do their own financing in some instances. Again, personal finance companies and industrial banks are beginning to enter the field. Neifeld, K. R., What Consumer Credit Is, Annals of American Academy, (March 1938), vol. 196, p. 72.

Another method of financing goods ordinarily sold on the installment plan is worth mentioning. However, it does not fall within the scope of the definition of installment credit stated in the introduction. It follows:

In a few instances retail stores have made arrangements with Morris Plan Banks for customers to borrow money with which to purchase merchandise ordinarily sold elsewhere on the installment plan. Customers who use this method secure their merchandise at regular cash prices and then make their payments with interest to the Morris Plan Bank. To facilitate this method of operation, a branch bank of the Morris Plan has, in the case of at least one big department store, been established within the store, namely, Crowley-Milner Company of Detroit.1

The Electric Home And Farm Authority2

The Electric Home and Farm Authority is a government agency performing similar services to those of finance companies. Its activities are national in scope although it was first organized for the purpose of selling and financing the sales of electrical appliances to people in the areas served by the Tennessee Valley Authority.

One procedure in selling such goods is to come to some agreement with the public utilities in the various areas as to rates and fees and then have the utilities collect the installments from the buyers. The electrical equipment is financed by the Authority and the payments are usually made by the customers as they pay their monthly bills for electric power. In other cases the Authority makes agreements directly with distributors of such


apparatus whereby it pays the dealer the cash selling price minus the down payment. The utilities as before collect the monthly payments with the monthly electric power bills. In case the purchaser defaults, the distributor repurchases the contract from the Authority for the balance due less the unearned discount.

The Authority has outlined its own terms. In the sale of appliances to consumers, the minimum unpaid balance after down payment has been made must be $40. The minimum down payment is five percent for some goods and ten percent for others. The maximum term for some goods (washing machines, vacuum cleaners and radios) is 24 months and for others it is 36 months. By certain combinations of purchases the terms can be made to run 48 months. Schmalz,\(^1\) writing in the Harvard Business Review, criticized these liberal terms stating that by setting the pace of competition they caused the risks of loss to be greater. The effective rate charged is 9.72 percent and for the period between August 1, 1935, and June 30, 1937, the Authority had a loss of $2,275.

Hart claims that the rate charged by the Authority does not appear to be much lower than that charged by private companies in the field and it, therefore, does not offer any serious competition with private sellers in this field on the basis of rate.\(^2\)


\(^{2}\)Ibid., p. 175.
Summary

Installment credit is financed by finance companies, commercial banks, retailers, and industrial banks. Most of the financing is done by finance companies. Installment financing requires a special technique and involves more expense than ordinary commercial financing. As a result banks have been reluctant to enter the field. The loan is much smaller than ordinary commercial loans. Manufacturers generally demand cash for the sale of their goods to retailers. Retailers stock up with a limited supply of goods and, as they make sales on the installment plan, they discount the paper with the finance company. The money received from the discounted paper is used very largely to replenish the stock. Sometimes the finance company acts as a direct intermediary between the manufacturer and the retailer when the latter does not have sufficient capital with which to pay the manufacturer for the products. Two of the functions performed by the finance company are investigation of the credit standing of the potential borrower and collection. Sometimes the retailer agrees to do both. The finance company gets its capital by the sale of stocks, from bond house, the bank, and sale of paper in the open market. What is true of the activities of the finance companies in financing installment credit is more or less true of commercial banks, industrial banks, and retailers.

In the financing of electric appliances the Electric Home and Farm Authority has recently entered the field. Its rates and terms may be used as a yardstick. The minimum purchase must be $40, down payment from five percent to ten percent of the amount purchased. The length of the period ranges from 24 months to 48 months and the effective rate is 9.72 percent.
CHAPTER V

LEGAL ASPECTS

It was stated in the definition of installment plan that the seller usually retains title to the goods until final payment had been made. When the consumer buyer defaults things begin to happen. The buyer and the seller then come face to face with the laws governing the sale of goods on the installment plan. The question of repossession then arises and the problem of taking back the furniture or other goods must be met. If the buyer should resist the efforts of the seller to repossess the goods, may the seller enter the home by force?

Only for a bottle of booze can the sanctity of a man's home be violated in this country. If he doesn't pay for his furniture, a writ must be obtained from the courts and a sheriff's officer hired before it can be confiscated. Ignorant of this fact many people who can not meet their terms let their furniture be taken without a writ or a murmur.1

Laws and methods of sale vary very widely from state to state, from city to city and from business to business. The types of contracts and the methods of enforcement vary widely. Court decisions vary from state to state so that the common law governing such sales is far from uniform.

Summary of State Laws2

Conditional Sales

Whenever goods are sold on the installment plan and the buyer signs


2This section on state laws is taken exclusively from Griffin, Bryant W., and Green, H. C., Installment Credits and Collections, New York, Prentice-Hall, 1936, pp. 218-220.
a contract whereby he agrees for the seller to retain title to the goods
the transaction is usually known as a conditional sale. Such a contract
will be enforced in all states. The seller may under the agreement take
possession of the property in case of default of payment by the buyer.
In the transaction, however, the buyer takes possession of the property
but the title remains with the seller until the full purchase price is
paid and whatever other terms agreed upon in the contract are met.

This contract gives the seller prior claims against the buyer for
satisfactory settlement of the amount due him. Originally other creditors
are the buyers not knowing that he did not have title to the property in
his possession considered such a transaction as unfair to them. As a
result of this complaint, laws have been passed in most states requiring
the filing of such contracts on the public records so that any would-be
creditor to the buyer will know whether he has the title to the goods in
his possession. In some states a conditional sale is regarded as a
chattel mortgage. This makes the laws governing chattel mortgages appli-
cable to such sales.

Exemptions

Many states exempt certain classes of property from the conditions of
sales agreements as a means of keeping the head of a family from losing
everything he has. The property that may not be taken from him includes
certain household furniture and land and building. To claim exemption one
must be living on his homestead in the case of land and building. The
claim must be placed on the public record. By use of special clauses in
contracts to the effect that the party to the agreement waives his right
of exemption, this law is circumvented. Some states will recognize the
clause while others will not. However, a person cannot claim exemption rights for property that he is buying on the installment plan under the terms of the agreement. Exemption privileges apply only to articles of household furniture that are already paid for.

Election Of Remedies

In the case of default in payment the seller has more than one method to use in protecting himself from loss. He may as a rule take possession of the property and keep the payments already made and declare them forfeited or as rentals for the use of the property. Again he may bring suit against the buyer for the price. In the case of a suit the seller often loses title to the goods and if he does not collect judgment he loses the property. However, there are disagreements as to this point. In some states laws are passed requiring that there be a resale of the property so that the buyer may get his equity out of it if there is enough left.

Foreclosure

In the case of chattel mortgage or other mortgage the procedure for repossession for default is that of foreclosure. In such cases the mortgagee may take possession of the property, sell it and sue the mortgagor for the remainder of the debt if the sale did not bring enough to pay the amount that he owed. On the other hand if the sale of the property brings more than the amount of the debt, he must turn over the surplus to the mortgagee. No court procedure is necessary. The property may be sold at public or private sale and in the case of public sale the party making the foreclosure may be one of the bidders. In case the mortgagee bids in the
property at a price less than the amount due him, he may take deficient proceedings against the mortgagor for the balance. In the case of chattel mortgage if the sale is not conducted properly and it does not bring a high enough price the mortgagor may bring suit for damage against the mortgagee. He has the right to redeem the property until it has been properly sold.

Uniform Conditional Sales Act

The uniform conditional sales act has been adopted in Arizona, Alaska, Delaware, Indiana, New Jersey, New York, Pennsylvania, South Dakota, West Virginia and Wisconsin.

The act provides that

to sue for part or all of the price is not a waiver of title, and, if the property is resold and not a sufficient amount is realized to pay the debt, the seller may recover a deficiency judgment. If the seller elects to retake the property, he may elect to give notice by registered mail to the buyer, and this notice must be given not more than forty days nor less than twenty days before the property is taken. If the buyer does not pay by the day set for retaking, he forfeits his rights to obtain possession of the property, but he does not forfeit all the payments that have been made. If one-half of the total price has been paid, the property must be sold at public auction within thirty days from the time that the seller takes possession. If less than one-half of the total price has been paid, the seller is not required to dispose of the property at public auction unless he is requested in writing to do so by the buyer within ten days after retaking. If the seller does not give notice of intention to retake, he may retake immediately but must then hold the goods for ten days, during which the buyer may redeem them by paying the balance due and the expense of retaking. Serving notice to retake merely affects the right to redemption by the buyer. With notice, the right to redeem is cut off; without notice the buyer has ten days in which to redeem. ¹

¹ Griffin and Greene, op. cit., p. 219.
Contracts

Having seen in a general way the state laws governing contracts it is of interest to look a little more closely at contracts themselves. Contracts vary widely as to types and as to terms of agreement. The non-legal buyer has a serious problem understanding them and sellers apparently are not too anxious for them to become very enlightened about them.

One type of contract is the add-on or open-end contract. From it many abuses arise.

A buyer, for example, agrees to liquidate an installment balance of $100.00 on dining room furniture in ten monthly installments. After nine payments have been made, with a ten dollar balance due in one month, the buyer purchases a living room couch with a down payment plus an installment contract for fifty dollars. The add-on contract makes the merchandise security of the second sale both the original dining room furniture and the living room couch. It is possible for this process to continue indefinitely with no single piece of furniture legally owned by the buyer until the last piece is entirely paid for.\(^1\)

Another type of contract which is the source of much abuse is the lease or rental contract. Under the terms of this agreement the buyer's payments for goods so bought are considered rentals. This type of contract is used quite frequently by furniture stores. In case of default and the goods are repossessed the buyer has absolutely no equity and cannot institute court proceedings.

A third type of contract is the closed-end agreement. Under its terms no goods may be added to the original purchase and no attachment can be made thereto. There must be a second contract for a second purchase.

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Contracts have several parts such as a personal statement to obtain credit, a conditional sales or chattel mortgage agreement, a note with power of attorney to confess judgment, and sometimes an assignment of wages. The power of attorney to confess judgment means that at any time during the life of the note, upon default, the holder may go to any court of record, and without notice to the buyer, or trial, or doing anything more than filing some papers, obtain a judgment for the amount due on the note. The holder can garnishee the man’s bank account, levy on and sell his household furniture, and in a great many other ways make him lament the day that he was ever enticed into the spider’s web of easy payments.

Another clause is the wage assignment. Under it the seller may demand the salary of the buyer from his employer for payment of the goods.

The abuses have caused one writer to remark:

The average American buyer wants a standard contract which, without reading, he can feel sure will protect his interests fairly. In many cases, particularly in the field of fire and life insurance, he has obtained such protection.

It was stated in the above paragraph that the ordinary contract has several parts. The two main parts are the personal statement to obtain credit or more commonly called the promissory note and the conditional sales or chattel mortgage agreement. These two parts or instruments are kept distinct because the introduction of the terms of the contract into the note would jeopardize its compliance with the requirements as to the form of negotiable instruments, contained in the Uniform Negotiable Instrument Law, in force in every state.

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2Haring, Albert, op. cit., p. 280.
The promissory note contains the promise of the buyer to pay to the seller or second party the unpaid balance of the purchase price of the article plus the carrying charge.

In order that the rights of the seller may be protected there are provisions for the enforcement of the agreement. In the first place, when the buyer defaults on any installment the whole sum that is owed becomes due and payable immediately. In the contract also are clauses which cover almost every act of the buyer which might lead to default and cause loss to the seller. There are other provisions such as attorney's fees, the retention of title to the article sold and in the case of an automobile, limitations on the use of the car (illegal operations, taxicab, etc.), sale and encumbrance of the car and provision for insurance.

It is estimated that from 950 to 980 out of 1,000 buyers will complete the transaction. However, when a buyer defaults the finance company will act to repossess or adjust the problem in other ways within thirty days. Often repossession takes place without legal procedure.

In case of furniture or domestic appliances, a couple of husky movers will be sent after the property, and seldom fail to return with it. The license to enter upon the premises is generally considered irrevocable, and in exercising it the vendor may exercise such force as may be necessary. But in case of resistance, the finance company must, at its peril, stop at the precise point where sufficient force ends and excessive force begins.

If repossession fails because of resistance or other reasons the vendor must use court procedure.

1Ibid., p. 226.
2Adelson, op. cit., p. 226.
Legal Relationships Of Dealers And Finance Companies

Installment Contract

After the installment contract has been signed by the buyer and seller and other problems settled the seller, to keep his enterprise solvent, usually discounts the paper with the finance company. One type of agreement that the finance company may make with buyer before it discounts the paper is known as the recourse plan. Under the terms of this agreement the dealer endorses the promissory note part of the buyer's contract and in other ways makes himself liable to the finance company in case the buyer defaults on the balance due. In the case of automobile financing this plan is seldom used although some authorities on marketing advocate the use of this plan by all retailers. But for most household furnishings the plan is in general use.

The second plan is the non-recourse plan. In this the dealer endorses the papers of the purchaser for the finance company but without making himself liable in the event that the consumer buyer defaults on his payments. As a result of this agreement finance companies accept only the highest class of papers. Besides, it makes an independent investigation of the credit standing of the purchaser necessary to see if it is as represented by the retailer. In the case of non-recourse paper the dealer agrees to be liable in case the property is encumbered in any way at the time of the sale or if he knew that the purchaser misrepresented himself in statements on the contract. In any event the finance company finds itself faced with the problem of disposing of repossessed goods when the buyer fails to meet his payments.

1.aring, Albert, op. cit., p. 281.
The problem of disposing of the repossessed property is solved by way of the repurchase plan. In it the dealer agrees to repurchase the goods in case of repossession. This is an agreement in addition to the non-recourse plan. In the case of recourse paper the repurchase agreement is made by the provision that the dealer is not liable unless the goods are returned. All cases of non-recourse, however, do not carry with them an agreement to repurchase.

Other Legal Agreements Between Dealer And Finance Company

Sometimes the finance company advances funds to the dealer for the purchase of automobiles from the manufacturer. When the cars are so financed, arrangements are made whereby the finance company has sufficient security to guarantee payment or satisfactory settlement from the dealer. One method is the chattel mortgage on the cars and another is the conditional sales arrangement. These two methods were discussed above and they are applicable to the dealer as well as to the consumer buyer of goods on the installment plan.

A third method is sales on consignment by which the cars went to the dealer but the title remained with the finance company. The terms of this agreement were such that the dealer in effect became an agent of the finance company and thus this agreement was not always satisfactory. The trust receipt was in some respects similar to sales on consignment and thus was not satisfactory.

The fifth type of agreement involved the use of the warehouse receipt. Under it the automobiles are shipped and placed in a bonded warehouse. Warehouse receipts are issued to the finance company. The warehouse then will not let any cars out except on the presentation of a warehouse receipt. Dealers as a rule have a few cars on display. When they are sold they discount the papers with the finance company thus getting money to get others from the warehouse. Warehouse receipts are given to the dealer by the finance company equal to the value of the paper discounted. This procedure is often satisfactory.

Judicial Interpretation Of Usury

Often there are court contests between the purchaser and the finance company on the grounds that the rates are usurious. The states, of course, have usury laws which give the plaintiff grounds for court contests. The finance company's defense in most instances is, according to Whitaker: ¹

That it is an innocent party, a bona fide purchaser for value, and that in any event the merchant merely charged a credit price higher than his cash sale price. The courts have commonly sustained such pleas even though the ability of (the plaintiff) to figure out the true meaning of such contracts was not up to par, especially when there is no mention of interest as such and payments were divided into equal installments.

In other words finance companies in court defenses insist on their status as merchants in the plea of "bona fide purchasers of value" and feel that usury will not be pinned on a merchant. Foster quotes what he considers is the pillar of defense of installment companies against prosecutions for usury. It follows:²

¹Ibid., p. 435.

It is manifest that any person owning property may sell it at such price and on such terms as to time and mode of payment as he may see fit and such a sale, if bona fide, cannot be usurious, however unconscionable.

Proposals Of New Legislation

The disadvantages and the losses which buyers have suffered from many policies and practices of installment sellers have brought about agitation for new legislation. In the first place organizations are agitating for the passage by the other 33 states of the Uniform Conditional Sales Act. Another movement is the elimination of misleading statements. Many bills have been introduced in various state legislatures for that purpose. The Federal Trade Commission in 1936 accused several finance companies of misrepresenting their terms by stating six percent when the rates were often twice as much. The finance companies made a strong public denial but in the end a group of such companies agreed to change the statement for one less misleading.

According to Schmalz the typical objectives of actual or proposed legislation are: (1) to require that the elements comprising the carrying charges be particularized in the contract or when the terms are announced; (2) to specify a given form of contract; (3) to license sales finance companies; (4) to set up an agency for receiving complaints of unlawful action by sellers or finance companies; (5) to protect sellers against sale, destruction, or concealment of goods pledged by customers; (6) to prohibit dunning by post card or collect telegrams; (7) to regulate wage assignments; (8) to limit rates; (9) to prohibit the acceptance of confessions of judgment; (10) to prohibit additions; and (11) to regulate repossessions.

Schmalz, C. W., op. cit., pp. 92-93.
Summary

All states have some form of conditional sales legislation. The special requirements vary from state to state except for those states that have enacted the Uniform Conditional Sales Act. In all states the title to the goods remains with the seller until payment has been completed. Some states construe a conditional sale to be a chattel mortgage and thus make the laws concerning chattel mortgage applicable to the transaction. Many states exempt certain household articles (which have been paid for) from conditional sales agreements. These exemptions are designed to prevent heads of families from becoming destitute as a result of repossession in case of default. These exemptions can be waived in the contracts in most states. In adjusting the situation when default occurs, sellers may elect to sue the buyer or repossess the product. If he elects to sue, he waives his right to repossess. Some states require in the case of repossession that there be a resale of the product and if any amount in excess of what is due the seller is received, it should be returned to the buyer. On the other hand, if there is a deficit the buyer must make it up. Chattel mortgage works somewhat similar to that of conditional sales. The Uniform Conditional Sales Act has more elaborate protection for the buyer. In case of default the buyer does not forfeit all the payments and the seller must give notice of intention to repossess.

Contracts are of many kinds such as open-end, lease and closed-end. Sellers insert many powerful clauses such as power of attorney to confess judgment and wage assignments.

The agreements between retailers and finance companies are known as recourse, non-recourse, repurchase plan, sale on consignment, trust receipt
and warehouse receipts.

The legal defense of finance companies against suits charging usury is made on the basis of their claim of being "bona fide purchaser of value". They claim before the law that they are not lenders. Courts have generally sustained this plea.

The variations in the types and clauses of contracts within the limits of the laws governing conditional sales and chattel mortgages are very important sources of differential gains for sellers. The judicial decisions of court contests over charges of usury give the advantage to the sellers. Legal advice to sellers, therefore, is very profitable.
Definition of Market

From the functional point of view, the market may be termed any condition in which demand and supply are interacting through price. This condition is characteristic of all buying and selling and does not refer to any particular place. By demand is meant the willingness of buyers to purchase commodities at a price. The buyers may be individuals with different incomes who purchase the products to be used directly for the satisfaction of their wants. They may be institutions which use the products in a similar manner such as hospitals. They may be producers who purchase raw materials or partly finished products to be converted into finished products. They may be wholesalers or retailers who purchase finished products for resale to consumers.

The supply of commodities and services is usually understood as the willingness of sellers to sell their goods and services at a price. The sellers may be workers who sell their labor services to producers. They may be producers of raw materials who sell to manufacturers; manufacturers or farmers who sell to wholesalers and retailers; wholesalers who sell to retailers or to large institutions like schools and hospitals; or retailers who sell to ultimate consumers.

When speaking of the market for a particular product one can think of this market as having a geographical significance. For instance, Smith says:
The definition of a market for a particular commodity must indicate the area within which are operating the forces that directly affect the price and volume of trading.1

Thus we may speak of the New York metropolitan market or Chicago market for automobiles, mills, wheat or furniture.

Market may be defined in terms of the commodity. One may speak of the automobile market. This market may be subdivided into high-priced, medium-priced and low-priced automobile markets or still further into Fords, Chevrolets, Dodges, Buicks or Packards. "There is no such thing as a demand for low-priced cars except as a composite of the demands for different specific makes of low-priced cars."2 The same is true of furniture and for many other commodities. There are markets for different styles, brands and qualities of furniture. There are demands not so much for electrical appliances in general as there are demands for General Electric or Westinghouse Electric appliances. People demand not radios in general but Philco radios or RCA radios.

Therefore, as the seller can separate his particular brand or make of a specific type of good or service from others of similar general class in the mind of the buyer, he can prevent buyer comparison of desired attributes of products and thus weaken competition between sellers. This is the process of product differentiation. Likewise, goods may be differentiated by variation in the kinds and/or extent of more or less separable services that are rendered along with the goods sold. Further, the location of competitive sellers in relation to the various buyers gives rise to differentiation.


2Ibid., p. 37.
However, there are important relations between the prices of Ford cars and Chevrolet cars as well as between the different makes of other similar commodities.

Within the low price field the probability of shifting from the purchase of one make to the purchase of another car in the same class, or in a higher price class, is so great that the demand, price, and volume of sales in each market are very closely related to the conditions in another.¹

In other words, while the differentiation process fosters an increase in the strength of monopoly in the market for a given seller's product, the degree of substitutability on the part of buyers between brands tends to weaken this monopolistic force and foster the approach toward conditions of perfect competition.

Durable consumer goods bought mainly on the installment plan offer an example of a market for a complex good composed of many attributes, some separable and some not, which is peculiarly susceptible to differentiation but likewise one in which substitution can be effectively carried out insofar as the desired attributes are known and can be detected by the consumer buyer.

Supply Price

By supply price of a commodity is meant the price that is sufficient to call forth that commodity in the amount necessary to meet the effective demand for it. It must include profit to the entrepreneurs who had a part in its production through the different stages, and profits to the transporters, wholesalers and retailers. It must cover wages and salaries of

¹McIsaac and Smith, op. cit., p. 37.
all the workers engaged in its production and distribution. Expenses of raw materials and capital equipment must be covered also. From the point of view of getting the commodity to the ultimate consumer from its crudest stage we have manufacturer's price, wholesaler's price and retailer's price. The price which the ultimate consumer pays is the retail price and it covers all the expenses incurred in getting the commodity to the consumer.

These prices, at different stages in the marketing process, are related to each other vertically. Indeed, it is through this vertical structure of markets and prices that the demands of consumers and the activities of producers are related to each other.¹

Not only are prices different for different stages in the marketing process but retail prices for a given commodity vary among retailers. Because of differences in distance of retailers from manufacturers or wholesalers, retail prices reflect such differences in transportation costs. Transportation costs vary according to the type of transportation. Water transportation is less costly than railroad transportation. Freight is cheaper than express. Prices differ within the same locality for a commodity according to size of the store, services rendered by or prestige of the merchant.

Perfect Competition In The Market

The activities of buyers and sellers in the market are usually characterized by economists as competitive activities. In an effort to get commodities to be used in the satisfaction of their wants, consumer buyers are assumed to compete with each other. This competition on the part of buyers

¹M.I. Isaac and Smith, op. cit., p. 39.
tends to raise the price of the goods. The sellers, on the other hand, are assumed to compete with each other for the patronage of consumer buyers. This competition on the part of sellers tends to lower the price of the commodity. The forces tending to raise prices and the forces tending to lower prices are neutralized at a point which is called the equilibrium point or price. At this point or price all the units of the commodity that are offered by the sellers are taken by the buyers.

To have perfect competition in the market so that this equilibrium price will be reached the following conditions must exist. The commodity whether it be credit or a material good must be strictly uniform and recognized as such by both buyers and sellers. There must be a large number of independent buyers and independent sellers who are motivated by their own desires for satisfaction or profit. There must be perfect knowledge on the part of buyers and sellers of the various prices for which the commodity is offered or bid. There must be perfect freedom of movement of the buyers and sellers to the place where the price is most favorable. Price must be the only inducement for buyers or sellers to act. Under such conditions no buyer or seller can by his independent action influence price.1 If these conditions govern the actions of buyers and sellers in the market, the effective power of buyers and sellers will be equal. Buyers would not organize to take advantage of sellers and sellers would not organize to take advantage of buyers. There would be no profit in doing so. There would be no profit in attempting to persuade consumers to buy through advertising.

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for consumers would know the uses of the uniform commodity. In the case of goods sold on the installment plan the prices of the physical good, credit, insurance, delivery and installation would be separated so that there would be a market for each of these commodities or items independent in many respects of the market for the other.

Under conditions of perfect competition a commodity may be defined as a "group of products surrounded by a gap in the chain of possible substitutes." For instance, we may speak of corn flakes in connection with other cooked cereals such as wheat flakes and rice crispies, and also with cereals that must be cooked, as a commodity. The knowledge of the prices of these substitutes and the tendency to act on such knowledge tends to keep the price of corn flakes down.

Perfect competition is an ideal situation in which equilibrium price is set. It does not exist in the retail market for goods sold on the installment plan. Its usefulness in this connection is in showing the contrasts from it in the real world. In the retail market for goods sold on the installment plan imperfect competition exists since there are relatively few sellers and many buyers. An individual seller can, by acting independently, influence price. In perfect competition the individual seller regards the demand for the output of his firm as perfectly elastic. That is, he assumes that all he can produce will be sold at the market price. This is due to the fact that the total output of his firm is so small in relation to the total output of the industry as to have only a negligible influence on the prevailing

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equilibrium price. If he doubled his output or tripled it, such action
would have no influence on price. If the seller raised his price, he
would sell no units of his product because buyers would purchase from the
sellers who sold at the market price. On the other hand, since the seller
assumes that he can sell his total output at the market price, there will
be no inducement for him to cut his price below the market price or to
seek an increase volume of sales by the use of aggressive selling methods
and persuasive advertising.

Imperfect Competition

It was explained above how sellers or buyers are unable individually
to influence price under perfect competition. The perfect knowledge and
perfect mobility of buyers would prevent any price manipulation. Under
imperfect competition, the situation is different. As a rule there are
many buyers and relatively few sellers. This is especially true in the
retail market. Because the sellers are few in number one seller of a com-
modity can by his independent action influence price. This condition gives
rise to the struggle for the most favorable trading position among sellers.

In defining an imperfect market, Feade\textsuperscript{1}says with reference to buyers
who are large in number:

An imperfect market for the industry's product exists if for
one reason or another the customers do not consider the output
of each firm to be identical, but prefer the product of one firm
to that of another, so that they will only change their custom
from one supplier to another if their preference is overcome by
a sufficiently large margin between the prices at which the two
suppliers are offering their products. But — and this is the

\textsuperscript{1}ibid., p. 165.
point of vital importance — this buyers' preference may be of two kinds "irrational" and "rational". If it is irrational, it is due to inertia or lack of knowledge on the part of consumers. Consumers may prefer A's goods to B's goods mistakenly, either simply because they are in the habit of buying A's goods or because they think wrongly that A's goods are superior to B's goods. If the buyers' preference is rational they prefer A's goods to B's goods for good and rational reasons such as differences in transport costs or in the qualities of the products.

The existence of transportation costs, of differences in the quality of products of firms of the same industry, and of ignorance and inertia on the part of consumers, when taken with the few sellers of the product, makes possible a wide range of play for the prices of the commodity of the industry. Sellers whose motive is maximum profits exploit this situation to their advantage. Effort is made by sellers to tilt the scale of bargaining power between themselves and buyers as far as possible in their own favor. They devise and employ methods to persuade the buyers to purchase their commodity at their price. They seek out those things which most buyers wish to believe and emphasize them in connection with their products. They study what they call the "weaknesses in the prospects' armour" of defense against being sold. They exploit the buyers' weaknesses to the greatest advantage to the sellers themselves. Rival sellers of an industry use every effort to differentiate their product in the minds of the buyers. They describe their product by its brand name and not by its utilitarian characteristic. They concentrate on a technique of giving a minimum of information and a maximum of emotional appeal.

For the success of such a policy, sellers rely first on advertisers who have developed the art of giving and securing belief in a mass of misinformation along with a small amount of genuine information. Secondly,
they rely on statisticians who tell them of the incomes and buying habits of consumers and of the effectiveness of their sales campaign. Thirdly, they rely on accountants who tell them of the cost conditions of their firms and of their revenue.

Under these conditions the definition of a commodity takes a different meaning from the one defined in a perfectly competitive market. Of this Meyers¹ says:

If the good is subject to product differentiation, we may consider the combination of physical product and the services that go with it as constituting a "commodity" in the mind of the buyer. Under these circumstances, the commodity would be the physical product as packaged, advertised, serviced, and sold by the individual dealer. In other words, the article as sold by an individual seller would be a commodity, while the same, or similar, article sold by a competitor would be a substitute for the commodity.

Such a definition of a commodity suggests that each seller has a market for his differentiated product. And as long as buyers can be persuaded to believe that there are differences between the differentiated products similar in general type and intrinsic attributes the markets will exist. This situation gives rise to costs that are distinct from the costs that are generally regarded as production costs. These costs are selling costs and are defined as the "costs necessary to persuade a buyer to buy one product rather than another, or to buy from one seller rather than another."²

In imperfect competition the sellers assume that he can influence price by his individual actions. Therefore, he considers that his individual

¹Ibid., p. 59.
²Meyers, op. cit., p. 144.
The demand curve will not be perfectly elastic. The number of sellers relatively is so few that the change in output of any one will appreciably affect the price, since it will notably change the total supply available. If the seller increased his output, the price at which he could sell his product would be lowered. On the other hand, buyers do not have perfect knowledge. Consumers are creatures of habit and reflect such in their purchasing. They will buy one and of a product in preference to another simply because they have been accustomed to purchasing it. The other brand may be equally as good or even better but the consumer buyers will cling to the former. It may be necessary for the seller of the second brand to lower the price consideration to induce the consumer buyer to forego purchase of the former brand and acquire the second brand. While consumer buyers are creatures of habits and tend to purchase a brand of product because of seeming differences from other similar brands, they also have a tendency to buy substitutes for a commodity. This tendency is evident in the purchase of low price automobiles, electric refrigerators, furniture and other household products. Things tending to limit substitutability are dislike of time consuming shopping, penny-pinching frame of mind, conspicuous consumption of a preferred brand, and the seeming differences between brands of commodities, and the attachment to a particular seller. This attachment may be due to the politeness of the seller, extra services or a combination of the two. These characteristics of consumer buyers make possible the success of product differentiation.

The Retail Market For Goods Sold On The Installment Plan

Thus far we have emphasized the economic nature of the market in general without reference to any particular commodities. We are interested in the retail market for goods sold on the installment plan. The consumers who buy such goods pay for the physical product plus brand, credit, delivery, assembly, installation, insurance, and terms. All of this is secured in one transaction and usually without being itemized or priced separately to the customer. Variation of any one by the seller can differentiate the commodity in the mind of the buyer. Therefore, we can say that the retail market for goods sold on the installment plan is imperfect. Such commodities would be defined as commodity is defined under conditions of imperfect competition.¹

The selling technique of these durable consumer goods is based on the policy of granting credit. In many instances the retailer grants the credit to the buyer. In other instances the financing is done by special agencies such as finance companies, commercial banks and industrial banks. In any case, however, the retailer of the product is likely to be the agent or intermediary for the consumer and the credit granting firm. The credit terms then become a part of the single sales contract.

This credit which vitally affects the sale of the commodity may be differentiated in many ways. Its market may be stratified by the kind of security offered.² Of course the physical product is the security for the debt in most instances but credit charges for automobiles are different from

¹Ibid., p. 164.

credit charges for furniture. Credit charges for electrical appliances are different from credit charges for either automobiles or furniture. The loan policy and procedure differ from seller to seller. Some take only A-1 risks others are less exacting. Some require that the buyer make direct contact with the credit financing agency before the deal is closed while others take that responsibility on themselves. Collection policies are differentiated from store to store. Some sellers insist upon prompt payment on threat of repossession. Others are more liberal with buyers who default. A fourth type of differentiation concerns the amount the buyer will be allowed to purchase on the installment plan. Some buyers are limited to only a few items while others may get much more. The fifth way that the credit market is stratified is by the terms of payment. Some sellers require a large down payment and a substantial amount at each period of payment. Others may require no down payment. On the other hand payments may be weekly, bi-weekly or monthly. Sixth, the reputation of the lender may influence choice or the personal relations of the buyer with the seller may be the deciding factor. Some buyers are flattered by the politeness and hospitality of sellers.¹

The buyer seems to prefer the convenience of getting the credit with the physical product rather than to shop for each separately. The combination of the two complicates the problem of distinguishing between the price of the product and the price of credit. Such factors as location of lender in relation to borrower and ignorance of the existence of other lending agencies or the terms they offer complicate the problem further. Prices are more

¹Yntema, op. cit., pp. 82-83.
easily concealed under such conditions.\textsuperscript{1}

The charge for credit may take the form of a flat interest rate on unpaid balances; a lump sum finance or carrying charge; a discount from the face of the note; an inadequate rebate; a fee; ... or some combination of these. When veteran credit men are unable intelligently to compare such credit terms, it is small wonder that the average borrower is hopelessly befuddled.\textsuperscript{1}

Market stratification is so complicated that price competition is severely restricted. The price structure is elaborately, and apparently deliberately, camouflaged. Consumer buyers are severely hampered in shifting from one seller to another on the basis of rate changes. Consumer preferences are kept irrational.

\textsuperscript{1}Intema, \textit{op. cit.}, pp. 82-83.
CHAPTER VII

COSTS

The costs of consumer credit of the installment type are of many kinds. Most of them are borne in some form by the consumer. It is difficult to separate the credit service from the article sold. Also credit charges vary according to the type of commodity. There are prime or direct costs which are incurred in the immediate act of granting credit. There are operating or fixed costs which are necessary in the provision for credit services to consumers in the aggregate. There are unit costs which are determined by the costs of unit per output. There are two classifications of unit costs — average costs and marginal costs. The average cost is the total cost divided by the number of units of output. The marginal cost is the amount added to the total cost as a result of the increase in output by one unit of the product. There are social costs which involve the costs to society of the installment plan of consumer credit as contrasted with private costs.

Direct Costs

The prime costs of consumer credit are those involved in the immediate consummation of the transaction and other short run factors. One such cost is that of the investigation of the reputation and credit standing of the purchaser. This investigation may be done either by the retailer or the specialized credit agency, or in some cases of non-recourse it may be done by both. Another is the salary or commission of the salesman involved in the transaction. Another is the cost of delivery in cases of commodities requiring such. This necessitates immediate wear on the delivery vehicle, that part of the wages of the workers involved in the task and gasoline and

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fuel expense. Another cost is the amount by which the note is discounted in case the finance company or the bank handles the credit transaction. If the commodity has not been assembled and is not ready for delivery, the cost of this work may be considered prime cost, or the implicit cost of credit.

Supplementary or Overhead Costs

Prime costs are the short run aspects of costs. Supplementary or overhead costs are long-run in nature and are not influential in the short-run period. However, in the long-run all costs become prime costs. Such costs include a long list of operations such as membership in a credit investigating agency, losses from bad debts, repossessing, reconditioning and selling articles, bookkeeping stationery and contract forms, collecting, advertising, delivery and upkeep of delivery vehicle, office and store equipment, insurance, rent, legal and professional services, depreciation, and interest on borrowed capital.

The increase in cost of production arising from the installment selling method can be seen by a comparison of the cost of stores selling on a cash basis with those that sell on the installment plan. Nystrom says: (See table on page 73)

The detailed items of expense in which increases occur for installment selling include (1) accounting, (2) interest on merchandise outstanding but not yet paid for, (3) losses on bad accounts, (4) credit and collection expenses, (5) legal services, (6) allowances to customers, (7) insurance, and (8) delivery expense. The expenses for accounting, interest, losses on bad accounts, credits and collections may easily be more than double the amount of such expenses incurred in ordinary retail business. There are also other items which because of the nature of the merchandise in which installment sales are most frequently made, are also likely to be higher than in other types of retail stores such as advertising, delivery, warehousing, freight and express expenses. Household furniture, musical instruments, and electrical washing machines are bulky goods whose
## COMPARATIVE OPERATING EXPENSES IN REGULAR AND INSTALLMENT RETAIL STORES

<table>
<thead>
<tr>
<th>Stores with</th>
<th>Stores with</th>
<th>Stores with</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Install-ment Sales (%)</td>
<td>Some Install-ment Sales (%)</td>
<td>All Install-ment Sales (%)</td>
</tr>
<tr>
<td>Sales</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td>69.7</td>
<td>61.2</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>30.3</td>
<td>38.8</td>
</tr>
</tbody>
</table>

### Expenses

<table>
<thead>
<tr>
<th>Category</th>
<th>Stores with No Install-ment Sales (%)</th>
<th>Stores with Some Install-ment Sales (%)</th>
<th>Stores with All Install-ment Sales (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling salary</td>
<td>7.3</td>
<td>6.1</td>
<td>5.6</td>
</tr>
<tr>
<td>Bonus</td>
<td>1.0</td>
<td>0.7</td>
<td>1.3</td>
</tr>
<tr>
<td>Buying expenses</td>
<td>1.2</td>
<td>0.3</td>
<td>0.2</td>
</tr>
<tr>
<td>Advertising</td>
<td>3.9</td>
<td>5.4</td>
<td>6.4</td>
</tr>
<tr>
<td>Window trimming</td>
<td>0.2</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Delivery</td>
<td>0.9</td>
<td>2.1</td>
<td>2.8</td>
</tr>
<tr>
<td>Freight &amp; expenses</td>
<td>0.8</td>
<td>2.0</td>
<td>1.1</td>
</tr>
<tr>
<td>Store supplies</td>
<td>0.3</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Direct dept. expense</td>
<td>0.8</td>
<td>2.0</td>
<td>---</td>
</tr>
<tr>
<td>Warehouse n</td>
<td>---</td>
<td>0.6</td>
<td>0.7</td>
</tr>
<tr>
<td>Workrooms</td>
<td>0.2</td>
<td>0.4</td>
<td>---</td>
</tr>
<tr>
<td><strong>Total Operating</strong></td>
<td><strong>16.6</strong></td>
<td><strong>20.0</strong></td>
<td><strong>18.7</strong></td>
</tr>
<tr>
<td>Rent, power, cleaning, taxes</td>
<td>4.5</td>
<td>5.4</td>
<td>5.3</td>
</tr>
<tr>
<td>Depreciation</td>
<td>1.0</td>
<td>0.7</td>
<td>1.1</td>
</tr>
<tr>
<td>Insurance</td>
<td>0.4</td>
<td>0.5</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>Total Fixed</strong></td>
<td><strong>5.9</strong></td>
<td><strong>6.6</strong></td>
<td><strong>7.3</strong></td>
</tr>
<tr>
<td>General expenses &amp; management</td>
<td>1.9</td>
<td>1.8</td>
<td>2.2</td>
</tr>
<tr>
<td>Office</td>
<td>1.5</td>
<td>2.1</td>
<td>2.8</td>
</tr>
<tr>
<td>Postage &amp; phones</td>
<td>0.2</td>
<td>0.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Interest</td>
<td>0.9</td>
<td>1.5</td>
<td>4.8</td>
</tr>
<tr>
<td>Loss on bad accounts</td>
<td>0.3</td>
<td>2.8</td>
<td>6.3</td>
</tr>
<tr>
<td>Donations</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Credit &amp; collections</td>
<td>---</td>
<td>0.5</td>
<td>1.8</td>
</tr>
<tr>
<td>Carfare</td>
<td>---</td>
<td>---</td>
<td>0.1</td>
</tr>
<tr>
<td>Legal &amp; professional services</td>
<td>0.1</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Customers' allowance</td>
<td>---</td>
<td>0.2</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>Total Overhead</strong></td>
<td><strong>5.0</strong></td>
<td><strong>9.4</strong></td>
<td><strong>19.3</strong></td>
</tr>
<tr>
<td>Grand Total Expenses</td>
<td><strong>27.5</strong></td>
<td><strong>36.0</strong></td>
<td><strong>45.6</strong></td>
</tr>
<tr>
<td>Net Profit on Merchandise</td>
<td><strong>2.8</strong></td>
<td><strong>2.8</strong></td>
<td><strong>2.8</strong></td>
</tr>
</tbody>
</table>

**Note:** Actual percentage average taken from group of each type.

Nystrom, Store Operation, p. 617.
expenses of handling run into high figures.

In the home furnishing retail business it may be possible to find retail stores or departments conducted at expenses amounting to from 27.5% up to 35% or 36% of net sales, whereas the operating expenses in similar stores depending upon installment for sales for the larger part of their business are likely to be from 35% to 45% sales.¹

Consumer credit, because of the small size of the average loan involved and because of the cost of collection, is more costly than producer credit, much of the higher cost must be expected and borne by consumers if they desire the advantages of installment buying. However, some cost may be reduced by better administration.

Losses

One item of expense that may be controlled is that of bad debt losses. They varied according to the size of the store; the greatest loss being experienced as a rule by stores with the smallest total annual sales.

In another investigation it was found that the loss from the sale of clothes was 25 percent of the gross sale.² However, this loss was covered by an increase in price of 150 percent. The writer stated that in no investigation that they made were losses found to be as low as those reported by the U. S. Department of Commerce. In the case reported the cost of installment credit was enormous. One writer states that there are two methods of keeping losses small. Either the merchant must be cautious of his risks when he makes the sale or he must adopt a system of merciless

¹Nystrom, op. cit., pp. 612-616.

²Griffin and Greens, op. cit., p. 38.
brutality when he makes his collections. Many businesses have been profoundly injured by the latter policy. Careful investigation will reduce losses but if it is carried too far the cost of investigation will be increased greatly.

Another cause of losses according to Seligman is the liberality of terms. He says that when terms are lengthened from 12 to 16 or 18 months, losses from repossessed cars jump 57 percent and when the terms are increased beyond 18 months the loss jumps 341 percent higher. On the other hand, the loss from bad debts of open credit accounts is much smaller for all classes of stores than for those of installment accounts:

**Percentages of Losses of Open Credit and Installment Accounts in 1937**

<table>
<thead>
<tr>
<th>Type of Store</th>
<th>Open Credit</th>
<th>Installment Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Furniture Stores</td>
<td>.4 of 1%</td>
<td>1.7</td>
</tr>
<tr>
<td>Household Appliances</td>
<td>.6</td>
<td>1.1</td>
</tr>
<tr>
<td>Department Stores</td>
<td>.3</td>
<td>.8</td>
</tr>
<tr>
<td>Jewelry Stores</td>
<td>.3</td>
<td>4.0</td>
</tr>
<tr>
<td>Men's Clothing Stores</td>
<td>.6</td>
<td>2.3</td>
</tr>
<tr>
<td>Women's Specialty Stores</td>
<td>.3</td>
<td>.7</td>
</tr>
</tbody>
</table>

Cost may be reduced as far as the lender is concerned in another way. While more careful investigation will reduce losses and therefore costs, the cost of investigation itself may be at least shifted. Neifeld says:

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2. Ibid., p. 303.
If the expense of investigation of the applicant can be shifted from the institution to the applicant himself, the operating cost, and therefore, the rate does not need to reflect the investigation cost. For instance an accounting statement customarily secured by the business man from a certified public accountant is a basis used by a commercial bank in considering credit extension. The cost of the preparation is borne by the borrower and does not become an item of expense to the lender.

Unit Costs

Information on the unit costs of selling goods on the installment plan is very fragmentary. Stores as a rule do not segregate their costs of installment selling from their costs of selling goods otherwise. However, as was noted above, the losses tended to decrease as the volume of annual sales increased. Besides, it is known that when the size of the retail enterprise and also the size of finance company increase up to a certain maximum size the opportunities for internal economies also increase. The existing supplementary costs and also variable costs can be more economically organized to take care of the increased volume of sales. Such factors as the number of orders per salesman for a week, a month, or a year, the sizes of the orders ($10, $15, $25, $100, etc.) and the number of repossessions per 100 orders are important in determining unit costs. The average size of the order in value is very important for too many small orders to the size and cost of the personnel will have a tendency to make unit costs rise. Unit costs are also influenced by the degree of specialization in those services that the nature of the business organization is most suitably adapted to. If financing of the installment sale can be more economically

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1 Pages 22-34.

handled by a special agency than by the retailer, then the special agency should be the one to handle it. However, the special agency should not take over any activities that the retailer can more economically handle. For a time the repossession of cars by finance companies and the consequent effort to resell them showed this tendency.¹ Unit costs are also influenced by the number and value of losses in relation to the volume of sales and by the length of the time that the installment debt remains outstanding.

Costs Of Distribution Under Conditions Of Imperfect Competition

So far we have emphasized the cost conditions of the individual firm in the field of distribution. We shall now widen the horizon and consider the cost factors of the distributive system as a whole. It will be recalled that a firm in an imperfect market reaches its most profitable size when its marginal cost equals its marginal revenue. When this point is reached under long-run normal conditions, however, average cost is larger than the marginal cost. Under perfect competition a firm is at its optimum size when its marginal cost equals its average cost — MR-AR. The most efficient size of a firm under perfectly competitive conditions is larger than the most profitable size of a firm under imperfectly competitive conditions. Furthermore, the most profitable size of the firm varies according to the degree of imperfection of the market for its product.

Marginal cost as the result of increase in output of a commodity influences average cost. This is due to the fact that the marginal cost is added to the previous total cost to get a new total cost. This new total

¹Seligman, op. cit., p. 309.
cost is divided by the new total output to get a new average cost. When the output of a firm is very small the average cost is larger than the marginal cost. As output increases the low marginal cost tends to lower the average cost. After a certain point is reached in output the marginal cost begins to rise, and it tends to raise average cost. When output has been extended to the point where marginal cost and average cost are equal, the firm is at its optimum size under perfect competition. In this way it is seen that the increase in output up to a certain point tends to lower unit cost. However, a firm which sells its product in an imperfectly competitive market will not extend its output to the point where its unit cost is lowest. It will stabilize its production at a point somewhat above the minimum average cost. This point will be reached when marginal cost and marginal receipts are equal.

Under such conditions it can be seen that more firms will be required to produce a given amount of output for an industry under imperfect competition than would be required under perfect competition. If more firms are required to produce a given amount of output it is quite likely that more workers will be required also. This situation is true for both production and distribution. Nevertheless it is more pronounced in the field of distribution than in the field of production. Margaret Ried says:

For every 100 workers in agriculture, in manufacturing and in marketing in 1910 there were by 1930, 92 in agriculture, 132 in manufacturing and 168 in marketing. It is also estimated that in 1929 the value added to products by manufacturers amounted to $28,550,000,000 while the value added by marketing amounted to $24,380,000,000.

According to the estimate of 1929, for every dollar spent on a commodity approximately 53 cents was spent for production and 47 cents was spent for
distribution. In a more recent estimate (1939) it is stated that the value added to a commodity by distribution is approximately 59 percent while that added by production is approximately 41 percent.¹

Much of the added costs of distribution go for what might be termed selling costs. Much effort, time and money are spent by distributors to persuade buyers to buy. All such costs are selling costs due to imperfect competition in the market. Elaborate programs are outlined and carried out which tend to increase and make permanent irrational buyers' preferences. In installment selling, product differentiation takes many forms. This differentiation makes it possible for almost every retailer to have his own market within limits. The commodity is differentiated by down payment, amount of the sale, size of monthly or weekly payment, method of credit charge, and policy of collection and repossession. The markets within markets due to product differentiation make possible the charging of prices that approach monopoly rather than perfect competition. All such costs are borne by consumers. From the table (page 73) it will be seen that stores selling goods on the installment plan spent more for advertising than stores selling products for cash only. The percentage is 3.9 percent for cash stores and 6.4 percent for stores selling goods on the installment plan.

Since more firms are necessary (or fewer firms are necessary) to supply a given output under conditions of imperfect competition than would be the case under perfect competition, other things being equal, one writer suggests a means of controlling the number of finance companies in a given area. He says:

¹Ibid., p. 217.
Does Distribution Cost Too Much?, op. cit., p. 334.
Intra-industry competition can be controlled effectively through state regulation. The number of credit institutions of any type permitted in a town can be limited by the application of the concept of "convenience and necessity" ... Instead of the present practice, which allows an unlimited increase in the number of credit institutions, the regulating authority of the state, guided by this concept, would issue authorizations for additional institutions only when required for the convenience and necessity of the community.¹

It is contended by most students of installment selling and buying that the plan stimulated sales in the durable consumer goods industries. This increase in demand enabled manufacturers to get the advantage of large scale production and reduce unit costs. One writer says:

It is highly probable that the installment buyer is paying less for his car today than he would be paying as a cash buyer, if there were no installment system.²

On the other hand, some claim that the increase in installment credit tends to promote economic instability. Others say that installment credit has heightened the peak of prosperity and deepened the pit of depression. Against this reduction in unit costs must be set the increase in selling costs and the costs of economic instability.

¹Neifeld, op. cit., p. 72.
²Plummer, op. cit., p. 31.
CHAPTER VIII

PRICES AND PRICE POLICIES

Fundamental Concepts

The price of a commodity is the amount of money that the commodity will command in exchange. It may be termed the equilibrium point of demand and supply. When we think of demand, we mean effective demand or the amount that will be taken at a price. Thus we may say that there is inequilibrium at a point when an equal number of commodities offered by sellers is bid for by buyers.

Price (or value) is affected by the conditions of supply. One condition of supply is the market period which includes that situation when the goods are in the market at an instant of time and without reference to how they got there. Another condition is the short-run normal period and it includes that time when the supply of the commodity can be affected by the existing supply of agents of production. The third condition of supply is the long-run normal period which includes the time when the supply of the commodities can be varied as a result of the variation in the supply of the productive agents themselves. In the market period price is analyzed with emphasis upon demand. In the normal periods price is analyzed with emphasis upon supply.

In the market period the equilibrium price is reached as a result of the haggling and bargaining of buyers and sellers. In this period the general law of demand is in operation. That is, as the price increases the amount bid for by buyers tends to decrease; and, conversely, as the price decreases the amount bid for by buyers tends to increase. This general law
assumes perfect competition in which there is perfect knowledge on the part of buyers of all prices at which the commodity is offered. It includes perfect mobility on the part of buyers (and sellers) to go where the price is most favorable. Again it means that the groups of buyers and sellers are so large that no buyer or seller can by his individual action affect the price. However, it is contended in this study that in the market of goods sold on the installment plan, competition is not perfect. In fact the activities of some sellers seem to be based on the imperfect knowledge of the buyers.

In the normal periods the price is affected by the cost of production. We are concerned with the supply price of meeting a given demand. It is the costs of the agents of production necessary to produce the supply. In the short-run period the supply price tends to increase in order to meet a temporary increase in demand. In the long-run the supply price tends to decrease as a result of the forces set in motion to meet the permanent increase in demand. These tendencies, however, assume the full employment of the community's productive agents.
An Imperfectly Competitive Market

So far in this chapter price determination has been explained on the assumption that perfect competition existed in the market. These assumptions have serious limitations for explaining price determinations in the real market for goods sold on the instalment plan. The theory of imperfect competition is a better means of explaining the real situation. Nevertheless, some of the factors and conditions that explain and determine price under perfect competition are applicable when the market for the commodity is imperfect. The equilibrium point of supply and demand determines price in imperfect competition as well as in perfect competition. However, the equilibrium point in imperfect competition cannot be described as competitive equilibrium. Furthermore demand is not characterized by perfect knowledge, but rather it is characterized by irrational buyers' preferences. The supply of the commodity is produced by a few sellers rather than a large number. From the forces of these variables the equilibrium prices are determined.

The three time concepts of market period, short run normal period and long run normal period are also applicable to imperfect competition. However, we are interested in this study in the short run period. Prices are administratively set after elaborate product differentiation.

Product Differentiation

We may now look at some of the common practices of selling which may be adequately described as product differentiation. In most instances the credit price is not separated from the cash price. When consumers enter the market on any day the credit price is quoted them as a rule. In addition the difficulty of comparing prices in one store with prices in another are serious because of this general failure to separate the price of the good from the price of the credit service.
Some consumers ask for information on the credit charge. Often they are told that there is no carrying charge; again they hear "6% on unpaid balance." Sometimes they are told that for cash they may get a discount of 10%. On the other hand many department stores and mail order houses quote the cash price and the carrying charge separately. If there is sales resistance there may be a reduction in the quoted price. More often, however, to divert attention from price salesmen emphasize liberal terms or prompt delivery. In case of a demand for lower price the salesman is likely to emphasize in a general way the costs and expenses that must be met. It was stated earlier that one of the characteristics of installment buying is that the purchase is likely to represent one which has not been duplicated in the recent past and is not likely to be repeated in the immediate future. This lack of repeated purchases makes the buying process less familiar to the buyer than it is to the seller.¹

The terms quoted by the sellers vary from store to store and from product to product. However, to catch the imagination of the buyer without giving much information at the same time, the sellers may use some of their advertising literature to get over the impression. It is likely to have some such terms as "quick delivery," "easy payments," "twelve easy payments," "family budget plan," "no down payment," "five years to pay," "the working man's friend." Attention is centered on how easy it is to pay and not on how much one must pay. Often the seller will tell the buyer that his price compares favorably with the price of competitors without giving an adequate basis for comparison. The fact that the cash prices and credit prices are not separated by most stores makes comparison very difficult.

¹See page 8.
Effort is centered on getting buyers to buy at the given price. Instead of reducing prices, the seller will make the terms more liberal. The down payment will be made smaller. The size of the payment will be made smaller and the time for the completion of the payment will be extended. Knowledge of the market by the buyers is not perfect and sellers apparently are not interested in making it perfect. In some cases, however, many department stores give genuine information to buyers about budgeting their income and the wisdom of making installment purchases on the basis of their incomes thus budgeted. Buyers when signing the contract for payment do not find prices stated any more clearly. The seller produces the contract form and after it is signed has it placed on the public record. The rights of the buyer under the contract are seldom explained to him by the seller.

Factors Affecting Prices.

The success or lack of success in day to day selling determines in large measure the prices and price policies of sellers of goods on the installment plan. Many factors enter into the determination of prices. The motive is to fix price at the point which will bring the highest total net return. The factors are cost, desirability of the commodity, competition, producers and distributors errors of calculation of demand and ethical influences. ¹

The cost factors which influence price were analyzed in the preceding chapter. It was seen that for stores

¹Nystrom, op. cit., pp. 461-473.
selling on the instalment plan the costs of delivery, bookkeeping and stationery, advertising, freight, insurance, legal services, postage, and bad debt losses were higher than for stores not selling on the instalment plan. Besides there are other added costs such as collection and interest. Therefore prices of goods sold on the instalment plan will reflect these added costs. Costs determine the lower limit of prices.

It was said that competition tends to increase cost in the field of distribution. Referring to a fact brought out in Chapter I, one is reminded of the tendency on the part of competitors to refrain from cutting prices to a minimum. However, there is some price competition. Some stores by their size and resultant advantages of internal economies are able to offer these commodities at lower prices. This is true of large department stores and mail order houses which have recently extended their selling on the instalment plan. It will be recalled that the losses of large stores selling on the instalment plan were much smaller as a rule than the losses of smaller stores.

Habits and customs of the people have their influences on price. If people feel that a commodity is not worth more than a certain price, the tendency is for that commodity to remain in that price range. However, the quality may be reduced if the costs of producing and handling the commodity go up. Another important influence on the price of goods sold on the instalment plan is the nature of and the judicial interpretations of the laws and legal instruments governing the sale of goods on the instalment plan. If lack of legislation or judicial interpretation of existing legislation seem to favor the sellers, prices to some extent will reflect it. Such added amounts to prices are concealed by the sellers.
These price policies are applied insofar as the lack of intelligence and credulity of the buyer will permit as was seen in the chapter on legal aspects.

Stores charge for their reputation and good will. If the reputation of the store is such that it can urge that on the buyer as a reason for accepting their prices it will be used thus.

When producers or distributors miscalculate, consumer demand thus causing their costs to go up from overproduction of style goods, prices are likely to be affected by the increased costs.

**Price Policies**

**Stores**

Before stores can correctly determine price they must formulate policies concerning the minimum size of the sale, the size of the down payment, length of the contract and schedule of payments, and right and penalties of buyers. Haring says that these policies should include:

"(a) Substantial down payments from 10% to 33\(\frac{1}{3}\)% depending upon the commodity; (b) contract period rarely exceeding one year; (c) eliminating poor risks to lower average instalment charges; (d) limiting the security to merchandise alone; (e) simplicity and standardizing contracts which give the buyer a fair deal; and (f) recourse paper only.

In addition, the operators of stores should know the market. This knowledge includes an analysis on the buying habits of the people, such as time of purchase and the frequency of purchases; the characteristics of the potential users, such as age, occupation, taste and education; and the size of family and income class to which they belong.

**Finance Companies**

The prices and price policies of retailers are influenced by the
prices and policies of finance companies. The credit costs and some collection costs of stores selling on the instalment plan reflect the charges of finance companies for discounting instalment paper. It is important, therefore, to consider the policies of finance companies.

Suppose that a finance company has $120,000 to invest in such paper:

Assuming that the amount of $120,000 is invested in January contracts which are repaid in 12 equal monthly instalments, it is obvious that in February 1/12th of $120,000, or $10,000, becomes due and payable. Assuming that this amount is actually paid and reinvested in February in $10,000 more of 12-month contracts, it is obvious that in March $10,000 of January's investment becomes due and 1/12th of February's investment of $10,000 also matures, making possible a reinvestment in March of $10,666.66. A continuation of this process becomes more and more involved...

To determine pricing policies the finance company must answer the following questions:
1. Are finance charges high enough to overcome the cost of operation?
2. How much volume is required to cover cost of operation?
3. How much capital will be employed in the operation?
4. How much business can be purchased and rediscoun ted profitably?
5. On the basis of commitment in hand, what is the maximum amount of operating cost permissible, making provision for normal return on the amount of capital invested?
6. How does this maximum cost permissible compare with the minimum operating cost requirements?1

The efficiency with which finance companies answer these questions may be reflected in the quoted prices of retailers.

Price Spreads

A price spread of a commodity is the difference between its wholesale price and the quoted retail price. This spread is sometimes called the markup. It includes charges for many or for all factors

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described above. Many of the factors are elastic in nature and the amount of spread between the wholesale and retail prices of a commodity varies according to this elasticity. The spread is influenced also by the channel of distribution.

Goodyear All-Weather Tires sold through usual wholesale distributors to retailers at $8.40 in 1930 bore total distribution cost of $13.44, or 41% of retail price. Intermediary distribution functions accounted for 18% and retail operating expenses were 25% of retail price. Sears Roebuck's All-State tire, a comparable product, and sold through Sears Roebuck's retail stores for $6.47 entailed total distribution cost of $2.07, or 30.2% of retail price. Difference in distribution costs accounted for most of the differential of $1.33, or 25%, in prices of the two tires. Similar tires were sold by Sears Roebuck's mail order division at $16.17, with a distribution cost of $1.16, or 18% of retail price.¹

In case of electric refrigerators the retail price was $156.00 while the manufacturer's price was $60.00 and the wholesale profit was $16.00 leaving a total spread between wholesale and retailer of $70.00. Some of this spread included the charges for instalment financing. It was found also that jewelry stores selling no goods on the instalment plan had a markup of 41.4%, while jewelry stores with instalment sales had a gross markup of 55%.² These markups in many instances are high in order to take care of losses. It will be recalled that a large representative clothing store, having a loss of 25% of total sales, had a markup of 150%. Markups are also made so that prices can be cut as a means of stimulating sales. Nystrom states that at least 80% of the goods handled by department stores are subject to mark downs.³ This

¹Does Distribution Cost Too Much, p. 54.
²Ibid., pp. 52, 54, 231.
³Nystrom, op. cit., p. 473.
policy of cutting prices to stimulate sales seems to be more effective than stating a low price from the start and holding to it.  

Finance companies in many instances charge straight rates to all territories. Yet the risks are higher in some territories than in others. In many instances stores which sell for cash and also on installments have a very narrow spread between the cost price and the credit price. Much of the cost of installment credit is included in the general markup of such stores, thus making cash customers pay part of the charges that should be borne by installment buyers.¹

Credit Charges

The rates or credit charges are usually made out by the finance company and given to the retailers. The method of stating these rates has caused much criticism in recent years. It will be recalled that the Federal Trade Commission accused a group of finance companies of misrepresenting their rates. They advertised six percent when the rate properly computed was 11 or 12 percent. If one is charged six percent on the unpaid balance and this balance is paid up in full within six months then it is obvious that the annual rate is between ten percent and 12 percent. This method of stating rates has caused people to get an erroneous impression of the amount of money they pay for installment credit.

We find the purchaser of a $20.00 article, or a number of articles totaling this amount from one of our largest mail order houses, is required to pay $4.00 a month until the payments are completed. This means that the buyer pays $4.00 a month for four months and $2.50 for the fifth month. The problem resolves itself into computing the yearly rate of a payment of $2.50 for the use of $16.00 under the above terms. Using the simple interest principle the rate becomes 75%.

¹Schmalz, op. cit., p. 91.
If one uses the compound interest method the result is a 64% normal rate, or an 86.6% effective rate ...

The most important consideration in the analysis, nevertheless, is not whether the rate is 75% or 86.6% but that it is far higher than most persons are aware.

Rates vary both according to the type of commodity sold and according to the length of terms. Another variation is due to the amount of the purchase. The table below gives rates for different goods. Other tables are found in the Appendix.

**REPRESENTATIVE INSTALLMENT CREDIT RATES**

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Range of Cost</th>
<th>Our Estimated Percentage</th>
<th>Average Cost (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Automobiles (with insurance)</td>
<td>22-23</td>
<td>24</td>
<td></td>
</tr>
<tr>
<td>Used Automobiles (with insurance)</td>
<td>35-47</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td>Refrigerators</td>
<td>8-52</td>
<td>17</td>
<td></td>
</tr>
<tr>
<td>Furniture</td>
<td>6-56</td>
<td>30</td>
<td></td>
</tr>
<tr>
<td>Radios</td>
<td>12-98</td>
<td>30</td>
<td></td>
</tr>
</tbody>
</table>


It can be seen that the average rate ranges from 17 percent to 40 percent of the price. Some report that the actual range is from 0% to 50% percent. Thus it can be seen that consumers pay for the service of installment credit at a much larger rate than the retailers and finance companies would have them believe. However, because of the pressure of public opinion and

1Froman, op. cit., pp. 227-236.

many criticisms in influential quarters finance companies and retailers have in many instances begun to state their charges openly and clearly. Mail order houses and department stores have lately begun to quote their cash price and then add the carrying charge. On the other hand, there are installment sellers who actually paid their charges as would be indicated by a 500 percent credit charge. It is estimated that the interest charges amounted to $465,000,000 a year (figured at an annual rate of 15 percent on $3,100,000,000).

Before 1920 the installment plan was used for the sale of only a few commodities. The rapid spread of the use of this method exhibited short-run tendencies of increased supply prices. This can be seen in the wide variation of credit charges. Much of these charges goes to make up for losses that earlier companies experienced and many retailers of today have experienced due to extending the plan to new commodities and to the making of more liberal terms. However, long-run tendencies toward lower credit charges and lower prices can be seen. Many small finance companies that emphasized long terms but carried hidden excess charges have been driven out of business. The finance companies that are doing the most business today are those which have conservative terms and fairly reasonable finance charges. Besides department stores and mail order houses have conservative programs with respect to risk and are able to quote lower prices to buyers.
CHAPTER IX

CONSUMER INTERESTS AND THE INSTALLMENT PLAN

Utility Of the Goods Purchased On the Installment Plan

The goods ordinarily sold on the installment plan are furniture and furnishings, electrical appliances, vacuum cleaners, washing machines, gas and electric stoves, automobiles, pianos, radios, sewing machines, books and jewelry. These goods are comparatively durable. By durability is meant that quality of a consumer commodity which enables its value not to depreciate as fast as a practical scheme of payments extending over a period of 12 weeks to three or four years will decrease the debt. Thus it ordinarily has a resale value, in case of cessation of payments, to cover the balance due at any time. This definition includes homes, lots and stocks and bonds but they were excluded at the outset. These commodities have important uses for the consumer in the home and in the case of the automobile in activities outside the home. They save time and energy. They often satisfy the desire of the consumer for social approval. They have many uses that make the organization of home life less monotonous and more convenient. The fact that the sale of these commodities has grown rapidly and has extended to all income classes in recent years is conclusive proof of their utility and broad acceptance by consumers. However no attempt will be made to appraise their utility. Such an appraisal must be made according to the values set on these commodities by the consumers themselves. It was mentioned at this point because it was felt that, logically,
it could not be left out entirely.

Limits To Wise Purchase Of Durable Consumer Goods

Credit Limit

Neifeld\(^1\) says that "any consideration of the social value of consumer credit must accept the worker's own scale of values". Nevertheless, we can recognize some objective limitations to consumer credit. An individual is most prosperous when he is in debt because of the added things he can show for his limited income. However, personal debt accumulation itself has limitations. If a person has an income of a certain amount, say $100 a month, and his necessary expenses require $80 a month, then he has $20 left for savings or other expenditures. Now suppose he contracts debts which require a monthly payment of $15. This added responsibility can be cared for out of the surplus of $20. Now if he should contract an additional debt of $10 monthly he will have gone beyond his $20 surplus by $5. He may be able to put off the payment of one debt this month and another next month. But sooner or later he will be faced with the inescapable necessity of meeting all at one time. When such a time comes, he will have gone beyond his debt limit. Debt accumulation should go no higher than one's surplus income can service it. Many purchasers on the installment plan have had this painful experience.

The Actual Situation

Although the limits stated above are real, the desires of many people for durable consumer goods have, in many cases, outrun their ability to pay

\(^1\)Ibid., p. 71.
or their realization of the inconveniences of extended payments.

Effective demand results in contract for future payments under conditions in which future utilities of the durable commodity present themselves in the consumers' imagination with the same motivating power as present utilities.¹

There is the case of the person who, with a salary of $60 a week, contracted installment debts to an amount beyond the credit limit of the buyer. He managed to struggle on for some time until the depression set in when it was impossible for him to meet his payments. He was persuaded to contract the debts by the several smooth talking salesmen who convinced him of the ease with which he could pay. This buyer as well as many others was of high integrity and the pressure of the collection departments of the several stores brought real mental agony.

It is interesting to note some of the methods of collection departments. In case they do not for any cause repossess the goods they write harsh letters or turn the accounts over to a professional collection agency. In either case the procedure is somewhat as follows:

A letter is written which may say, "If your name goes on our list it will ruin your credit in your city. Our list goes to 25,000 merchants in your city. If completed payment is not made on your account by Saturday, we will put your name on the black list and your credit will be destroyed."²

Or the situation may be this:

If a woman debtor writes them, "Of course I am an honest woman," they promptly berate her as a fraud and an embezzler; if a man writes, "Naturally I don't want this to get into the courts," the agency informs him a summons is on the way.³

Some people bring suit against such companies for humiliation and mental anguish. In the case of threat of repossession, most people go through mental anguish because of strong desire to keep the commodity. They feel that they have invested too much money in the article to lose it.

Many people, unable to control the ratio of their income to their debts are forced into bankruptcy. However, in the case of installment debts, bankrupt persons usually systematically cut down such obligations as their financial positions become more insecure. Repossessions were prompt and very few additional debts were contracted.¹

Though there are some disasters as a result of the overextension of installment credit, it is claimed that the people on the whole make conservative use of it. It is claimed that people regulate their installment obligations according to their incomes. This plan has gained its widest use among city dwellers (probably due to the regular flow of the incomes of city workers) and it is contended that such satisfactory use supports the statement that budgeted income and expenses have had a wide and strong appeal among city dwellers.

The "Good" Market For Goods Sold On The Installment Plan

A good consumer market would be one in which he could get maximum satisfaction from given resources. There would be such standardized and systematized arrangements that the demands on the time and energy of the consumer buyer would be reduced to a minimum. The policies and practices of retailers would be standardized and simplified to the extent that mistakes

in selection would be reduced to a very low point. The prices would be fair. They would include a fair profit to the retailer, fair payment to the agents of production, and fair charges for services demanded by consumers. There would be no inefficiency of management and organization and wasteful duplication of services of competing retailers. It is important to emphasize at this point that a "good" market is an ideal. It is a goal toward which to strive.

Of course this ideal market does not exist but we are interested in pointing out those practices and policies in the real market, as it is constituted today, that tend to move in that direction. Also we are interested in those that could be easily adopted by retailers. From these practices we shall attempt to appraise the market in general. In this study we are primarily concerned with those policies and practices that reduce mistakes in selections and with fair prices. A good example of fair prices and reasonable terms for installment credit can be found in the policies of the Electric Home and Farm Authority. It is a government agency. The effective credit charge is 9.72 percent. The terms range from 24 months to 48 months. The minimum amount for any purchase is $40 and the minimum down payment is five percent and ten percent of the price. Another practice is that of some department stores and mail order houses in separating the cash price from the credit price. Another is the description of the credit charge not as interest but as carrying charge expressed in dollars. One very badly needed improvement in the retail market for goods sold on the installment plan is a standardized contract with standard clauses which fairly protect the rights of both the buyer and seller. The lack of such is the source of the worst abuses of the installment plan.
Better investigation of credit risk is very desirable so that losses will not be excessive and therefore will not necessitate a large increase in price. The budget plan of many stores is also useful in providing consumers information on which to base their decision as to whether they should assume an obligation to make installment payments. Nevertheless, it does not touch the problem of information on price and quality.

The basis of rational buying is adequate information. In the chapter on price we have seen how information is withheld. Cash and credit prices are not separated in most cases. Such advertising slogans as "six percent on unpaid balance" deceive rather than inform. Is it six percent per annum or six percent for the number of months the obligation runs? How many months will the obligation run? When one payment has been made, is the principal reduced on which interest is charged? Another slogan says, "easy payments". But the consumer would be better informed if he was told whether excessive hidden charges accompanied the "easy payments". In other words, sellers give glowing and frequently misleading descriptions and very little analytical exposition. Some sellers label the sales contract a receipt. The many clauses are seldom explained. Legal statements are, by their very nature, complicated. But many tricky clauses are written into contracts in fine print and in obscure places.

Price under imperfect competition is determined by many factors not present in the enlightened atmosphere of a perfect market. The habits of the people, reputation of the merchant, bad judgment and inefficiency of the retailer and advertisement are some additional factors. These factors account for the large spread between the wholesale price and the retail price. Part of this spread is a result of the success of product differentiation by retailers. When more firms are in an industry than are necessary to
supply the demand, many are likely to be smaller than the most efficient size. The average unit costs of these small firms tend to be higher than that of the firms of optimum size. These high costs are reflected in the prices of these small firms. The fact that most retailers fail to separate their cash price from their credit price makes it very difficult for consumers to make price comparisons.

Losses From Legal Obligations And Actions

The legal instruments used in installment selling are complicated. Besides, the state laws are also complicated. Some think that the consumer should be advised to see a lawyer before obligating himself on a contract. Retailers and dealers do not make it their business to give consumer buyers adequate information about them. Stores, as a rule, select the type or types contracts under which they intend to do business. The managers are usually acquainted with them, of course. There is a number of different types of contracts with various tricky clauses and the consumer must be very alert and intelligent to protect himself against the pitfalls. Wage assignment clauses, open-end and lease contracts, and the power of attorney to confess judgment are clauses and contracts are used to take advantage of unwary buyers. One thing that is badly needed from the consumer point of view is a standard contract which would fairly protect the rights of both parties. Such an instrument would be one of the most effective means of reducing mistakes in selection. The losses from the consistent employment of these powerful clauses are enormous and are a serious challenge to the consumer's efforts for maximum satisfaction.

While state laws are designed to protect the interests of the public,
they tend to lean toward the seller. The great majority of the states have not enacted the Uniform Conditional Sales Act which contains elaborate provisions for the protection of the rights of the buyer. The laws which protect the consumer from becoming destitute can be waived in a contract in most states. Judicial decisions which state that the merchant may charge an excessive price for his goods (which covers financing charges) make it difficult for the consumer to protect himself after he has signed the contract. Many think that the law should lean toward the consumer because he is less acquainted with the intricacies of legal procedure.

**Wage Assignments**

One practice that installment sellers use in trapping workers is the wage assignment. This practice though frowned upon by the courts, is in use in most of the large cities. The wage assignment is a clause in which the buyer agrees for the seller to collect the installments out of his wages in case he defaults on any payments. The story is told of a worker of Procter and Gamble Company in New York. The worker was persuaded by the salesman to buy a watch at a price of $40.00 with the down payment of $2.00 and terms of $2.00 weekly. The salesman had him to sign what he described as a "receipt". This "receipt" was in reality a folded contract which was not explained to this buyer. One morning he was called to the service department of the company for which he worked. The watch company had sent a court order demanding the salary of the employee for payment for the watch. The service department had the watch valued and it was found that it was worth only $19.75. However, the company was compelled to pay the $40.00 out of the man's wages.1

1Hugent and Henderson, *op. cit.*, p. 94.
Out of 108,000 employees in eight representative firms there were 1,900 orders for wage assignments in 1931. In Chicago a street railway firm reported an average of 3,400 wage assignments against their 17,000 employees for the years from 1929 to 1932. Armour and Company reported that for its 5,380 workers, most of whom are Negroes, wage assignments were received for approximately one-half of them for each year from 1929 to 1932.¹

State laws have attempted to cope with this problem and have declared such clauses in contracts void. Others have declared them void after a certain date of about six months after the agreement. Many sellers, however, get around this six months' limit by having the worker sign several assignments leaving the date blank in each instrument. The company dates them as they are sent to the worker.

Repossessions

Repossession is another source of loss to consumers. It is a reversal economic process.

While many retailers use an elaborate precaution to keep from repossessing goods others adopt the practice as a source of additional profits. For the task of repossession of goods which involves the necessity of going on the premises of the buyer, special men are selected. The men used are called pulled men and are usually six feet tall, weighing about 200 pounds. It is said that they are employed for the purpose of obtaining peaceful repossession.

¹Ibid., p. 95.
However, the procedure may be anything but peaceful. These men are expected to bring back the property and are not paid unless they do.

He thinks nothing of wiring around ignition locks, towing away locked cars, breaking the windows to get into a locked house, or using a bolt-cutter to remove the padlock from the garage door. Frequently he and the purchaser get into a fist fight, and there are few pull men who don't tote a gun. That such acts frequently amount to burglary or larceny bothers the pull men but little. Recruited as they are mainly from the lowest order of hoodlums, they are quite willing to take chances in order to earn $5.00. Also they know that the average person is not likely to get after them. Once in a while, however, they run into a tartar.1

The following statement indicates clearly the profitability of repossession procedure to sellers and the tremendous loss to buyers.

Hundreds of cars are repossessed for the sake of repossession charges when the purchaser fails to pay one of the last payments promptly. Fees are sometimes $35.00. One case recently referred to involved the repossession of a car on which the last payment of $15.00 was overdue. A repossession charge of $35.00 was demanded.

One person whose car was repossessed for a small balance decided to go to the sale and bid for his car. But the car was not put on sale, and he was politely notified when he asked about it that there must have been some mistake — his car had been sold at another auction. Sales of repossessed cars are frequently the happy hunting ground of a closed membership of used car dealers whose objections to intruders might take violent forms.

After repossession comes the deficiency judgment, garnishment proceedings, etc.

The abuses though exceedingly common, do not apply to installment selling as a whole ... The major part of the installment selling and the installment financing business is highly reputable and has had no part in the conditions which we have just described.2

The seller has repossession troubles from the buyer in many cases. However, they do not compare with the losses to the consumer. Sometimes when he attempts to repossess, there is the garage lien.

1 Whitaee, op. cit., p. 436.

2 Argent and Henderson, op. cit., pp. 97-98.
The buyer may owe the garage and the garage manager will not release the car until the amount due him is paid. Sometimes the garage manager and the buyer may agree to tell the finance company that the charges are two or three times as much as they actually are.

It is important at this point to note the extent and proportion of repossessions to total sales. J. D. Weiss states that:

Repossessions jumped from slightly over 4% in 1928 and 1929 to 8.5% in 1931 and 10.4% in 1932. In 1937 they were 9.4%.... If 9.4% of the cars were repossessed in 1937, it is safe to assume that from 25% to 30% of the instalment buyers have found themselves in acute distress.

In the case of substandard cars (that is where the down payment is less than 25%) repossessions are around five times the normal rate. There was a probable repossession figure of 20% to 25% of sales in this classification.

Repossessions are greater for used cars than for new cars. It is claimed that the reasons for this are that used cars are purchased, as a rule, by people of lower incomes, lower intelligence and less foresight than purchasers of new cars and that these used cars have no standard price. The purchaser may feel that he has been cheated and will let the car go back, thus losing what he has invested, rather than put more money in the car.

It can be seen in retrospect that there are many conditions which obstruct the realization of maximum satisfaction of consumer well being from the instalment plan of consumer credit. Since these commodities are frequently subject to production under conditions of decreasing costs, consumers may be benefited by a drop in prices. Nevertheless, to these reduced manufacturing costs must be added the large distribution costs.

\(^1\)Ibid., p. 98.
The consumer buyers must pay for all in the retail price. Many practices in the market have been noted which tend to perpetuate and to increase rather than to reduce mistakes in selection.
CHAPTER X

CONCLUSION

Having come to the end of this study one sees the importance of gathering up the main threads of the analysis and interpreting them in general statements. The installment plan is a connecting link between production and consumption. In a less general sense it is a connecting link between distributors of durable consumer goods and consumer buyers. The motive of consumers is maximum satisfaction from given resources of time, energy, purchasing power and choice making. This process of maximizing satisfactions may be termed consumption. The motive of producers is the attainment of maximum profits from given resources of land, labor, capital and enterprising ability. While consumption and production are complements of each other, the motives of consumers and the motives of producers are not always harmonious. The conflict of motives can be seen best in a study of the marketing practices of distributors. The assumption of this study is that an exposition of the marketing practices of sellers provides a satisfactory basis for studying the interests of consumers.

The installment plan of selling seems to be sound from the point of view of the theory of credit. That is, it is sound as long as it is applied to goods whose resale value depreciates slower than the unpaid balance on the commodity. Buyers, who make use of this form of consumer credit, meet the requirements of good credit risks. These requirements are character, capacity and collateral. As compared with producers, who require commercial credit, their ability to pay is small. However the consumer loan is much smaller than the producer loan.

Recognizing the soundness of the plan we may now turn our attention to the two criteria for appraising the existing practices of retailers with the plan. The first criterion is fair prices to consumers. This fair price includes a
fair profit to the retailer. The second criterion is policies and practices which reduce mistakes in selecting credit services. Under conditions of perfect competition, prices would be fair. There would be no mistakes in selection because knowledge would be perfect. Then the credit charges for installment credit would measure the marginal lenders' and the marginal borrowers' preference of present utilities over future utilities. We shall summarize those imperfections in the market for goods sold on the instalment plan. They show why the credit charges do not measure the marginal borrowers' and the marginal lenders' preference of present over future utilities.

Differential gains is a term applied by economists to gains arising out of variations in costs and price advantages among sellers. In the market these price advantages arise from product differentiation in many instances. The rapid spread of the practice of selling and buying on the instalment plan has been accompanied by product differentiation. In fact, it is claimed that one of the main causes of the extensive use of the plan is successful advertising. We have seen that members of all the income classes make use of the convenience of the plan except the very rich. In every region or section of the nation some people buy on "easy payments". Selling on the instalment plan has not only been extended to a larger number of commodities but the method has been adopted by more retailers and more types of retailing establishments. The latest entry into the field is the department store. It has been estimated that the annual instalment debt is $6 billion while 25 years ago in 1915 it was very small. The plan then was confined to only a few commodities which were sold primarily to people of low incomes.
The limitation of the incomes and the utility of the relatively high priced commodity constitute the basis of the acceptance of the plan by consumer buyers. The rise in the real income of workers in 1920 made it possible for the workers to buy more of these durable consumer goods. Advertising, the highly developed art of describing a commodity in glowing terms, was and still is used to persuade buyers to buy on the instalment plan. Advertising and branding which are the greatest vehicles of product differentiation reach the consumer through every channel of communication. Every human impulse, good and bad, is played upon. In this way the brand and the instalment terms of a particular retailer are differentiated in the minds of consumers.

The finance company performs an important and necessary function in financing instalment credit. It deals with the buyer in most instances only indirectly. However, in the case of automobiles and some household appliances it collects from the buyers directly. Nevertheless its main business is with the retailer. The credit charges are set by the finance company. It turns them over to the retailer who figures them as a part of his costs. When an article is sold on instalments, the paper is sold to the finance company by the retailer at a discount.

The charges that the finance company makes include interest on the money borrowed, costs of investigation, and costs of collection. In fact, they include all the costs of the company. It is quite possible in view of product differentiation for the charges to be higher than would be necessary to cover costs. One indication that the charges may be too high is the fact that some companies pay retailers rebates
in order to get trade. While the charges may be high, finance companies have developed the technique of stating their terms and charges to the public that buyers gain the impression they are low.

Laws and legal terminology are complicated and are not often understood by the layman. While all states have laws concerning conditional sales and chattel mortgages, consumers do not always understand them. Many state laws do not go far enough to guarantee the consumer sufficient protection. On the other hand, consumers often sign contracts that nullify some of the provisions of the law. This is especially true of one legal provision. If the head of the house has paid for his household furniture, sellers cannot require it for additional security on now debt. However the right of exemption may be waived under contract.

The legal phases of instalment selling and buying are an important source of differential gains for sellers. The cost of legal advice is high for individual consumers. When the cost is added to the price of the article bought, the article becomes too expensive. On the other hand, the cost of legal advice to retailers in comparison with the volume of sales is low. Furthermore, the retailer can frequently pass on his legal costs to the consumer in the form of a higher price for the product. The consumer, therefore, pays directly for his legal advice and pays indirectly for the seller’s legal advice. Hence he generally pays for the whole show. Because he can spread the cost of his legal advice among all of his buyers, the seller is able to pay a large salary and thus get the best lawyers. The consumer is at a disadvantage here. This brilliant lawyer is able to frame contracts within the letter of the law that give the seller a notable
advantage over the buyer. Consequently, we have open-end contracts, lease contracts and wage assignments and power of attorney to confess judgment clauses in contracts. Such legal devices assure sellers of the payment of the article sold or, in case of repossession, a resale value usually larger than the size of the debt. Where the repossession value is likely to be small relative to the amount owed, the loss is avoided by a higher than normal mark up. In the absence of new legislation judicial interpretations which classify installment finance companies as merchants and bona fide purchasers of value, the consumer is at a serious disadvantage.

From the foregoing statements it can be seen that differentiation, from advertising, from collusion between finance companies and retailers, and from the preponderant legal advantages of sellers, prevents credit charges from measuring the marginal borrowers' and marginal lenders' preference for present utilities over future utilities. In the case of the buyer the two preferences of present utilities and future utilities are not placed before him with the same vividness. Advertisers see to that. Attention is deflected from price to terms of sale and liberality of payments. Every effort is made to make each product with its combination of credit terms and mode of payment appear different in the mind of the buyer. To the extent that these efforts succeed each commodity -- though identical in physical nature-- is different and each retailer has his individual market within more or less narrow limits. Within limits, therefore, price competition is nullified.

Differentiation is not completely successful. Consumers change from one seller to another but they do not change as freely and as quickly as they would under conditions of perfect competition. Also the changes from
one seller to the other are not always motivated by a consideration of price. Nevertheless the monopolistic forces within the market are fairly persistent. Thus we have imperfect competition in the market whereby the forces of equilibrium price do not reduce average total cost to a minimum. Retail stores and finance companies fail to grow to their most efficient sizes. The result in this field is a larger number of firms than would be necessary to meet the demand if all resources were utilized to their utmost.

When one looks at the costs of individual retail stores that sell goods on the instalment plan he will realize that costs are not reduced to a minimum. Compared with stores that do not sell on the instalment plan one of the main items of costs that increases is advertising. (Advertising accounted for 3.9% of the total costs of the cash stores while it necessitated 6.4% of the total costs of stores selling on instalments.) Other costs increase as a result of the services of instalment credit also. Many of them are necessary such as collection and credit costs. However losses from bad debts and large increases in delivery costs could probably be decreased with more efficient performance. The increased costs make the price of the commodity high. Since sellers are motivated by the desire to maximize profits and since the market is imperfect there may be a large spread between these higher costs and the retail price.

We may conclude, therefore, that prices are not fair in most cases. Furthermore, policies and practices that induce mistakes in the selection of credit services and the physical product are conspicuous by their absence in these instalment credit markets. There seems to be in this field a well developed technique of giving misinformation. Notwithstanding these general practices some tendencies in this direction should be noted. The leadership in this direction has been taken
by department stores and mail order houses. The first is the separation of the cash price from the credit charge. The second is the budget plan that has been adopted by many stores. The latter tendency does not touch the problem of direct information on the price and quality of the commodity.

To remedy the situation some writers recommend a standard contract which would protect both the buyer and the seller. Such a contract is found in life and fire insurance. New legislation, to regulate repossessions, to limit rates, to license finance companies, and to limit or prohibit some of the clauses found in contracts, is proposed by various state legislatures.
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