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Operating Methods and Collection Experience

CONTROL of credit risk in the personal finance business presents special aspects intrinsic to the nature of such lending, geared in each case, as it must be, to the extension and administration of hundreds and even thousands of small loans. Under these conditions, credit granting must proceed speedily, accurately and at low cost, necessitating procedures and standards that are highly routinized yet acutely sensitive to dubious risks. The loss from slow collection or ultimate charge-off on a single small loan is not an imposing sum, but successful operation requires that better than ninety-five out of every hundred loans consistently pay out, and that delinquency, a vital element of collection cost, be held within tolerable limits. Not only must credit granting proceed swiftly and effectively, but business continuity requires that a steady flow of loan demand be maintained. Since profitability of operations tends to increase (up to a certain point) with loan volume, every loan office must continuously strive to increase the number of customers it serves.

METHODS OF OBTAINING BUSINESS

Students of credit retailing have frequently pointed out that in the personal small loan business the longer a lender can keep his money in the hands of the same group of borrowers the larger his profits will be. When there are no special credit-granting and investigating fees, customer turnover increases costs of investigation and adds nothing to revenue.

On the other hand, lengthening the period of customer indebtedness, either by longer contracts or by successive loans to the same borrowers, increases risk. Extended repayments weaken the morale of borrowers, and the favorable situation with respect to income and stability of home conditions that obtained at the time of the original investigation may become increasingly uncertain as time passes. In seeking maximum revenue, lenders necessarily strive to maintain a loan portfolio in which these cost and risk factors are counterbalanced.

With these considerations in mind, lenders actively solicit loan applications from former customers, and draw about one-tenth of their applicants from this group. Such applications are readily granted if past loans have been repaid; three-fourths or more of them, according to the experience of two chain companies, are accepted. Also, present borrowers are actively encouraged to apply for additional sums; such requests typically amount to more than half of all loan applications, and they are granted, when payments on outstanding balances are up to date, in more than nine out of ten cases. The lender cultivates these borrower groups because a given volume of loans to them costs less than the same volume to new borrowers.

The importance of past and present borrower groups as a source of loan demand does not, of course, free lenders from the necessity of finding new customers to sustain and swell their loan volume. Nearly half of all loan applications come from new customers, though only about a third to a half of their applications are granted. Office location and advertising are important factors in attracting new borrowers. At one time loan company offices were on the second floor and had painted windows, and the result was the encouragement of furtive borrowing. The business is now conducted with entire openness, though loan companies still retain private consultation rooms where prospective borrowers may discuss their circumstances with the manager without fear of being overheard by clerks or other applicants. In former years the surreptitious character of the business made it impossible to develop an aggressive advertising program,[1] but after operations were legalized and the personal finance company became a recognized financial institution, advertising methods came to duplicate those used in any other business. Newspapers, periodicals, radio, mail circulars, theater and billboard advertising, bus, train and streetcar posters, have all been utilized to communicate with potential borrowers, and have helped to establish the present market for small loans.

Other promotional devices to attract new customers include the granting of special rates for preferred risks, and the use of unsecured notes. To attract schoolteacher borrowers, for example, some companies offer them lower rates than those offered borrowers in other occupations, the security of schoolteacher income providing the greater safety which justifies the lower charge. Lower rates are sometimes offered on larger loans in order to attract borrowers from the higher income brackets, for there is a direct correlation between income of borrower and size of loan. One large chain company, as mentioned in Chapter 2, has established over the past few years a number of offices making only unsecured loans, an appeal to customers who do not care to pledge household chattels as loan security.

Finally, in order to cultivate community goodwill, lenders consider it effective promotion to furnish a budget service to their customers. Loan men are taught how to prepare budgets for families of given size, income and tastes. Sometimes loans are granted only on condition that the borrower adhere to the budget worked out for him, and occasionally the borrower receives his loan not in cash but in one or more checks payable to creditors. Not infrequently the loan company,

[1] Newspaper advertising was used to some extent even in the loan-shark era, however; see L. N. Robinson and Rolf Nugent, *Regulation of the Small Loan Business* (1935) pp. 37-42.

with the borrower's permission, approaches creditors in an effort to persuade them to accept partial payment in full settlement of their claims. At least one chain company has urged borrowers, upon completion of their payments, to continue setting aside each month, as savings, an amount equal to their monthly instalments. In some cases loan companies have acted as employment agencies. It has become customary in the business for lenders to view themselves as consultants in family finance, with the object of fostering community goodwill and a wider familiarity with their credit facilities.

Although most small loan borrowers intend to meet their obligations, they are as a group particularly subject to unexpected loss of employment, and when this occurs they may find it impossible to repay in accordance with the terms of the contract. Lenders therefore find it highly important to pursue a policy of diversification, in order to limit the number of borrowers likely to be affected by the shutdown of a particular factory or the decline of a particular industry.

The two principal bases of diversification are occupation and geographic location. They are not, of course, mutually exclusive: the need to spread operations over many communities results partly from the dependence of certain localities on one or two industries—the concentration of automobile manufacturing in Detroit, for example—and partly from the circumstance that an industry may be flourishing in one part of the country and stagnant in another.

The necessity for occupational and geographic diversification as a means of spreading risk has accelerated the chain lenders' extensive market expansion in recent years. The Beneficial Industrial Loan Corporation, in citing the extent of its operations, has stated that "the wide geographical and industrial diversification thus obtained, in addition to the essential character of the business, minimizes adverse effects of business depressions upon the operations and profits of the

Company."[2] The stability of the earnings of large chain lenders during the depression of 1929-33 emphasizes the wisdom of widely distributing risks.[3] Independent offices and very small chain lenders are able to achieve some diversification, but they lack the advantages of a wide territorial distribution of business.

OFFICE ORGANIZATION AND PROCEDURE

A licensed office usually requires at least three people to conduct all essential activities: a manager, an "outside" man and a clerk. The manager interviews applicants, decides on all applications and is in charge of the office. The outside man investigates applicants, undertakes to collect long-delinquent accounts and institutes a search for borrowers who have disappeared. The clerk receives and records payments, and usually does all the bookkeeping as well as the secretarial work of the office. It is estimated that a staff of three can administer effectively about 750 loans at a time, representing outstandings of $70,000 to $100,000. Independent licensed offices may operate on the basis of a substantially lower loan balance, but if a chain office is not able to maintain an average of more than $50,000 outstandings, with good prospects for expansion, the staff will probably be reduced or the office transferred to another community where the time of employees can be utilized more fully.[4] Larger offices require an assistant manager and an additional number of outside men and clerks, the total number depending upon the volume of business and the quality of personnel. Chain offices are controlled through a system of supervisors, each in charge of six to twelve offices that he visits at least once a month.[5]

The rise of chain lending has necessitated the development

[2] Beneficial Industrial Loan Corporation, *Annual Report for 1929.*

[3] For the two largest chain lenders the ratios of net income to total assets were 11.2 and 9.3 in 1929. In 1933 the ratio was 8.9 for both companies.

[4] Robinson and Nugent, *op. cit.,* pp. 203-04.

[5] *Ibid.,* p. 205.

of centralized methods of control, the training of a staff along uniform lines being especially imperative. To this end the larger chains have found it advantageous to establish courses of instruction for employees, the best known of which is the two-year correspondence course of the Industrial Lenders Technical Institute, operated by the Beneficial Industrial Loan Corporation. For several years the company made the course available not merely to its employees, who were required to take it, but to anyone connected with the industry, and reports state that at one time 1,200 outside persons were enrolled. The Household Finance Corporation also has an extensive training course for its own employees, developed with the aid of Northwestern University; it includes manuals, written tests and lectures illustrated with sound-slide pictures.

The applicant for a cash loan is interviewed privately by the manager of the loan office or one of his assistants, and an- 10
swers standardized questions for an application form which the manager usually fills out. He states the purpose of borrowing, gives an account of his financial condition and makes a tentative estimate of his ability to repay within a stated period. During this confidential interview the manager must determine whether the applicant appears to be a good credit risk; in some cases the applicant's statements or manner call for an immediate refusal of the loan.

All applications not patently ineligible for loan consideration are investigated. The stated facts are checked by the outside man, who visits the home of the applicant, estimates his financial responsibility and reviews the household budget, paying particular attention to the amount of debt to which the family is already committed. The investigator also evaluates those intangible factors that indicate the extent to which the home is stable and well managed. Unless the applicant can show a file of receipted bills his financial responsibility is investigated among the tradespeople in his neighborhood, the investigator sometimes posing as the representative of a mythical credit bureau or life insurance company. This practice, though considered justified in some cases, is generally frowned upon by lenders as unethical, since the private or confidential character of the borrowing transaction is strongly emphasized in advertising. The lender may consult a credit exchange, retail credit bureau, legal files of debt judgments or competing lenders. As a rule, small loan companies have been opposed to joining established retail credit bureaus, preferring to organize their own[6] because of the emphasis they place on a confidential relationship with borrowers. Sometimes such bureaus in different cities cooperate in order to reduce duplicate borrowing and the evasion of obligations by customers.

Investigation of former and present borrower applicants is facilitated by offices files, which record previous investigations and past payment performance. As has already been stressed, such borrowers are much more successful than new applicants in obtaining credit. Table 16, presenting the records of two chain lenders over a several-year period, shows that one company granted loans to only one-third of all new applicants, the other company to somewhat more than one-half. Former borrowers fared much better, 78 and 87 percent of them having their applications approved by the two companies respectively. While the general trend of these proportions is significant, no special importance should be attached to the differences between the two companies, because they may vary in their loan policies and also may follow different principles in classifying their loan applications. Both companies approved about 95 percent of present borrowers' applications.

Supplementary information from the Household Finance Corporation indicates that in this period 14 percent of all applicants were refused immediately, without investigation, and that such refusals were approximately 40 percent of all

[6] For a list of these bureaus see American Association of Personal Finance Companies, *Roster of Personal Finance Companies* (1938).

TABLE 16

NUMBER OF APPLICATIONS RECEIVED AND OF LOANS GRANTED BY 2 PERSONAL FINANCE CHAINS, 1933–37, BY STATUS OF CUSTOMER[a]

Status of Customer	*Applications*		*Loans*		*Loans in Percent of Applications*	
	Household Finance Corp.	Amer. Invest. Co. of Ill.	Household Finance Corp.	Amer. Invest. Co. of Ill.	Household Finance Corp.	Amer. Invest. Co. of Ill.
New	1,634,710	149,650	543,291	85,664	33.2	57.2
Former	389,363	24,921	303,373	21,740	77.9	87.2
Present	1,508,621	127,921	1,421,506	121,874	94.2	95.3
TOTAL	3,532,694	302,492	2,268,170	229,278	64.2	75.9

[a] Based on data supplied by the two companies. Applicants not receiving loans include those who decided not to borrow at all, or to borrow elsewhere.

rejections. Outright rejections were relatively fewer in the depression period of 1932-34 than in subsequent years.

COLLECTION PROCEDURE AND EXPERIENCE

Borrowers are required to mail or bring payments to the loan office each month, and collection procedure is set in motion if payments are not made when due. A routine has been established whereby a series of form letters is mailed to delinquent borrowers; if the first few letters fail to bring results an investigator is sent to ascertain the cause of the delinquency and to bring pressure to bear for payment.[7] The collection problem in personal finance starts with delinquency and ends with refinancing, foreclosure or final charge-off.

Delinquency[8]

Much so-called delinquency is merely technical, as in the case of borrowers who on the last day of the month mail checks

[7] See Robinson and Nugent, *op. cit.*, pp. 211-12.
[8] See also "Charge-off of Bad Debts," pp. 78 ff.

TABLE 17

DELINQUENCY PERCENTAGES ON SMALL LOAN ACCOUNTS DELINQUENT ONE MONTH OR MORE ON BOTH PRINCIPAL AND CHARGES IN SELECTED STATES, 1937[a]

State	One Month	Two Months	Three Months or More	Total
Connecticut[b]	4.35	1.16	7.63	13.14
Florida[c]	4.08	1.20	4.09	9.37
Illinois	5.90	1.45	2.81	10.16
Indiana	6.59	1.89	3.49	11.97
Iowa	6.98	1.66	2.21	10.85
Kentucky	7.49	1.86	3.18	12.53
Maine[c]	3.00	.74	1.38	5.12
Maryland	5.66	1.69	5.46	12.81
Massachusetts[b]	4.87	1.05	3.91	9.83
Michigan	5.63	1.42	1.73	8.78
Missouri	5.55	1.41	2.30	9.26
New York	3.99	.83	1.46	6.28
Ohio	3.77	1.42	2.26	7.45
Virginia	5.60	2.30	6.50	14.40
Wisconsin	2.20	.54	.66	3.40

[a] Based on annual reports of state banking departments. Figures are as of December 31, 1937, unless otherwise indicated. Delinquency percentage represents the unpaid principal on all delinquent accounts expressed as a percent of the unpaid principal on all outstanding accounts.
[b] September 30, 1937.
[c] September 30, 1936.

that arrive a day or two late. One estimate[9] places delinquency at 15 percent—measured, as is customary in the business, as the ratio of unpaid principal on all delinquent accounts to the unpaid principal on all outstanding accounts; but this estimate includes accounts delinquent on principal alone, as well as those delinquent on both principal and charges. Only the latter type of delinquency is included in the annual reports made by licensees to state supervisors. Table 17 shows this delinquency in a number of states as of the end of 1937 (in Florida and Maine, September 30, 1936). In some

[9] Robinson and Nugent, *op. cit.*, pp. 211-12.

states such delinquency approaches the estimated 15 percent total delinquency.

In order to eliminate technical delinquency the Household Finance Corporation now classifies as delinquent only those accounts which at the end of the month have had no payments made on them since the nineteenth day of the preceding month, thus allowing an average period of grace of about twelve days after the nominal due date. Mainly because of this change in definition, but also because of a healthier condition of accounts, average delinquency declined from about 15 percent during 1929-34 to about 5 percent in 1935 and subsequent years. This change in the method of measuring delinquency has affected chiefly the figures for "delinquency on both principal and charges," which declined from 7.44 percent in 1934 to 1.83 percent in 1937; "delinquency on principal alone" was less than half the other type until 1932, but is now about twice as large.

Analysis reveals that, on the average, loans to schoolteachers fall into delinquency three times as often as those secured by household goods or automobiles, or the unsecured notes of others than schoolteachers. Practically all of this delinquency on teacher loans is concentrated in the summer months, and is sufficient to introduce a very pronounced seasonal movement into the picture of total delinquency. Yet delinquency on these loans rarely leads to loss of principal. It occurs largely because teachers are not paid during the summer, and because many travel or are otherwise away from home. While such delinquency is real and inconveniences the lender, it differs radically from the type of delinquency that produces collection expense and possible charge-off.

Technical delinquency and delinquency on loans to schoolteachers thus give rise to an overstatement of true delinquency, but on the other hand there are "hidden slows"—accounts that have made only partial payment on principal but are not counted delinquent.

Refinancing

Refinancing occurs when borrowers cannot meet payments due or when they seek additional funds before an existing loan is paid off. In the first case, preceded usually by a period of delinquency, the lender gains more by adjusting the terms of payment than by attempting to enforce immediate collection of the entire unpaid balance, even though the latter is 11 legally due in full as soon as an account becomes delinquent. In the second case the adjustment is made at the borrower's request and is an accommodation to him. A loan refinanced without additional funds is termed by lenders a "straight renewal"; one entailing new credit is a "loan to a present borrower."

When a loan is refinanced an entirely new contract is drawn, usually with the same terms of payment as the original. In straight renewals, assuming that at least one payment has been made before renewal, the effect of refinancing is of course to reduce the size of the monthly payment.[10] Renewal loans are comparatively rare; in the business of one lender they amount to less than 1 percent of all loans made. On the other hand, the refinancing of loans to present borrowers in order to provide them with additional funds is of considerable importance; in the business of two chain lenders such loans amount to more than 60 percent of all loans made.

Foreclosure

If the lender holds a chattel mortgage on property of the borrower, delinquency may lead to foreclosure. Although frequently threatened, actual foreclosures are fewer than might 12 be expected. As can be seen in Table 18, total amounts due on foreclosed accounts in 5 states were less than 1 percent of outstandings in 1936, and in general the voluntary surrender of furniture by borrowers occurred more frequently

[10] Ordinarily, but not always. A new contract might be drawn to run for a much smaller length of time than the original contract.

TABLE 18

AMOUNT DUE AT TIME OF FORECLOSURE ON CHATTEL MORTGAGES AND BILLS OF SALE, AND AMOUNT REALIZED, IN SELECTED STATES, 1936[a]

State	Due on Furniture Taken When in Use[b]	Due on Furniture Taken When Not in Use[b c]	Due on Furniture Not Recovered[b]	Total Amount Due: Percent[b]	Total Amount Due: Dollars	Amount Realized in % of Amount Due
Kentucky	.06	.13	.05	.24	$ 6,100	26.1
Massachusetts[d]	.01	.15	.01	.17	28,735	66.7
Michigan[e]	.20	.08	[f]	.28	63,531	61.6
Nebraska[e]	.24	.43	.05	.72	40,938	52.2
Virginia	.02	.05	.05	.12	6,304	30.5

[a] Based on annual reports of state banking departments, for calendar year 1936 unless otherwise specified.
[b] Amount due at time of foreclosure in percent of total loan balances outstanding at end of year. A more useful ratio would be one based not on total outstanding loans but on outstanding loans secured by chattel mortgages on furniture. This is possible only for Michigan, and there the understatement caused by using total outstandings amounts to 51 percent. For Kentucky, Massachusetts and Virginia the closest approximation to outstanding loans secured by chattel mortgages on furniture is outstanding chattel mortgage loans in general, and if data on these loans are used as a basis the figures in the table are found to represent understatements of 31, 31 and 90 percent respectively.
[c] Furniture taken when not in use is either abandoned or released by owner.
[d] Year ending September 30, 1936.
[e] Data for 1937.
[f] Less than 0.005 percent.

than actual foreclosure, though the distinction between these two situations may be finer than the lenders imply. The necessity for maintaining community goodwill makes foreclosure a hazardous policy, and the low resale value of used furniture and household goods also causes the lender to avoid foreclosure wherever possible. In regard to the latter point, Table 18 shows that the ratio of amount realized on recovered chattels to amount due on unpaid balances ranged from 26 to 67 percent. Deficiency judgments for the balance are of little practical value, and therefore are seldom obtained.

Charge-off of Bad Debts

The practice followed in charging off loans as losses varies widely among lenders. Loans charged off as losses are typically those on which a resumption of principal payments is not expected, but lenders often err in judging loans as losses and subsequently recover all or part of the amount charged off. The usual test of loss is the period of time during which payments have been delinquent, though loans not delinquent are charged off in some cases because a change in the borrower's status definitely presages a long interruption or a complete breakdown of principal payments. To illustrate charge-off practices and experience we rely mainly on data furnished by the Household Finance Corporation, acknowledging that its methods of operation may differ in some respects from those of other lenders.

Although charged-off accounts are not necessarily delinquent, and although delinquent accounts are not always charged off, it is reasonable to expect a significant degree of relationship between delinquency and charge-offs. This relationship cannot be measured directly from available data, but it is possible, as an approximation, to relate delinquency to "bad-debt loss." In any given year the latter is obtained by subtracting from total charge-offs the amount recovered in that year. This method does not accurately state the loss for that year, however, since there may be a lag between charge-off and recovery, the two not necessarily occurring in the same year.

Table 19 presents figures on delinquency and bad-debt losses experienced by the Household Finance Corporation and the American Investment Company of Illinois. Since the two companies use different definitions of delinquency their respective data are not comparable.

The year-to-year movements of the delinquency and bad-debt figures for the Household Finance Corporation are sufficiently alike, notwithstanding the discrepancies men-

TABLE 19

LOAN DELINQUENCY AND BAD-DEBT LOSS OF 2 PERSONAL FINANCE CHAINS, 1923–37, IN PERCENT OF MONTHLY LOAN ACCOUNT[a]

Year	*Loan Delinquency*[b]		*Bad-Debt Loss*[c]	
	Household Finance Corp.	American Investment Co. of Ill.[d]	Household Finance Corp.	American Investment Co. of Ill.
1923	6.13	...	.59	...
1924	6.38	...	.80	...
1925	6.58	...	.86	...
1926	6.84	...	.90	...
1927	7.02[e]	...	.86	...
1928	10.68[e]	...	1.50	...
1929	9.22	...	1.58	2.14
1930	10.48	11.45[f]	1.81	1.51
1931	13.55	12.93[f]	2.21	1.76
1932	19.43	17.86[f]	5.39	3.11
1933	21.08	22.01[f]	6.18	3.16
1934	13.41	13.52[f]	4.13	4.17
1935	10.60[g]	10.09[f]	1.24	2.26
1936	8.60[g]	8.46	−.83	1.36
1937	10.28[g]	9.91	.37	1.52

[a] Based on data supplied by the two companies. For the American Investment Company data are not available for the earlier years of the period.
[b] Twelve-month average.
[c] Annual figure.
[d] An account is considered one month delinquent on the first day of the first month following a due date on which full payment of charges and of principal was not received. Thus accounts not paying full charges and principal, or paying charges only, or charges and part of principal, all become one month delinquent on the first of the following month. An account is classified as two months delinquent on the first day of the second month following the lapsed payment. This method hides a certain amount of delinquency, on the average about 15 days, but actual delinquency is overstated when it is registered. For example, a payment due on May 15, if not paid, is not registered as delinquent until June 1, but at that time it is called one month delinquent.
[e] Before 1928 figures are for delinquency on principal and charges. In 1928 and all subsequent years the figures include delinquency on principal alone as well as on principal and charges. In 1928 average delinquency on principal alone was 2.99 percent of average loan account.
[f] No automobile loans included.
[g] In 1935 the Household Finance Corporation changed its method of measuring

tioned above, to indicate a rather close connection between delinquency and charge-off. In twelve of the fourteen year-to-year changes both series move in the same direction, and a computation of link relatives[11] for both series shows that in seven of the fourteen changes the degrees of change are almost identical; the 1925-26 link relative, for example, is 1.040 for delinquency and 1.047 for bad-debt loss. When the figure on bad-debt loss for any given year is compared with the figure on delinquency for the preceding year—thus allowing for a one-year lag between delinquency and charge-off—the correlation of year-to-year change is definitely weakened. This indicates that the period between delinquency and charge-off is not very great.

The delinquency and bad-debt figures for the American Investment Company move in the same direction in six of the seven times for which data are available. A comparison of the link relatives shows that the degrees of change are closely similar for two years, very dissimilar for one year and fairly close for four years. For the American Investment Company, as for the Household Finance Corporation, a comparison of the bad-debt figure for any given year with the delinquency figure for the preceding year shows the correlation of year-to-year change to be much less close.

Data on the length of delinquency prior to charge-off are shown for the Household Finance Corporation in Tables 20 and 21. In Table 20 delinquency is classified according to the usual practice of measuring it from the last date on which some payment was received, either on principal and charges

[11] Link relatives are derived by dividing the figure for any one year by that of the preceding year.

delinquency. Formerly all accounts which failed to make any payment during the month were considered to be delinquent. Under the present method delinquent accounts are all those on which, at the end of the month, no payment has been received since the nineteenth day of the preceding month. In the interests of comparability the figures for 1935–37 have been adjusted upward according to a formula supplied by the company. The unadjusted ratios reported for these years are 5.35, 4.31 and 4.79.

TABLE 20

PERCENTAGE DISTRIBUTION OF NUMBER OF ACCOUNTS CHARGED OFF BY A PERSONAL FINANCE CHAIN, 1935–37, BY NATURE OF DELINQUENCY AT TIME OF CHARGE-OFF[a]

Nature of Delinquency	*Dec. 1935*	*June 1936*	*Dec. 1936*	*June 1937*	*Dec. 1937*
Not delinquent	23.8	19.5	16.8	12.3	11.1
Delinquent on principal only, 40 days or more	15.5	12.9	12.1	10.8	10.3
Delinquent on charges and principal					
40–59 days	20.9	17.3	16.9	16.3	18.3
60–89 days	11.0	16.0	13.9	17.3	17.4
90 days or more	28.8	34.3	40.3	43.3	42.9
TOTAL	100.0	100.0	100.0	100.0	100.0

[a] Based on data supplied by the Household Finance Corporation. Delinquency is measured from the last date on which some payment was received, either on principal and charges or on charges alone.

TABLE 21

PERCENTAGE DISTRIBUTION OF NUMBER OF ACCOUNTS CHARGED OFF BY A PERSONAL FINANCE CHAIN, 1935–37, BY EXTENT OF DELINQUENCY AT TIME OF CHARGE-OFF[a]

Months Delinquent	*Dec. 1935*	*June 1936*	*Dec. 1936*	*June 1937*	*Dec. 1937*
1 or less	12.3	12.2	9.2	7.8	7.0
2– 4	30.7	32.7	30.5	33.0	33.8
5– 7	26.3	26.8	32.4	31.7	34.0
8–10	10.6	13.3	11.9	16.1	15.5
11–13	5.1	5.4	5.7	5.3	5.6
14–16	3.3	2.8	2.7	2.3	2.0
17–19	2.1	1.2	1.8	1.1	.7
20 or more	9.6	5.6	5.8	2.7	1.4
TOTAL	100.0	100.0	100.0	100.0	100.0

[a] Based on data supplied by the Household Finance Corporation. Delinquency is measured from date of last payment of charges plus at least half of the instalment due on principal.

or on charges alone. For example, if the last payment was made more than 40 days prior to charge-off, and covered charges but nothing on principal, the charged-off account is included among those "delinquent on principal only, 40 days or more."[12] If nothing had been paid on the account, either on principal or on charges, for more than 40 days but less than 60 days, it is classified as "delinquent on charges and principal, 40-59 days." If the account paid charges and at least something on principal within 40 days prior to charge-off it is classified as "not delinquent." It should be pointed out that this classification overstates the period of actual delinquency, since it measures from the date of the last payment made rather than from the date on which the subsequent payment was due. The terminology of the trade is used here, but it is important to bear in mind that an overstatement is involved.

According to Table 20 more than 40 percent of all accounts charged off in 1937 were delinquent 90 days or more on both principal and charges at the time of charge-off, and about 35 percent were delinquent 40-90 days. About 10 percent of all loans charged off were delinquent on principal only, and another 10 percent were not delinquent at all.

It is reasonable that a substantial proportion of charged-off accounts should show a delinquency of 90 days or more, for lenders will delay charge-off as long as they can afford to keep delinquent accounts on their books. The fact that accounts delinquent on principal alone constituted but 10-15 percent of the total number charged off reflects the expectation of the lender that as long as charges are collected there is some prospect for ultimate repayment of principal. In fact, it may be asked why accounts on which charges are being met are written off at all. There are several possible explanations: perhaps only a portion of the charges is being met each month; the

[12] Some of the accounts in this class are delinquent also on part of the interest charges due.

expense of attempting to collect amounts due on principal may be excessive and refinancing inexpedient; the company may consider it inadvisable to allow borrowers to pay charges indefinitely, for this practice is actively opposed by state regulatory authorities and, if publicized, may arouse unfavorable public sentiment.

It is rather surprising that as many as 11-24 percent of all charged-off accounts are recorded as not being delinquent at the time of charge-off. In a few cases this is explained by the death of the borrower, leaving no one legally responsible for the debt, but probably the chief explanation is that borrowers are not nominally delinquent when they make at least some small payment on principal in addition to charges, and the expense of collecting even this amount may be too great to justify continuing the account.

Table 21 provides a somewhat different statement of delinquency at time of charge-off, reckoning it from the time of the last payment of charges plus at least half of the instalment due on principal. By this definition average delinquency is somewhat longer, because charge-off usually occurs a longer time after the last payment of half or more of a principal instalment than after a smaller fractional payment; in other words, payments frequently begin to fall off before they cease altogether. Even under this definition, however, well over two-thirds of all delinquent accounts are charged off after 7 months of delinquency or less.

It may reasonably be inferred from Tables 20 and 21 that delinquency is expensive to the personal finance lender and that an experienced company is reluctant to carry delinquent accounts as assets for any extended period.

Charge-offs as an Expense of Lending

Since the inauguration of licensed lending some twenty years ago, bad-debt losses on personal small loans have declined substantially. Illegal lenders charged such exorbitant rates of interest that they could afford to lose large amounts on principal. They could allow indefinite delinquency on principal as long as these interest charges were paid; in fact, delinquency was rather to the lender's advantage than otherwise, for the total amount of interest collected usually exceeded the principal many times over. Licensed lenders, however, operate within narrower profit margins, and must keep bad-debt losses correspondingly low.

It has been estimated that before the depression of 1929-33 bad-debt losses of licensed chattel lenders averaged less than 2 percent of total outstanding loans, and those of endorsed-note lenders less than ½ percent.[13] In the depression years reported loss ratios rose to about 5 percent, but substantial recoveries on charged-off accounts were subsequently made. As has already been indicated (Table 19), in each year from 1923 through 1927 the bad-debt losses of the Household Finance Corporation amounted to less than 1 percent of the average investment in loans. By 1933 this proportion had risen to a peak of over 6 percent, but recoveries subsequently made caused repayments to exceed charge-off losses in 1936 and helped to reduce losses to 0.37 in 1937. Figures for the American Investment Company do not show such a wide range, but they too reflect very clearly the effects of the depression years.

Though small in proportion to total outstandings, bad-debt losses form a substantial item in the total operating expenses of personal finance companies. One authority quotes testimony, given before the Virginia Corporation Commission, to the effect that 17.75 percent of the expenses of 52 small loan corporations in that state arose from bad debts during the period 1927-30.[14] Data covering all states for which the figures are available show that bad-debt losses of all reporting per-

[13] Robinson and Nugent, *op. cit.*, p. 197.
[14] M. R. Neifeld, *The Personal Finance Business* (1933) p. 207.

sonal finance lenders averaged 10.3 percent of total expenses in 1929, 22.7 percent in 1932, and 10.6 percent in 1936.[15]

It is of course true that actual bad-debt losses constitute a small proportion of total expense compared to the costs of preventing these losses, that is, costs of investigation and collection, and therefore an index of loss provides no indication of the general operating efficiency of a lender. But other things being equal, one criterion of the efficiency of a given office is the extent of its bad debts compared with the average experience of similar offices in the business.

Repayment Record of a Sample of Loans

An especially clear picture of operating methods and collection experience in the personal finance business appears in the repayment record of a large sample of loans extended by the Household Finance Corporation, as presented in Table 22. The sample covers 30,951 original loans to new and former customers and 59,379 loans to "present" borrowers (those who substitute a present contract by a new one, either with or without the advance of additional cash) made during the year ending July 31, 1935.[16]

The prevalence of "repeat" borrowing, which has already been mentioned, is confirmed by this sample: 58 percent of the loans extended to new and former customers were terminated by fresh loans; and for loans to present borrowers—those who had already replaced at least one loan by another—the percentage so terminated was even higher, 74 percent. This indicates that repeat customers are more likely than other borrowers to terminate the second loan by a third. More than four out of five present customers who terminated their

[15] See Table 31, p. 110. These ratios of bad-debt losses to total expenses have been computed by dividing the ratio of bad-debt loss to average employed assets by the ratio of total expense to average employed assets.

[16] These figures represent all loans made by 32 offices distributed over the territory served by this company. All the loan contracts included were repayable in 20 months, except about 8 percent for $50 or less, which were repayable in 10 months.

Table 22

REPAYMENT RECORD OF A SAMPLE OF LOANS MADE BY A PERSONAL FINANCE CHAIN DURING THE YEAR ENDING JULY 31, 1935[a]

Age of Contract When Terminated[b]	*Contracts Terminated by Cash Payment*		*Contracts Terminated by New Loan*		*Contracts Terminated by Charge-off*		*Total Contracts Terminated*	
	Percent of Original Number	Cumulative Percent	Percent of Original Number	Cumulative Percent	Percent of Original Number	Cumulative Percent	Percent of Original Number	Cumulative Percent
			30,951 CONTRACTS MADE WITH NEW AND FORMER CUSTOMERS					
1 – 6	14.08	14.08	25.38	25.38	.11	.11	39.57	39.57
7 – 12	13.32	27.40	24.74	50.12	.44	.55	38.50	78.07
13 – 18	6.04	33.44	6.69	56.81	.33	.88	13.06	91.13
19 – 24	7.38	40.82	1.02	57.83	.12	1.00	8.52	99.65
			59,379 NEW CONTRACTS MADE WITH PRESENT BORROWERS[c]					
1 – 6	6.74	6.74	30.71	30.71	.14	.14	37.59	37.59
7 – 12	6.18	12.92	33.67	64.38	.52	.66	40.37	77.96
13 – 18	4.33	17.25	8.49	72.87	.36	1.02	13.18	91.14
19 – 24	6.78	24.03	1.32	74.19	.17	1.19	8.27	99.41

[a] Based on data supplied by the Household Finance Corporation, covering all loans made in 32 branch offices.
[b] Number of months after month of origin.
[c] These contracts are of two kinds: those which involve the advance of additional cash, combining the obligation for the new cash with the unpaid balance on the old loan; and those (renewals) which extend the time of payment, reduce the amount of the monthly principal payment, or effect adjustments or settlements. In a renewal loan the borrowers receive no additional cash.

contracts by new loans did so within 12 months; almost half of the new and former customers and around two-fifths of present borrowers who repeated their borrowing did so within 6 months.

Many loans, of course, were repaid fully in cash. In the present sample these amounted to about 40 percent of the loans made to new and former customers, and 24 percent of those made to present customers. Repayment of loans before the scheduled maturity was not at all uncommon: among the loans terminated by cash payment about two-thirds of those to new and former customers, and about half of those to present customers, were retired within a one-year period.[17] The average contract life of the loans in this sample was 19.2 months, but at the end of 12 months some 27 percent of all new and former borrower loans and 13 percent of all present customer loans had been fully repaid in cash, and by the end of 18 months over 33 percent of the former and 17 percent of the latter had been so repaid.

It would be interesting to know how many previous loans repeat borrowers had already received. Supplementary data furnished by the same lender, covering 21,843 loans paid off during 1937 and 1938 in New Jersey, where the maximum legal contract length is shorter than the average—15 months—bear on this point. Roughly one out of every three repeat borrowers repaying their loans with cash had one previous loan; one out of every five had two previous loans; and one out of every two had three or more previous loans.

From these two sets of data it seems fair to conclude that present borrowers, to whom practically two-thirds of these sample loans were made, afford a steady source of demand for the credit of personal finance lenders.

According to the sample of contracts in Table 22—originating, it is true, in a period of rising employment and industrial

[17] Allowance must be made in these percentages for the fact that the sample data include a few loans of $50 or less which carried a 10-month, rather than a 20-month, repayment term.

activity, from loan offices located in populous industrial centers—only 1 percent of the loans to new and former customers, and a fractionally higher percent of those to present customers, were terminated by charge-off. For both groups the proportion of contracts terminated in this manner was lower in the first and last six months of the contract life than in the intervening periods. The outstanding fact regarding collection experience, however, is that under careful loan administration the proportion of personal loans charged off is extremely small for all classes of borrowers and for all lengths of contract. The ultimate credit control problem of the personal loan company is to keep this crucial percentage low.